Fourth Quarter & Full Year 2020 – Earnings Conference Call Prepared Remarks

Jud Bailey *Baker Hughes – VP of Investor Relations*

Thank you.

Good morning everyone, and welcome to the Baker Hughes Fourth Quarter and Full Year 2020 Earnings Conference Call. Here with me are our Chairman and CEO, Lorenzo Simonelli; and our CFO, Brian Worrell. The earnings release we issued earlier today can be found on our website at bakerhughes.com.

As a reminder, during the course of this conference call, we will provide forward-looking statements. These statements are not guarantees of future performance and involve a number of risks and assumptions. Please review our SEC filings and website for a discussion of some of the factors that could cause actual results to differ materially.

As you know, reconciliations of operating income and other GAAP to non-GAAP measures can be found in our earnings release.

With that I will turn the call over to Lorenzo.

Lorenzo Simonelli *Baker Hughes – Chairman & CEO*

Thank you, Jud. Good morning everyone and thanks for joining us.

We are pleased with our fourth quarter results as we generated strong free cash flow and executed on our cost-out programs while navigating the impacts of the global pandemic and industry downturn. During the quarter, OFS and DS executed well on commercial opportunities and cost-out initiatives while TPS delivered solid orders and operating income.

Despite an incredibly challenging year for Baker Hughes and the industry in 2020, we generated over $500 million in free cash flow, booked $6.4 billion in TPS orders, and executed on our substantial cost-out and restructuring program. We also took several important steps to accelerate our strategy and invest in new energy transition technologies, helping to position the company for the future. I cannot thank our employees enough for their hard work and dedication to achieve our goals and move the company forward over what has been a trying year for everyone.

As we look ahead to 2021, we are cautiously optimistic that the global economy and oil demand will begin to recover from the impact of the global pandemic. Assuming a successful roll out of vaccines around the world, a synchronized global recovery should help drive solid growth in oil demand over the next 12 to 18 months and support a meaningful reduction in excess capacity over that time period.

We believe this macro environment likely translates into a somewhat tepid investment environment for oil and gas companies during the first half of 2021. However, we expect spending and activity levels to gain momentum over the course of the year as the macro environment improves, likely setting up the industry for stronger growth in 2022.

In the natural gas and LNG markets, 2020 proved to be a more resilient year for demand primarily due to growth in China and accelerated coal-to-gas switching across several countries. LNG demand growth is estimated to have held firm versus 2019 levels and fared much better than other commodities that saw meaningful declines. We believe this resiliency highlights the structural demand growth for LNG and reaffirms our positive long-term view for natural gas as a transition and destination fuel for broader energy consumption.

Regardless of the state of the short-term macro environment, Baker Hughes remains focused on executing the three pillars of our strategy to transform the core, invest for growth, and position for new frontiers.

Our efforts to transform the core are the most visible and immediate components of our strategy. We delivered over $700 million of annualized cost savings in 2020, and will continue to optimize our processes and infrastructure in order to deliver further cost reductions and footprint consolidation in 2021.

On the second pillar of investing for growth, we continue to identify opportunities to expand in the industrial sector and increase our condition monitoring and asset management offerings. We recently won awards in our DS segment that encompass our full suite of industrial asset management and digital capabilities and we are having promising discussions for future awards in both the oil and gas and industrial sectors. We also continue to see good traction with our non-metallic offerings, where we broke ground on our facility in Saudi Arabia with our partner Saudi Aramco and will soon be completing our new facility in Houston.

On the third pillar of positioning for new frontiers, we continue to evaluate multiple concepts and business models across the CCUS, hydrogen, and energy storage value chains. We see several opportunities to deploy our existing technologies or add to our offering through targeted investments and bolt-on acquisitions.

In CCUS, we acquired Compact Carbon Capture, or 3C, in November. 3C is an early stage carbon capture technology that offers a 75% smaller footprint and lower capex requirements compared to what is available today. In hydrogen, we are seeing positive momentum with our product offerings and remain engaged with several customers across a wide range of industries to advance their hydrogen projects.

