Second Quarter 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 Second Quarter 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.

The second quarter of 2020 was challenging in several areas as our company navigated through the impacts of the COVID-19 pandemic and the sharp decline in activity levels due to lower oil and gas prices. Despite these headwinds, I was pleased with how our team executed with strong margin performance in TPS and DS, solid cost-out execution in OFS, solid order bookings in OFE and TPS, and another quarter of free cash flow generation.

Although the majority of lockdowns have been easing globally and economic activity likely troughed during the second quarter, visibility on the economic outlook remains extremely limited. More specifically, the risk of a second wave of virus cases globally, the reinstitution of some lockdowns, and the potential for lingering high unemployment create an uncertain economic environment that likely persists through the rest of 2020.

We expect this economic uncertainty to weigh on the oil and gas markets, which are currently in an excess supply position. Given these factors, we are preparing for potential future volatility, while also focusing on both structurally reducing our cost base and implementing a number of strategic initiatives across all of our product companies.

In our Oilfield Services segment, despite the challenging environment we remain strongly engaged with our customers to proactively offer solutions that lower costs, improve efficiency, and deliver returns for Baker Hughes.

In North America, drilling and completion activity declined largely in line with the expectations we referenced on our first quarter call, with activity down over 50%. While the US market appears to have troughed and we started to see some improvement in our production-related businesses in June and July, visibility over the second half of 2020 remains limited, with any incremental activity closely tied to oil prices. Overall, we maintain our view that US drilling and completion spend will be down more than 50% for the full year.

Internationally, the decline in activity was higher during the second quarter than our initial estimates, primarily due to quarantines and COVID-related impacts in Latin America and Sub-Saharan Africa. As we look into the second half of 2020, we see competing forces with potential for some COVID-impacted rigs to come back online, but likely offset by signs of further activity declines in the Middle East. Based on these dynamics, we now see full year international drilling and completion spending down 15% to 20% versus our initial estimates of a 10% to 15% decline compared to 2019.

Given this challenging backdrop and the high likelihood that 2021 will also be somewhat subdued, we are focused on what we can control in OFS, from both a cost and product perspective. Looking at costs, we are accelerating our efforts in remote operations to drive further cost reductions for both Baker Hughes and our customers, improving productivity, and ensuring safety by reducing person-to-person interactions. We have seen a solid increase in remote operations so far in 2020, with over 70% of our drilling operations in the second quarter utilizing remote capabilities, up from 60% in the first quarter and roughly 50% in 2019.

The best example of our success in remote operations is with Equinor in Norway, where we have recently implemented their IO3 automated remote operations model on another six rigs, reducing our field service personnel on the rigs by 50%.

While the majority of our drilling operations are now utilizing remote capabilities, we still see further opportunities for margin improvement as we are in the relatively early stages of recognizing the full scope of cost and productivity benefits of this technology. Additionally, we see increased opportunities over time as we apply remote operations capabilities outside of drilling and towards broader well construction and completion-related activities.

Looking at products within our OFS portfolio, we remain committed to providing the best technology in drilling services and completions, and we see opportunities to capitalize on our strong presence in the production value chain. More specifically, we see opportunities to leverage our strength in artificial lift and production chemicals with our growing competencies in remote operations and A.I. to provide a comprehensive production solutions platform to help customers optimize production.

Overall, I am quite pleased with the execution and strategic direction of our OFS business in navigating this downturn and positioning for the future.

Moving to our TPS segment, the team continues to execute very well despite a challenging environment. With lockdowns in Italy and other parts of the world easing, I am pleased to report that our facilities in Italy are almost back to 100% utilization and our schedule for equipment backlog execution remains largely intact.

As we indicated on our first quarter earnings call, the biggest impact to our TPS operations in 2020 from the pandemic is in TPS Services, which experienced dislocations during the second quarter due to mobility restrictions and the delay of some customer outages. Despite the short-term headwinds impacting Services, the team is managing the environment extremely well and has been able to drive productivity improvements, supporting higher year-over-year margins for the business.

