Third 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 Third 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.

We are pleased with our third quarter results as we successfully managed the company through the immediate impacts of both the pandemic and the industry downturn, while also accelerating our long-term strategy. From an operational perspective, I am pleased with the continued solid execution on cost-out from our OFS and OFE teams, as well as the commercial success and performance demonstrated by TPS and DS. We also saw continued free cash flow generation during the quarter and expect to be free cash flow positive for the year.

As we move forward, we continue to be intensely focused on improving the margin and return profile of Baker Hughes despite the near-term macro volatility, while at the same time executing on the long-term strategy to evolve our portfolio along with the energy landscape.

After significant turmoil during the first half of the year, oil markets have somewhat stabilized. However, there is still quite a bit of uncertainty expected over the next several quarters as the demand recovery is beginning to level off and significant excess capacity remains. The outlook for natural gas is slightly more optimistic as forward prices have improved with strong demand in Asia and lower expected future gas production in the US.

On the economic front, the global economy has rebounded from the severe contraction experienced in the second quarter. However, the recovery so far has proven to be quite uneven and the risk of a second wave impacting economic demand remains relatively high. While some industrial sectors have experienced a rebound in activity, others have remained somewhat suppressed. The current environment has also resulted in the acceleration of different parts of the economy, including technology adoption and the acceptance of new ways of working and living.

Importantly, one of these areas where we have been witnessing a step change in activity and mindset is the broader energy industry. The COVID-19 pandemic has revealed the speed at which the environment can respond to lower carbon levels. This has accelerated the debate on how to fuel economic growth while transitioning to a lower carbon future. We have not only seen this acceleration in government response to the pandemic, but we are also seeing it in society at large, and increasingly from our customers.

As we have recently highlighted, Baker Hughes remains committed to being a leader in the energy transition and becoming a key enabler to decarbonizing oil and gas and other industries from within. We also believe that the changes rapidly unfolding across the oil and gas landscape warrant an acceleration of this strategy.

We have developed a three-pronged approach to accelerate our transition to an energy technology company.

The first of these strategic pillars is to transform the core. This targets multiple workstreams that are focused on improving our margin and return profile through a combination of structural cost reductions, portfolio rationalization, and the use of digital technology.

On the cost side, we continue to execute the rigorous cost reduction program we outlined in April, targeting $700 million in annualized savings by year end. Through the third quarter, we have achieved approximately 75% of our target and believe that we will likely achieve a higher run rate by the end of the year.

On the portfolio front, we have already divested of several businesses this year and will continue to evaluate further actions, specifically around businesses that likely don't have the potential to meet our return requirements. This process could lead to further divestments, alternative business structures like joint ventures or partnerships, or the exit of some product lines in select regions. In any scenario, we are taking a holistic view across Baker Hughes and will take decisive action to improve margins while also maintaining businesses continuity and delivering for our customers.

The other major component of our transform the core initiative will be the expanding use of digital technology and remote operations. We view the expansion of remote operations in OFS and TPS as key enablers to drive better cost and margin productivity.

The second of our strategic pillars is to invest for growth. Given the subdued upstream outlook, the primary growth opportunities we see within our existing product and service footprint are the broader industrial sector, specialty chemicals, and non-metallic materials.

On the industrial side, we see the opportunity to develop a solid industrial platform by leveraging the strongest core competencies within our TPS and Digital Solutions segments. Our efforts will be focused on delivering energy efficiency and process solutions, targeting adjacent non-energy industrial sectors.

In addition to industrials, we remain focused on driving growth in the non-metallic and chemicals sectors. Due to the lower carbon footprint associated with non-metallics, we believe this segment provides significant opportunity for expansion, as well as synergies with our upstream and chemicals businesses.

In chemicals, we see opportunities to grow internationally, in the downstream segment, and potentially into other adjacent specialty chemicals markets to complement our current capability.