As we execute on these three strategic pillars and our broader evolution as an energy technology company, we are committed to operating in a disciplined manner that prioritizes free cash flow and returns above our cost of capital.

Now, I will give you an update on each of our segments.

In our **Oilfield Services** business, activity has stabilized globally with modest improvement in select areas and positive signs for further improvement across multiple regions over the course of 2021.

In the international markets, the decline in fourth quarter activity was mostly in line with our expectations, aside from some additional softness in the Middle East that developed late in the year. For 2021, our view remains largely intact with a modest recovery in the second half across several low-cost basins. Looking across different geographies, we expect a solid recovery to continue in Latin America off depressed levels, modest improvement in the North Sea and Russia, and the potential for a modest second half recovery in the Middle East.

In North America, a solid year-end improvement in drilling and completion activity outweighed typical fourth quarter seasonality. Looking into 2021, we expect further improvements in drilling activity over the first half of the year as public E&Ps begin to add back rigs. Although the rig count is moving higher, we believe that the commitment towards capital discipline and maintenance-mode spending remains intact.

While we are pleased to see that the outlook for OFS is gradually improving, our primary focus remains on increasing the margin and return profile of this business through improved operating efficiency and portfolio actions. During 2020, we executed on our cost-out actions in OFS and continue to work through multiple work streams to further reduce our cost structure. This includes a plan to reduce our rooftops by over 100 facilities in 2021 and shut down completions-related operations in select countries in Latin America and Africa.

Overall, we believe that OFS operating margins remain on track to reach double digits in the coming years following the significant structural cost reductions in 2020, and as we institutionalize both remote operations and better operating processes.

Moving to **TPS**, our focus remains on executing the significant backlog of LNG projects awarded in recent years, continuing to grow our aftermarket services offering, driving growth in our valves business, and capitalizing on attractive opportunities in the new energy space.

During the quarter, we booked an additional award for power generation for the North Field East LNG project in Qatar. This follows the main refrigerant compression award we booked in the third quarter. For the LNG market overall, our long-term outlook for demand growth remains intact. The recent increase in LNG spot prices has solidified a similar view for many of our customers and improved momentum for a number of projects. As a result, we continue to expect that 3 to 4 projects are likely to move forward in 2021, followed by a robust pipeline of LNG projects that we expect to reach FID beyond 2021.

In our pipeline and gas processing segment, we secured an award with South Gas Company in Iraq for the design, manufacture and construction of an integrated natural gas processing and production facility. An important part of this project is the supply of compression equipment and digital monitoring systems that will enable the re-use of previously flared natural gas, which is estimated to reduce Iraq's carbon emissions by roughly 6 million tons annually. This award highlights our broad capabilities as we seek to deliver a diverse range of decarbonization solutions to our customers.

For TPS Services, we are optimistic about the outlook for recovery in 2021 and 2022 after a difficult year in 2020 as customers resume spending to maintain and, in some instances, upgrade their equipment. While our contractual services business has remained resilient through the recent market turbulence, we expect growth to be led by a recovery in transactional services and upgrades, areas that were particularly impacted during the pandemic. On a longer-term basis, we are excited by recent traction for upgrade opportunities as customers look to decarbonize and improve the efficiency of their equipment.

Next, on **Oilfield Equipment**, we executed on our cost-out efforts and have taken several portfolio actions over the course of 2020. We continue to focus on right-sizing the business and optimizing the portfolio in the face of a challenging offshore market environment.

In the fourth quarter, we won an order from Eni for the Agogo field in Angola. The project includes several solutions from our Subsea Connect suite of technologies, including multiple subsea trees, wellheads, and manifolds.

With Brent prices returning to the $50s and a more optimistic view for oil demand over the next few years, we see the outlook for industry subsea tree awards improving modestly in 2021, though still well below 2019 levels. As we look out longer term, we believe that deepwater activity will be increasingly dominated by low cost basins and that it will be difficult to sustain 2019 industry order levels for the foreseeable future.

Finally, in **Digital Solutions**, the oil and gas and aerospace end-markets remain challenging. However, we have seen some recovery in industrial end-markets outside of aerospace, in line with the rebound in the global economy.