On the TPS equipment side, our Onshore/Offshore Production segment has held up relatively well despite the pressure on offshore-related equipment. For the first half of 2020, order activity for Onshore/Offshore Production is up versus the first half of 2019, following several FPSO bookings this year.

We also continue to gain traction in our growing industrial gas turbine segment, highlighted by the second quarter award of nine NovaLT gas turbines for a utility power generation project in the Middle East. The NovaLT family provides a more efficient, cleaner power generation solution for a broad range of industrial and emerging energy applications. With our growing range of competitive products as well as new applications such as operating on 100% hydrogen, we are confident in the potential growth of this product line.

For our LNG equipment business, the near-term outlook remains challenging, but we continue to stay optimistic on the longer-term fundamentals for natural gas, and especially LNG.

In the near term, LNG FIDs remain uncertain given the macro-economic environment, with the economic impact of COVID-19 putting pressure on LNG demand and driving further weakness in LNG prices. Despite this uncertainty, we expect there could be one or two FIDs by year-end, with smaller or brownfield projects likely more competitively advantaged.

Longer-term, we remain firm believers that natural gas and LNG demand growth will outpace oil demand as natural gas will be both a transition and destination fuel as the world looks for cleaner sources of energy in the coming decades. In fact, we have seen several actions during the pandemic that could help accelerate the shift away from coal and oil to natural gas. For example, we see signs that the lower cost of natural gas is helping to drive incremental demand as LNG prices in most economies are not only cheaper than oil but also cheaper than the coal equivalent in some instances.

Furthermore, a number of government pandemic stimulus packages have included requirements for green energy or a focus on energy transition, including LNG. For example, clean energy features heavily in the European Commission’s stimulus package, and in Germany, LNG trucks have been granted toll road exceptions into 2023.

The positive long-term outlook for LNG re-affirms our strategy to position Baker Hughes and our TPS segment to capture the high-value, higher-technology opportunities along the gas value chain. We see quite a few opportunities across our TPS portfolio, including the introduction of more efficient power generation and compression technology to help minimize carbon emissions for new projects and for our current installed base of LNG equipment.

For example, one of the key differentiators of our LM9000 aeroderivative turbine is its lower carbon footprint and efficiency, which was recently validated by the completion of the First Engine To Test with Novatek for their Arctic LNG 2 project, an important milestone for the ongoing development of this leading turbine technology.

With our installed base of over 400 MTPA of liquefaction equipment globally, our TPS Service franchise is uniquely positioned to offer upgrades and technology services that can extend equipment life, enhance equipment availability and performance, and contribute to further emissions reductions and controls.

Some recent examples include upgrading our gas turbines to increase fuel flexibility, specifically around hydrogen blends and injecting new technology into equipment with a focus on reducing potential methane leakages.

Overall, we are very excited with the direction of our TPS franchise and how it is positioned to benefit from the growth in natural gas and LNG demand as well as the growing demand for lower carbon solutions.

Next, our Digital Solutions business is executing well in the face of weakness across all of its major end-markets. The slowdown in the oil and gas markets, specifically in the midstream and downstream areas, is negatively impacting volumes for our Bently Nevada and Process and Pipeline Services businesses. Going forward, a key focus for DS will be to leverage the strong condition monitoring technology at Bently Nevada to drive new opportunities in the oil and gas, renewables, and industrial sectors.

Broader industrial activity trends are also negatively impacting our inspection, measurement, and sensing businesses. Outside of oil and gas and power, the aerospace segment is a significant end market for DS and has also been the weakest as global flight activity remains far below historical levels. Conversely, the electronics markets and some other industrial end markets are showing improvement, but visibility is limited. On a more positive note, customer activity in the Asia Pacific region has rebounded well from the lows of the first quarter.

Despite these challenges, our team is executing incredibly well, taking decisive cost actions and delivering strong sequential margin improvement in a difficult environment.