The third pillar of our strategy is focused on positioning for new frontiers. As the energy landscape continues to evolve, we have spent considerable time evaluating the key growth areas associated with energy transition and analyzed where Baker Hughes can capitalize on these opportunities.

Overall, we see a range of options for our technology with the greatest near-term potential in carbon capture, hydrogen, and energy storage. Although it is still very early in the evolution of these three markets, we believe that Baker Hughes can play a key role in the future development of these areas with the technology we have in-house. In fact, we are in active conversations today with multiple stakeholders in all three of these areas, primarily focused on how our compression and turbine technology can play a role in future 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, returns above our cost of capital, paying our dividend, and maintaining our investment grade rating.

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

The persistent weakness in oil prices continues to create a challenging environment for **Oilfield Services**. In the international markets, the decline in third quarter activity was in line with our expectations as COVID-impacted regions remain depressed and activity in the Middle East and other areas continued to decline. For the full year, we expect international drilling and completion activity to decline closer to the high end of the 15% to 20% range that we outlined on our last earnings call. As we look into 2021, we expect activity to stabilize early next year and see the opportunity for recovery in some markets over the second half of the year. However, we believe that any potential second half recovery in 2021 will require higher oil prices and that most of the activity increases are likely to come from low-cost basins.

In North America, completion activity rebounded strongly during the third quarter while drilling activity stabilized in August and September. A key driver helping to support our North American OFS results during the quarter was a recovery in our production driven businesses, particularly in our Artificial Lift product line. Looking ahead, E&P customers in North America are increasingly signaling their commitment to capital discipline and a maintenance mode for spending that will allow for minimal or modest production growth. While this shift to maintenance mode likely implies an increase in activity from current levels, we believe that it suggests an uncertain outlook over a longer time period.

While the outlook for OFS remains challenging into 2021, we are closely engaged with our customers to help find solutions and remain committed to structurally reducing our cost base and finding ways to improve the margin profile for this business. Although our company strategy involves pivoting the portfolio and leading the energy transition, the OFS business remains core to our company as we believe that oil and gas will still play a leading role in the energy landscape for the foreseeable future.

Moving on to **TPS**. This segment, as you know, is a multi-faceted business with a leading position in LNG, a robust aftermarket services franchise, and an improving valves business. It also has attractive growth potential in industrial and new energy applications. TPS has remained resilient in a challenging market environment.

The most significant development for TPS in the quarter was the award for the main refrigerant compressors for four mega trains at Qatar Petroleum's North Field East LNG project, executed by Qatargas. The order reinforces over two decades of trust and successful turbomachinery collaboration between Baker Hughes, Qatar Petroleum and Qatargas. With six LNG mega trains driven by Baker Hughes technology already in operation, the NFE award underscores the strength of our offerings for the world's most complex LNG projects.

Taking a broader view of the LNG market, our long-term outlook for LNG demand growth remains intact. We continue to view natural gas as a transition and destination fuel for a lower-carbon future, supported by a few key drivers.

First, the phasing out of coal should support natural gas demand in the power generation space. With coal still accounting for nearly 30% of global energy supply, natural gas has ample opportunity to displace coal in both developed and developing markets over the coming decades. China's recent pledge to be carbon neutral by 2060 implies continued growth in gas consumption and India is also expected to see almost a doubling in natural gas demand over the next 15 years.

Second, we also believe that LNG, and gas more broadly, is well placed to support renewables growth. It can provide cleaner, flexible, reliable, and competitively priced power for peak load management and grid stabilization.

Third, we see the capacity to further reduce the carbon footprint of existing and future LNG operations through the use of new technologies. We have been a pioneer from the early days of LNG and a clear leader in LNG development for almost 30 years, introducing new technologies to enable more efficient production and operations. For example, TPS continues to partner with customers to reduce their carbon footprint across our installed base of over 5,000 gas turbines and 8,000 compressors. So far in 2020, we have booked upgrade orders that will result in a reduction in excess of 160,000 tons of CO_2 per year.