In the fourth quarter, we were awarded several projects that demonstrate our capabilities in industrial asset management. We secured an extension to a previously awarded project with Petrobras. We will provide a suite of digital solutions and services to optimize productivity, reduce operational and safety risks, and lower carbon emissions across Petrobras sites. Our Bently Nevada business secured a contract with a major hydroelectric operator in the U.S. to provide Orbit 60, System 1 software and a five-year services agreement for industrial asset management across multiple dams. Bently Nevada also secured a fleetwide contract with American Energy Power to deploy System 1 software, remote monitoring and analytical services to diagnose machinery issues in real-time. These wins are an example of our deep domain expertise in industrial asset management. Going forward, we see significant opportunities to apply these capabilities in the oil and gas sector, and we believe that these core competencies are also applicable to a number of industrial sectors.

Overall, we executed well in 2020 against the challenges of the global pandemic and the industry downturn, delivering strong free cash flow and executing on our cost-out programs.

Baker Hughes is well placed to navigate the current market environment and positioned to lead the energy transition. We remain focused on executing for customers, being disciplined on cost, and delivering for our shareholders.

With that, I will turn the call over to Brian.

Brian Worrell *Baker Hughes – CFO*

Thanks, Lorenzo. I will begin with the total company results and then move into the segment details.

Orders for the quarter were $5.2 billion, up 2% sequentially driven by OFE and Digital Solutions, partially offset by declines in OFS and TPS. Year-over-year, orders were down 25%, with declines in all four segments.

Remaining Performance Obligation was $23.4 billion, up 2% sequentially. Equipment RPO ended at $8 billion, down 3% sequentially and services RPO ended at $15.4 billion, up 5% sequentially. Our total company book-to-bill ratio in the quarter was 0.9 and our equipment book-to-bill in the quarter was 0.9.

Revenue for the quarter was $5.5 billion, up 9% sequentially, driven by TPS and Digital Solutions, partially offset by low single-digit declines in OFS and OFE. Year-over-year, revenue was down 13%, driven by declines in OFS, OFE, and Digital Solutions, partially offset by an increase in TPS.

Operating income for the quarter was $182 million. Adjusted operating income was $462 million, which excludes $281 million of restructuring, separation, and other charges. Adjusted operating income was up 98% sequentially and down 15% year-over-year. Our adjusted operating income rate for the quarter was 8.4%, up 380 basis points sequentially. We are particularly pleased with the margin improvement in the fourth quarter, which was largely driven by strong execution on our restructuring actions and improvements in operating productivity.

Corporate costs were $111 million in the quarter. For the first quarter, we expect corporate costs to be roughly flat with fourth quarter levels.

Depreciation and amortization expense was $307 million in the quarter. For the first quarter, we expect D&A to decline slightly from fourth quarter levels and gradually decline through the year.

Income tax expense in the quarter was $568 million, driven by our geographic mix of earnings, a valuation allowance tax expense of $225 million, and a $91 million tax expense related to business dispositions. Although we expect our book tax rate to remain elevated in 2021, we expect our cash taxes to decline.

Diluted GAAP earnings per share were $0.91 cents. Included in diluted GAAP earnings per share is a $1.4 billion gain on our investment in C3.ai, recorded in other non-operating income. We invested $69 million in C3.ai when we formed our partnership in June 2019. In December, C3 completed its IPO, which requires us to mark our investment to fair value. Since our C3 investment is recorded as a marketable security on our balance sheet, the change in fair value will be reflected in the other non-operating income line on a quarterly basis going forward.

While we are very pleased with our investment, we are equally as pleased with our strong partnership with C3 as we develop and market new AI solutions for the oil and gas industry. We also view our unique C3 partnership as a good example of our capital allocation philosophy as we invest in new technology frontiers and energy transition.

Adjusted loss per share was $0.07 cents. Included in adjusted loss per share are the valuation allowance tax expenses mentioned earlier.

Turning to the cash flow statement, free cash flow in the quarter was $250 million. This was driven by an improvement in sequential operating results and modestly lower net capex. Free cash flow for the fourth quarter includes $189 million of cash payments related to restructuring and separation activities. For the first quarter, we expect free cash flow to decline sequentially primarily due to seasonality.

