



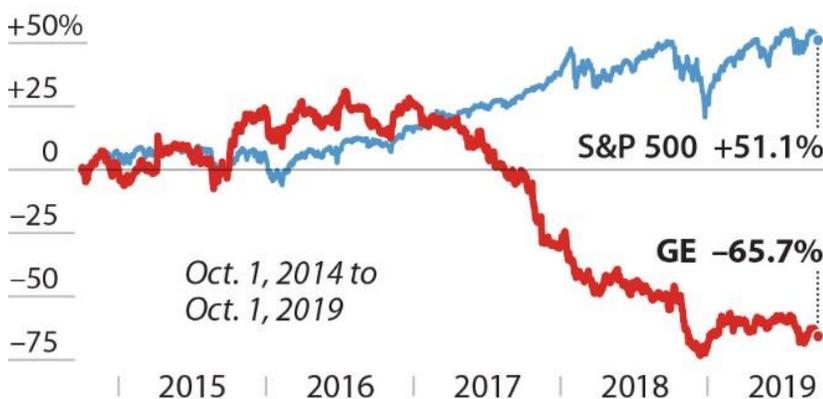
# GE's \$7.4 Billion Loss, Write-off on Baker Hughes: Another Bad Bet on Fossil Fuels

*Q3 Loss, Write-Off Likely to Be \$9+ Billion; More Red Ink to Flow, as O&G Has \$25 Billion of Goodwill on Balance Sheet*

## Executive Summary

General Electric, once a blue-chip stalwart in global markets, now struggles with declining revenues and earnings. One important thread that runs through the tattered cloth of GE's decline is its misreading of changing dynamics in the energy sector. Throughout the ongoing energy transition, as GE has continued to bet heavily on fossil fuels, many of those bets have turned sour for the company and its shareholders. GE's Oil & Gas (O&G) division's 2017 merger with oil services company Baker Hughes was a particularly costly bet, one that epitomizes how GE has been blind-sided by the rapidly evolving energy transition.

## 5-Year Performance of GE Shares vs S&P 500



Source: Nasdaq

Over the past year, GE has formally announced it has taken, or will take, losses or write-offs of approximately \$9.6 billion (bn)<sup>1</sup> in connection with two partial sales of its stake in one of the world's largest oil services companies, Baker Hughes, a GE company (BHGE). These losses include the company's \$2.2 bn Q4 2018 pre-tax loss on the first sale of BHGE shares in November 2018, and an estimated pre-tax loss

<sup>1</sup> All figures are US\$ unless noted.

and write-off of an additional estimated \$7.4 bn from the second sale in Q3 2019.<sup>2</sup> The \$9.6 bn in losses and write-offs have occurred just two years following the merger in 2017.<sup>3</sup>

In its announcement of the Q2 2019 sale, GE warned that its next quarterly earnings report is likely to contain a further write-down as the company reconciles higher than anticipated losses on the second sale.<sup>4</sup> IEEFA estimates the total loss on the Q3 2019 sale of BHGE stock could rise to \$9.1 bn, up from the company's earlier estimate of \$7.4 bn and raising the total loss to \$11.67 billion. These distressed sales, in Q4 2018 and Q3 2019, leave GE with nearly 40% of Baker Hughes (no longer called Baker Hughes, a GE company). GE may face additional value losses as it adjusts its status from majority owner.

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These losses are likely to be followed by future write-downs related to O&G. The goodwill<sup>5</sup> on GE's balance sheet for O&G, as of June 30, 2019, was \$24.7 bn, the highest of any of GE's divisions.<sup>6</sup> GE's total goodwill on its balance sheet is \$52.3 bn, with O&G representing 47%, or nearly half, of the company's total goodwill. In its Q2 2019 report, GE warned, "While the goodwill in our reporting units within our Oil & Gas segment is not currently impaired, the oil and gas markets continue to be volatile. While the long-term outlook for the industry remains strong, any future declines in macroeconomic or business conditions affecting these reporting units, or sustained declines in BHGE's share price in future periods, could result in a goodwill

<sup>2</sup> [GEReports.com. GE announces \\$2.7 bn in net proceeds from reduction of its ownership of Baker Hughes, a GE company to approximately 38.4%. September 11, 2019.](#)

<sup>3</sup> These figures do not include the \$7.5 bn GE paid to Baker Hughes shareholders at the time of the merger.