We are also having productive discussions with customers regarding the use of carbon capture technology and hydrogen for various projects. Carbon capture technology can be added to liquefaction trains through upgrading existing equipment or new installations, which can meaningfully reduce carbon emissions.

For hydrogen, we are seeing increased applications for hydrogen blend turbines for mechanical drive in LNG. At Baker Hughes we have turbines running on 100% hydrogen, as well as blended hydrogen in several power generation applications across our fleet. We believe that hydrogen blend applications will grow as LNG operators seek to reduce the carbon footprint of their projects, and as the hydrogen infrastructure becomes more efficient around the world. Importantly, as customers weigh the economics of future projects with the demands for a lower carbon footprint, we have the technology portfolio in place that can help execute their plans and satisfy all stakeholders.

Next, in **Digital Solutions**, while broader industrial activity trends are improving, we see continued weakness in the oil and gas and aerospace markets. Despite these challenges, our team is executing well, taking decisive cost actions. Our strategy for DS is focused on driving continued expansion across the oil and gas and industrial end-markets and building on our condition monitoring and other leading technologies to deliver outcome-based solutions for a range of industries.

An example of where we would like to see our DS business in this environment is reflected in an important contract we won this quarter with Petrobras to deliver innovative solutions and safer operations in plants across Brazil. The three-year frame agreement combines Digital Solutions' hardware and edge devices with our leading software offerings to provide holistic, outcome-based solutions to the customer.

DS will deliver to Petrobras a wide set of hardware technologies from our Bently Nevada, Nexus Controls, and Panametrics product lines to enhance multiple aspects of the customer's operations through risk mitigation and performance standardization and improvements. On the software side, we will also be deploying our new Bently Nevada Orbit 60 series, a machinery protection and condition monitoring system, for the first time in Latin America. When combined with our System 1 condition monitoring and diagnostics software, Orbit 60 provides customers with the ability to create pro-active maintenance and fleet management programs for maximum productivity and cost reduction.

Finally, on **Oilfield Equipment**, we continue to navigate a difficult environment and remain focused on cost-out efforts and improving the margin profile of this business. In the third quarter, we made solid progress on these initiatives, executing on our cost goals related to the restructuring plan for the business.

Also, during the third quarter, we reached an agreement to sell our Surface Pressure Control Flow business, which operates primarily in North America. We are retaining the SPC Projects business, which operates in the Middle East, Africa, North Sea and Asia. This disposition is in line with our strategy to focus the portfolio on core activities.

For our offshore-leveraged businesses, the market outlook remains challenged. Lower oil prices and continued macro uncertainty has led offshore operators to focus on conserving cash flow and re-prioritizing their portfolio of potential projects and investments. As a result, although tree awards are now trending closer to 150 trees for the year, we are not expecting any material growth in new awards in 2021. Within our shorter cycle services business, we continue to experience weakness in intervention work due to both budget and mobility constraints. While we believe this type of activity will improve with higher oil prices, we do not anticipate a material change in this business for the next few quarters.

A bright spot within our OFE portfolio remains the non-metallic and flexible pipe business, which is seeing positive momentum with customers around the world. Our offshore flexible pipe business continues to book solid awards in Brazil, while our non-metallics business continues to provide significant opportunity for expansion in broader energy markets.

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 free cash flow for 2020, and to achieve the $700 million in annualized cost savings by year end.

Baker Hughes is uniquely placed to navigate the challenging market environment the industry is currently facing, and positioning 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.

Orders for the quarter were $5.1 billion, up 4% sequentially driven by TPS and DS, partially offset by declines in OFS and OFE. Year-over-year, orders were down 34%, with declines in all four segments. Remaining Performance Obligation was $23 billion, up 1% sequentially. Equipment RPO ended at $8.3 billion, up 4% sequentially and services RPO ended at $14.7 billion, down 1% sequentially. 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 $5.0 billion, up 7% sequentially, driven by TPS, OFE and Digital Solutions, partially offset by declines in OFS. Year-over-year, revenue was down 14%, driven by declines in OFS and Digital Solutions, partially offset by an increase in TPS.