When I look at the total year 2020, I am pleased with our financial results considering the disruptions in the global economy, the impact of the COVID-19 pandemic, the significant restructuring that we executed over the year, and the number of corporate transactions that we completed.

Orders of $20.7 billion for the full year were down 23% in 2020, driven by declines in all segments. Total company book-to-bill was 1 in the year.

Total year revenue of $20.7 billion was down 13%. OFS was down 21% and DS declined 19%, partially offset by an increase of 3% in TPS.

Adjusted operating income of $1 billion was down 35% in the year, with total company adjusted operating income margins declining 170 basis points, mostly driven by volume declines in OFS and DS.

Corporate costs for the year were $464 million. For 2021, we expect corporate expenses to decline versus 2020. Our cost-out efforts and lower separation costs should lead to a gradual reduction in quarterly corporate expenses over the course of the year.

During 2020, we exceeded our goal of $700 million in annualized cost savings with the majority coming out in the second half of the year, and the average cash payback of our restructuring actions has been less than one year.

In addition to restructuring, we completed the sale of three businesses in 2020, including SPC Flow in the fourth quarter. These dispositions are in line with our strategy to exit businesses that do not meet our return requirements and are aligned with our broader portfolio evolution objectives.

Overall, we believe that the actions taken in 2020 have greatly improved our global operations and help to lay the groundwork for further improvement in our margin and return profile in the coming years.

For the full year, we generated $518 million of free cash flow. We are pleased with our performance as our capital discipline, cost-out initiatives, and working capital release helped to offset lower operating results and $670 million in cash restructuring and separation costs incurred during the year.

In order to achieve some of our cost-out initiatives in 2021, we booked restructuring and impairment charges of $256 million in the fourth quarter, with an expected cash payback of less than one year. Following our cost rationalization actions in 2020, this next phase is primarily associated with optimizing our structural cost, most notably reducing our facilities footprint to align with our broader business transformation objectives.

For 2021, we expect free cash flow to improve significantly versus 2020 and to approach historical levels, largely driven by higher operating income, modestly lower capex, and significantly lower restructuring and separation cash expenditures.

Now I will walk you through the segment results in more detail and give you our thoughts on the outlook going forward.

In **Oilfield Services**, the team delivered a strong quarter to close out a challenging year in the market.

OFS revenue in the quarter was $2.3 billion, down 1% sequentially. International revenue was down 5% sequentially led by declines in Asia Pacific, the North Sea, and the Middle East. North America revenue increased 11% sequentially due to solid growth in both the North American land and offshore markets.

Operating income in the quarter was $142 million, a 53% increase sequentially and a 220-basis point improvement in margin rate. The improvement in margin was driven by our restructuring and cost-out initiatives as well as favorable product mix.

As we look ahead to the first quarter, we expect to see typical seasonal softness during the quarter even though international drilling activity has largely stabilized. As a result, we expect our first quarter international revenue to decline modestly on a sequential basis.

In North America, we expect the recent momentum in drilling and completion activity in the US land segment to continue into the first half of 2021 as operators refresh spending budgets. As a result, we expect a modest sequential increase in North American OFS revenues.

Although we should benefit from our cost-out initiatives, margin rates may decline modestly in the first quarter due to international seasonality and fewer product sales.

For the full year 2021, our expectations are largely in line with the view we shared in October on our third quarter earnings call.

Internationally, we expect activity levels to stabilize and remain relatively unchanged for the first half of 2021. We currently anticipate a second half recovery in activity across multiple regions. However, we still expect that our international revenue will be down in the mid-single digit range on a year-over-year basis.

The recent increase in commodity prices and the redeployment of budgets have improved the near-term outlook in North America. At the moment though, activity in the back half of the year remains less clear. As a result, we believe that drilling and completion activity in North America is also likely to be down in the mid-single digits on a year-over-year basis.

Although OFS revenue will likely be down modestly for full year, we believe that our cost-out actions should still translate to a strong improvement in OFS margin in 2021.