<sup>4</sup> [GEReports.com. GE announces \\$2.7 bn in net proceeds from reduction of its ownership of Baker Hughes, a GE company to approximately 38.4%. September 11, 2019.](#) The company's report noted that the estimated \$7.4 bn write-off was "based upon BHGE's share price of \$24.84 as of July 26, 2019. A change in the BHGE share price of \$1, as of the relevant determination date, would increase or decrease the estimated loss by approximately \$500 million." GE ultimately closed the sale on 9/16/2019. The sale of the 132 million shares of the stock was at \$21.50, according to Baker Hughes Investor Center. [Baker Hughes, a GE company announces closing of secondary offering by GE and its share repurchase.](#) September 16, 2019.

<sup>5</sup> Goodwill, as an accounting practice, is often misunderstood. It arises only when a company acquires another business and pays more than book value for its tangible and intangible assets. According to Investopedia, "Goodwill is an intangible asset associated with the purchase of one company by another. Specifically, goodwill is recorded in a situation in which the purchase price is higher than the sum of the fair value of all identifiable tangible and intangible assets purchased in the acquisition and the liabilities assumed in the process," Investopedia. [What is goodwill?](#)

<sup>6</sup> GE.com. [GE Q2 2019 10Q](#), p. 55.

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impairment in one or more of our Oil & Gas reporting units.”<sup>7</sup>

Much of the responsibility for misreading the transition away from fossil fuels has been placed on the Power division,<sup>8</sup> which primarily makes and services large-scale coal, gas and nuclear turbines.<sup>9</sup> But the precipitous decline in sales of coal and gas turbines is only part of the story. O&G bears much of the responsibility and deserves greater scrutiny for its role in the company's faltering finances over the past two years.

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<sup>7</sup> GE.com. [GE Q2 2019 10Q](#), p. 55.

<sup>8</sup> Historically the company's largest division, Power represented 50% of its total profits in 2016. The division built, installed and maintained gas, coal and nuclear power plants for utilities, independent power producers and numerous industrial applications. GE Power's core was manufacturing and servicing leading-edge gas turbines that cost hundreds of millions of dollars and have an expected life of 25 years.

<sup>9</sup> The global collapse of new thermal power construction caused a large part of GE's value destruction between 2016 and 2018, when it destroyed an almost unprecedented \$193 bn, or 74%, of its market capitalization, as IEEFA detailed in its report: [GE made a massive bet on the future of natural gas and thermal coal, and lost](#). Sales of large-scale natural gas and coal turbines roughly halved during this period – a collapse that caught GE entirely by surprise. The Power division decline cost CEO John Flannery his job in 2018, after just a year (the average tenure of a GE CEO, prior to Flannery, was 12 years), and hastened the retirement of its chair, Jeff Immelt. For the first time in history, the company did not hire from within, selecting Larry Culp, former CEO of Danaher, who is the current CEO as of October 2018. When GE announced a massive \$23 bn write-off in Q4 2018, analysts rightly blamed the Power division, which failed to anticipate the sharp drop in global demand for gas and coal turbines. Its purchase of the Thermal, Renewables, and Grid power businesses of French company Alstom for \$13 bn in 2015 was, at heart, a bet on the future of gas generation. This ill-fated acquisition was responsible for the lion's share of the Q4 2018 write-off, which triggered an earnings shortfall, a cash flow crisis, a dividend cut, and a rout of the company's stock price.

**GE's \$7.4 Billion Loss, Write-off on Baker Hughes:  
Another Bad Bet on Fossil Fuels**

Date	Description of Impairment	Amount	Source from SEC Filings and/or GE Press Release
November 2018	Pretax loss on sale of BHGE @ 23/share of: <ol style="list-style-type: none"> <li>1) 101.2 million shares of Class A shares</li> <li>2) 65 million shares of Class B shares</li> <li>3) 65 million membership interest in BHGE, LLC</li> </ol>	\$2.2 bn	GEREports.com. GE announces pricing of secondary offering of shares of Baker Hughes, a GE Company, and concurrent private sale of ownership interests in BHGE. November 14, 2018.  GE 2018 Annual report  GE 8K Q4 2018
September 2019	Pretax loss on sale of BHGE and write-off of BHGE @ 21.50/share <ol style="list-style-type: none"> <li>1) 132.25 million shares of Class A</li> <li>2) 250 million Class B shares</li> <li>3) 250 million membership interests in BHGE, LLC</li> </ol>	\$7.4 bn	GEREports.com. GE announces \$2.7 bn in net proceeds from reduction of its ownership of Baker Hughes, a GE company to approximately 38.4%. September 11, 2019.
September 2019	Additional Pretax loss on sale of BHGE and write-off of BHGE	\$1.67 bn estimate	IEEFA estimate. Based on actual sale price of BHGE stock on September 16, 2019 at \$21.50.  GEREports.com. GE announces \$2.7 bn in net proceeds from reduction of its ownership of Baker Hughes, a GE company to approximately 38.4%. September 11, 2019.
November 2018-September 2019	GE Declared Losses & Write-offs of BHGE	\$9.6 bn	
November 2018-September 2019	GE Declared Losses & Write-Offs of BHGE stock with IEEFA Adjustment	\$11.27 estimate	