Operating loss for the quarter was $49 million. Adjusted operating income was $234 million, which excludes $283 million of restructuring, separation, and other charges. Adjusted operating income was up 124% sequentially and down 45% year-over-year. Our adjusted operating income rate for the quarter was 4.6%, up 240 basis points sequentially.

We are particularly pleased with the margin improvement in the third quarter, which was largely driven by our restructuring execution. We have achieved roughly 75% of our $700 million in cost-out initiatives and are on track to complete the rest during the fourth quarter. Based on our execution to date, as well as additional opportunities that we have identified through this process, we feel confident that we can exceed our initial cost-out estimates by the end of this year.

Corporate costs were $115 million in the quarter. We expect corporate costs to decline slightly in the fourth quarter versus third quarter levels. Looking ahead to 2021, we expect our cost-out efforts and lower separation costs to reduce corporate expenses.

Depreciation and amortization was $315 million in the quarter. We expect D&A to be flat sequentially in the fourth quarter.

Net interest expense was $66 million.

Income tax expense in the quarter was $6 million. Included in income tax is a $42 million benefit related to the CARES Act, which will lower our net cash tax payments in future periods.

GAAP loss per share was $0.25 cents. Adjusted earnings per share were $0.04 cents.
Free cash flow in the quarter was $52 million, which includes $178 million of cash payments related to restructuring and separation activities. For the fourth quarter, we expect free cash flow

to be roughly flat to sequentially higher supported by stronger operating results, continued capex discipline, and modest improvement in working capital. For 2021, we expect free cash flow to improve significantly versus 2020 levels, largely driven by higher operating income, as well as lower restructuring and separation charges.

Lastly, as Lorenzo mentioned, in the third quarter we reached an agreement to sell our Surface Pressure Control Flow business, which operates primarily in North America within OFE. We expect the transaction to close in the fourth quarter. Additionally, during the quarter we completed the sale of our Specialty Polymers business in OFS. These dispositions are part of our strategy to exit businesses that do not meet our return requirements and are aligned with our broader portfolio evolution objectives.

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 despite the ongoing market challenges. OFS revenue in the quarter was $2.3 billion, down 4% sequentially. International revenue was down 3% sequentially while North America revenue was down 7%.

Operating income in the quarter was $93 million, which was a solid increase sequentially and a 210-basis point improvement versus the prior quarter. The improvement in margins was driven by strong execution on the cost-out initiatives we announced in April.

As we look ahead to the fourth quarter, visibility in both the North American and international markets remain limited. Internationally, activity remains soft in multiple regions, which is likely to be further impacted by typical seasonality. We expect year-end product sales to be muted in the fourth quarter due to customer budget constraints. Based on these factors, we expect our fourth quarter international revenue to decline modestly on a sequential basis.

In North America, we expect relatively firm drilling and completion activity versus the third quarter and a modest sequential improvement in our production-related businesses partially offset by typical seasonality. Given these dynamics, we expect our North American OFS revenue to be roughly flat with third quarter levels. While we expect to experience modest volume pressure in the fourth quarter, we remain committed to executing on our cost actions and believe that OFS margin rates could be roughly flat to slightly higher in the fourth quarter.

Although we still do not have great visibility for 2021, I will give you some initial thoughts on how we see the market next year.

In the international market, we expect activity levels to stabilize late this year or early next year and remain relatively unchanged for the first half of 2021. Based on conversations with customers, we believe that a second half recovery in activity in select international basins is a reasonable expectation if oil prices begin to improve. However, despite a potential second half recovery, we believe that international activity will still be down on a year-over-year basis for 2021.

In North America, we have limited visibility next year due to the short-cycle nature of the market, uncertainty in oil prices, and the rapidly evolving business models of some of the largest US producers. As more E&Ps commit to maintenance mode capex levels, minimal production growth, and returning more cash to their shareholders, we believe that overall North American drilling and completion activity will struggle to be flat on a year-over-year basis in 2021 and that US oil production should decline on a year-over-year basis.