Finally, on Oilfield Equipment, the business faces challenges on several fronts. With lower oil prices and significant macro uncertainty, major operators are re-prioritizing their portfolio of potential projects and investments, which is delaying the sanctioning of many offshore projects.

As a result, our outlook for the subsea tree market remains muted, with an expectation for approximately 100 trees being awarded to the industry in 2020. We see this uncertainty extending into 2021 as majors and NOCs reassess their portfolios and capital allocation priorities.

We continue to see strength in our offshore flexibles offering, with strong orders performance in the second quarter in Brazil and Saudi Arabia. Orders for the first half of the year are roughly flat versus 2019, and FPS remains well positioned not only in Brazil, where we have seen success, but also in the rest of the world, where our flexibles offering continues to gain traction.

The continued weakness in floater activity is also likely to linger through the second half of 2020, which would negatively impact service activity in our subsea drilling systems business. Budget and mobility constraints are also negatively impacting intervention work and other subsea services across our installed base.

As these challenges persist, we remain focused on identifying ways to right-size the business and improve profitability across OFE.

Overall, we are executing on the framework we laid out on our first quarter earnings call. We are on track to hit our goals of right-sizing our business and generating positive free cash flow for 2020, and to achieve the $700 million in annualized cost savings by year end. We continue to explore and identify further ways to make all of these savings structural in nature.

We believe that the expanded use of remote operations and multi-skilling will drive greater productivity and a step change in service delivery capabilities, ensuring the health and safety of our employees during the pandemic and greatly reducing our resource needs in a longer-term recovery. We also continue to improve our supply chain organization and procurement processes, by identifying and eliminating redundant infrastructure and excess inventory.

Although we are managing through this downturn and focused on ways to structurally improve our cost base and productivity levels, I would reiterate that our portfolio evolution and energy transition very much remain a strategic focus for Baker Hughes.

Over the past two years, we have evaluated the key growth areas associated with energy transition and analyzed where we can leverage our core competencies and technology to capitalize on these opportunities. As we go through this process, we are committed to taking a disciplined approach and focusing on areas that can provide growth but also good financial returns.

We are evaluating a range of opportunities, and see potential in a few key areas that include carbon capture, mechanical energy storage, and various parts of the hydrogen value chain. In all three of these, we believe that our turbine, compression, valves, sub-surface, monitoring and detection technologies can play a key role in providing solutions. In fact, Baker Hughes has been involved in CCUS projects for more than a decade in our OFS segment, and our turbomachinery technology is currently deployed in the world's largest CCUS project in Australia.

Although it is still early days, I am excited about the level of engagement we are having with customers on these topics, as well as multiple trials around the world in which we are currently participating.

Before I turn the call over to Brian, I want to take a moment to thank our employees for their resilience and commitment to delivering for our customers, shareholders and each other, all while balancing the potential threats and implications from the coronavirus pandemic and the broader challenges in the economic environment.

I am extremely proud of the Baker Hughes team during these difficult past few months, and we have once again proven our collective strength, as we have adapted in the face of unprecedented market conditions and COVID-19.

Baker Hughes' portfolio operates across the energy value chain, which makes us uniquely positioned to navigate the challenging market environment the industry is currently facing. We remain focused on execution, disciplined on cost actions, committed to supporting our customers, 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.

I am very pleased with the results in the second quarter, the level of execution in operations, and our progress on cost-out initiatives in a particularly volatile environment.

Orders for the quarter were $4.9 billion, down 25% year-over-year driven by declines in OFS, TPS and Digital Solutions partially offset by growth in OFE.

Remaining Performance Obligation was $22.9 billion, up 1% sequentially. Equipment RPO ended at $8 billion, up 2% sequentially and services RPO ended at $14.9 billion. Our total company book-to-bill ratio in the quarter was 1 and our equipment book-to-bill in the quarter was 1.1.