Moving to **Oilfield Equipment**, orders in the quarter were $561 million, down 49% year-over-year, and up 30% sequentially. The sequential improvement in orders was driven by the Eni Agogo award and a strong performance by our SPC Projects segment, specifically in the Middle East, which helped offset a sequential decline in Flexibles orders.

Revenue was $712 million, down 7% year-over-year. Revenue declines in Subsea Services and Subsea Drilling Systems were offset by growth in SPS and Flexibles.

Operating income was $23 million, a 47% improvement year-over-year. This was driven by higher volume in SPS and Flexibles along with help from our cost-out program, which was partially offset by softness in services activity.

For the first quarter, we expect revenue to decrease sequentially driven by lower SPS and Flexibles backlog conversion. We expect operating income to also decline sequentially but remain in positive territory primarily based on our cost out initiatives.

For the full year 2021, we expect the offshore markets to remain challenged as operators re-assess their portfolios and project selection. We expect OFE revenue to be down double digits on a year-over-year basis due to the lower order intake in 2020 and a likely continuation of a difficult offshore environment in 2021. Although revenue is likely to be down in 2021, our goal is to maintain positive operating income as our cost out efforts should offset the decline in volume.

Next, I will cover **Turbomachinery**. The team delivered another strong quarter with solid execution.

Orders in the quarter were $1.8 billion, down 4% year-over-year. Equipment orders were down 10% year-over-year. We were pleased with another solid quarter of bookings for TPS despite the challenging environment. Orders this quarter were supported by awards for the Iraq flare gas project and power generation units for Qatar Petroleum's NFE project. Service orders in the quarter were up 2% year-over-year, driven by growth in Contractual Services.

Revenue for the quarter was $1.9 billion, up 19% versus the prior year. Equipment revenue was up 67% as we continue to execute on our LNG and Onshore / Offshore production backlog. Services revenue was down 11% versus the prior year.

Operating income for TPS was $332 million, up 9% year-over-year, driven by higher volume and strong execution on cost productivity. Operating margin was 17.1%, down 160 basis points year-over-year largely driven by a higher mix of equipment revenue.

For the first quarter, we expect revenue to decline sequentially roughly in line with the last couple of years. Based on this revenue outlook, we expect TPS operating income to grow year-over-year but expect margin rates to be roughly flat versus the first quarter of 2020 due to a higher mix of equipment revenue.

For the full year 2021, we expect to generate solid year-over-year revenue growth, driven by the conversion of our current equipment backlog and a modest increase in TPS Service revenues. Although a higher mix of equipment revenue may be a slight headwind for growth in margin rates next year, we still expect solid growth in operating income based on higher volume.

Finally, in **Digital Solutions**, orders for the quarter were $528 million, down 18% year-over-year. We saw declines in orders across most end-markets, most notably transportation, oil and gas, and industrial. Sequentially, orders were up 7% driven by seasonality in power and some improvements in transportation.

Revenue for the quarter was $556 million, down 16% year-over-year due to lower volumes across all DS product lines, with the largest declines in Waygate and Reuter Stokes. Sequentially, revenue was up 10% as some industrial end-markets begin to recover.

Operating income for the quarter was $76 million, down 30% year-over-year driven by lower volume. Sequentially, operating income was up 66% driven by higher volume across all product lines and cost productivity.

For the first quarter, we expect to see sequential revenue declines in line with typical seasonality and operating margin rates back into the single digits.

Looking into 2021, we expect a modest increase in revenue on a year-over-year basis, primarily driven by a recovery in industrial end-markets. With higher volumes and the benefit of our cost-out program, we believe DS margin rates can get back to low double digits for the full year.

Overall, I am pleased with the execution in the fourth quarter and the total year amid a difficult macroeconomic backdrop. While 2021 may have some challenges, we are confident in our strategy and our ability to execute. We remain focused on free cash flow and improving margins and financial returns.

With that, I will turn the call back over to Jud.

Jud Bailey *Baker Hughes – VP of Investor Relations*

Thanks, Brian. Operator, let's open the call for questions.