Although this activity outlook suggests that OFS revenue will be down modestly in 2021 on a year-over-year basis, we believe that our cost-out actions should still translate to a modest improvement in OFS margins and operating income for 2021.

Moving to **Oilfield Equipment**, orders in the quarter were $432 million, down 58% year-over-year, with no major subsea tree awards in the quarter and the challenging offshore environment impacting results. Our offshore flexible pipe business saw a solid orders quarter, specifically in Brazil, continuing to build on the strong momentum we have seen from that segment over the past 18 months. Revenue was $726 million, flat year-over-year. Revenue growth in Subsea Productions Systems and Flexibles was offset by declines in Subsea Services.

Operating income was $19 million, a 37% improvement year-over-year driven by higher volume in our Subsea Production Systems and Flexibles businesses along with solid cost-out execution, partially offset by softness in services activity.

For the fourth quarter, we expect revenue to be roughly flat sequentially driven by continued backlog execution in SPS and Flexibles. With roughly flat revenue and further cost-out actions, we expect an increase in operating income versus the third quarter.

Looking ahead to 2021, we expect the offshore markets to remain challenged as operators re-assess their portfolios and project selection, as well as how they will allocate capital internally moving forward. We expect OFE revenue to be down on a year-over-basis due to lower order intake in 2020 and a likely continuation of a soft environment next year.

Although revenue is likely to be down in 2021, our goal is to maintain positive operating income as the decline in volume is offset by our cost out efforts.

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

Orders in the quarter were $1.9 billion, down 32% year-over-year. Equipment orders were down 39% year-over-year, and equipment book-to-bill was 1.7. We were pleased to receive the order from Qatar Petroleum for the North Field expansion that Lorenzo mentioned earlier. Service orders in the quarter were down 17% year-over-year, mainly driven by fewer upgrades and lower transactional services orders.

Revenue for the quarter was $1.5 billion, up 26% versus the prior year. Equipment revenue was up 78% as we executed on our LNG and Onshore/Offshore production backlog. Services revenue was up 1% versus the prior year.

Operating income for TPS was $191 million, up 18% year-over-year, driven by higher volume and strong execution on cost productivity. Operating margin was 12.6%, down 90 basis points year-over-year largely driven by a higher mix of equipment revenue.

For the fourth quarter, we expect strong sequential revenue growth due to the continued execution on our LNG and Onshore/Offshore Production backlog, as well as typical fourth quarter seasonality. Based on these dynamics, we expect TPS revenue and operating income to increase on a sequential basis. For the full year 2020, we now expect operating income to increase modestly on a year-over-year basis.

Looking into 2021, we are planning 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 $493 million, down 20% year-over-year. We saw declines in orders across all end markets, most notably aviation, oil and gas, and power. Sequentially, orders were up modestly as the global economy began to recover.

Revenue for the quarter was $503 million, down 17% year-over-year due to lower volumes across most product lines. This was driven by a reduction in maintenance activity in Pipeline & Process Solutions, as well as the weaker automotive and aviation sectors, which impacted the Waygate, Druck and Panametrics product lines. Sequentially, revenue was up 7% as most industrial end markets began to recover.

Operating income for the quarter was $46 million, down 44% year-over-year driven by lower volume. Sequentially, operating income was up 12% driven by higher volume across all product lines.

For the fourth quarter, we expect to see sequential growth in revenue and operating income driven primarily by typical seasonality and backlog execution.

Looking into 2021, we expect a modest recovery in revenue on a year-over-year basis driven primarily by a rebound 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 third quarter amid a challenging economic backdrop. As I discussed on our last earnings call, our goal through this downturn is to remain disciplined in our capital allocation to preserve our financial strength and liquidity. We remain focused on free cash flow, improving financial returns, and protecting our dividend, while maintaining our investment grade rating.

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.