Revenue for the quarter was $4.7 billion, down 13% sequentially, driven by declines in OFS, Digital Solutions and OFE. Year-over-year, revenue was down 21% driven by declines in OFS, Digital Solutions and TPS.

Operating loss for the quarter was $52 million. Adjusted operating income was $104 million, which excludes $156 million of restructuring, separation, and other charges.

Adjusted operating income was down 56% sequentially and down 71% year-over-year. Our adjusted operating income rate for the quarter was 2.2%.

Corporate costs were $117 million in the quarter. We expect corporate costs to be at similar levels in the third quarter as we continue to execute separation-related activities.

Depreciation and amortization was $340 million. We expect D&A to decrease slightly in the third quarter.

Net interest expense was $69 million. The sequential increase was primarily driven by lower interest income as rates fell globally.

We had a $21 million income tax credit in the quarter. Included in income tax is a $75 million benefit related to the CARES Act, which we expect will lower our cash tax payments in the second half of 2020.

GAAP loss per share was $0.31 cents. Adjusted loss per share was $0.05 cents.

Free cash flow in the quarter was $63 million. We are pleased with another positive cash performance during the second quarter, which was supported by a reduction in capital spending and $205 million from working capital.

Included in free cash flow were $221 million of cash payments related to restructuring and separation. As Lorenzo mentioned, we are on track with the $800 million in cash expenditures related to restructuring, separation and cost reduction programs we announced on the first quarter call as well as the associated paybacks.

For the rest of the year, we expect to make further reductions in capex from second quarter levels but also expect cash flow from working capital to moderate versus the strong levels in the first half.

Moving to the balance sheet, as I discussed on our last earnings call, our goal through this downturn is to remain disciplined in our capital allocation. We continue to focus on liquidity and cash preservation, and protecting our investment grade rating, while maintaining our current dividend payout.

During the second quarter, we took further steps to strengthen our balance sheet by issuing $500 million of 10-year senior notes in early May as well as drawing on a UK short-dated commercial paper facility to ensure we have ample liquidity on hand to manage through this downturn and the uncertainty it has created.

Our positive free cash flow and incremental liquidity actions resulted in over $4 billion in cash on hand at the end of the quarter. We continue to view our financial strength and liquidity as a key differentiator.

During the quarter we completed the sale of our rod lift product line. This disposition is in line with our strategy of exiting businesses that do not meet our return requirements and aligns with our objectives of transitioning the portfolio to a higher mix of industrial and chemical end markets and capitalizing on energy transition-related growth opportunities.

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 solid quarter despite a significant drop in activity.

OFS revenue in the quarter was $2.4 billion, down 23% sequentially. North America revenue was down 41% sequentially as the rig count fell 58% in the quarter. International revenue was down 15% sequentially. As anticipated, our production-related product lines and geographic mix helped to mitigate some of the broader market declines in the second quarter, allowing us to outperform activity trends in North America and internationally.

Operating income in the quarter was $46 million, down 78% sequentially with margins declining 470 basis points. The team executed well on the cost-out initiatives we outlined in the first quarter.

As we look ahead to the third quarter, visibility in both the North American and international market remains limited. In North America, production-related activity is beginning to recover as some operators bring previously shut-in wells back online. Completion activity is also showing signs of recovery, though from a very low base.

Conversely, while drilling-related work is showing some signs of stabilizing, the rig count is still drifting lower at the beginning of the third quarter. Taking all this into account, we expect overall North American activity to be relatively flat on a sequential basis.
Internationally, we see competing forces over the second half of the year with some COVID-impacted rigs potentially coming back online likely more than offset by expected slowdowns in the Middle East and some offshore markets. Overall, we estimate that international activity could decline sequentially in the high-single-digit to low-double-digit range.

Although we expect to experience continued volume pressure in the third quarter, we remain committed to taking aggressive cost actions to offset activity declines and believe that OFS margin rates could be flat to down slightly versus the second quarter.

As Lorenzo mentioned earlier, for the full year 2020, we continue to expect US drilling and completion spending to be down more than 50% versus 2019 and now expect international spending to decline 15 to 20% versus 2019.

Moving to **Oilfield Equipment**, orders in the quarter were $699 million, up 13% year-over-year, driven by an extension of a Subsea Production Systems project we were awarded in 2019. We also had another solid orders quarter in the Flexible Pipe Systems business, specifically in Brazil and the Middle East. We are pleased with the orders performance by OFE, which demonstrates the strength of our product offering, even in a difficult offshore environment.

Revenue was $696 million, flat year-over-year. Revenue growth in Subsea Productions Systems and Flexibles was offset by declines in Surface Pressure Control in North America and Subsea Services.

Operating loss was $14 million driven by lower volume in Subsea Services due to mobility limitations and suspension of several installation campaigns as well as lower volume in Surface Pressure Control driven by activity declines. This was partially offset by the increased volume in our Subsea Production Systems business.

For the third quarter, we expect a modest sequential revenue increase as continued backlog execution in SPS and Flexibles is offset by declines in Surface Pressure Control and Subsea Services. With higher revenue sequentially and incremental cost savings from the restructuring projects currently underway, we expect operating income for OFE to be better than the second quarter.

As we look at our OFE segment for 2020, we continue to expect revenue in SPS and Flexibles to grow as the team executes on current backlog; however, we expect to see declines in Surface Pressure Control and Subsea Services driven by broader market dynamics, largely offsetting these increases. Overall, we estimate that this likely results in margins below 2019 levels.

Next, I will cover **Turbomachinery**. The team delivered a solid quarter with very strong execution and cost productivity despite significant challenges related to the pandemic.

Orders in the quarter were $1.3 billion, down 34% year-over-year. Equipment orders were down 48% year-over-year, and equipment book-to-bill was 1.2. We were pleased to receive the order for the third train of the Arctic LNG 2 project, several awards in Onshore/Offshore Production, and an order for nine NovaLTs in the industrial sector in the Middle East.

Service orders in the quarter were down 19% year-over-year, mainly driven by fewer upgrades and lower services orders from midstream and downstream customers.

Revenue for the quarter was $1.2 billion, down 17% versus the prior year. Equipment revenues were down 15% driven primarily by COVID-19 related-delays. Services revenue was down 19% versus the prior year due to COVID-19 mobility limitations and customer spending delays caused by lower commodity prices.

Operating income for TPS was $149 million, up 10% year-over-year, driven by strong execution on cost productivity. Operating margin was 12.8%, up 320 basis points year-over-year.

For the third quarter, we expect equipment-related revenue to grow as we execute on our LNG and Onshore/Offshore production backlog. We expect TPS services to continue to face pressure as operators delay service activity and upgrades where possible to conserve cash flow. Based on these factors, we expect TPS revenue and operating income to increase on a sequential basis.

For the full year 2020, we expect operating income to be roughly flat with 2019.

Finally, in **Digital Solutions**, orders for the quarter were $465 million, down 32% year-over-year. We saw declines in orders across all end markets, most notably aviation, oil and gas, and power. Orders were down across all regions as well.

Revenue for the quarter was $468 million, down 26% year-over-year due to lower volumes across all of our product lines. This was driven by a large drop in maintenance activity in Pipeline & Process Solutions, as well as the weaker automotive and aviation sectors, which impacted the Inspection and Measurement & Sensing product lines.

Operating income for the quarter was $41 million, down 51% year-over-year driven by lower volume. The team executed on their cost-out plans, improving margins 280 basis points sequentially.

For the third quarter, we expect Digital Solutions to continue to be impacted by weakness in several end markets, particularly oil and gas and aerospace. As a result, we expect to see revenue and operating income flat to modestly higher versus second quarter levels.

For the full year, we continue to expect revenue declines in the double digits as the current weak economic outlook dampens customer spending.

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

Jud Bailey *Baker Hughes – VP of Investor Relations*

Thank you, Brian.

Operator, let’s open the call for questions.