Once the most valuable company in the world, GE has lost more than half a trillion dollars in value in less than 20 years. Its market capitalization (market cap) is now roughly \$80 bn,<sup>10</sup> down from \$600 bn in 2001. Excessive financial leverage, lax board oversight, corporate complexity and GE's difficulties in financial services all played a role in the value destruction. Its over-reliance on business segments tied to fossil fuels, however, has been responsible for much of the value destruction between 2016 and 2018, when GE's market cap declined by nearly \$200 bn, massively underperforming the general stock market boom. GE appeared blind to what is commonly referred to as the "technology driven energy transition," the process whereby the economy is moving significantly away from fossil fuels and towards more technologically driven sources of energy. Once a leader in innovation, GE's focus on energy of the past suggests it has lost its innovative edge.<sup>11</sup>

## GE's Losing Bet on the Oil and Gas Industry

O&G was once part of GE Energy, which also included GE Power and Water and GE Energy Services. The division grew rapidly, fueled by \$14 bn in acquisitions of oil and gas services, and equipment and technology companies between 2010 and 2014.<sup>12</sup> During this period, the company made at least ten acquisitions. Oil prices were rising steadily, hovering around \$100/barrel through the middle of 2014.<sup>13</sup>

O&G has become an increasingly important part of the company's revenues and profits, and one of its fastest growing divisions.

- In 2012, its revenues were \$15.2 bn and accounted for 15 percent of the company's industrial segment revenues.
- In 2013, revenues grew to \$17 bn, accounting for 16.4 percent of the

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<sup>10</sup> GE's market capitalization, as of 9/27/19, is \$78.72 bn, and includes GE Industrial Segments and GE Capital. Other financials in this report focus primarily on GE's Industrial Segments, including its O&G division.

<sup>11</sup> IEEFA.org. [GE made a massive bet on the future of natural gas and thermal coal, and lost.](#) Buckley, K. Hipple & T. Sanzillo. June 2019.

<sup>12</sup> Oil and gas-related acquisitions, primarily oil services and technology, included at least ten companies. Some of the acquisitions were small, such as Naxis and PRESENS, small Norwegian companies that offered GE an entry into cutting-edge technical expertise in the high risk deep-water drilling segment. Some acquisitions were larger, in the \$3 bn range. These included a \$2.8 bn acquisition of John Wood (Wood) Group's Well Support Division (2011); a \$3 bn acquisition of Dresser (2011); and a \$3.3 bn acquisition of Lufkin (2013).

Many acquisitions were related to unconventional production (horizontal drilling and hydraulic fracturing, or fracking) sector, which GE increasingly eyed as a growth engine. For example, the 2011 \$2.8 bn acquisition of Wood's Well Support Division, would enhance its "position in unconventional hydrocarbon production," GE noted in its announcement. The \$3 bn Dresser acquisition, also in 2011, was spread across its larger Energy division, and would allow its O&G customers access to Dresser's leading gas engines technology. By 2013, GE was especially bullish on the shale boom, such that it paid a 38 percent premium for its \$3.3 bn drilling equipment maker Lufkin in 2013. Oil prices were averaging around \$100/bbl. Lufkin was a leader in artificial lifts, which, GE noted in its SEC filing, were important for unconventional shale and liquids-rich resource plays.

<sup>13</sup> Fortune.com. [What the hell happened at GE?](#) Geoff Colvin. May 24, 2018.

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company's industrial segment revenues.<sup>14</sup>

- In 2014, when oil prices peaked at \$100/bbl, O&G's \$19.1 bn<sup>15</sup> of revenues accounted for 18 percent of the company's industrial segment revenues, and 16 percent of its profits.<sup>16</sup> As oil prices declined in the second half of 2014 through 2016, the O&G segment ran into financial difficulties. In 2015, revenues had fallen to \$16.5 bn, and in 2016, dropped 22 percent to \$12.9 bn.<sup>17</sup>
- In 2017 and in 2018, O&G's revenues were 20% of GE's industrial segment revenues.

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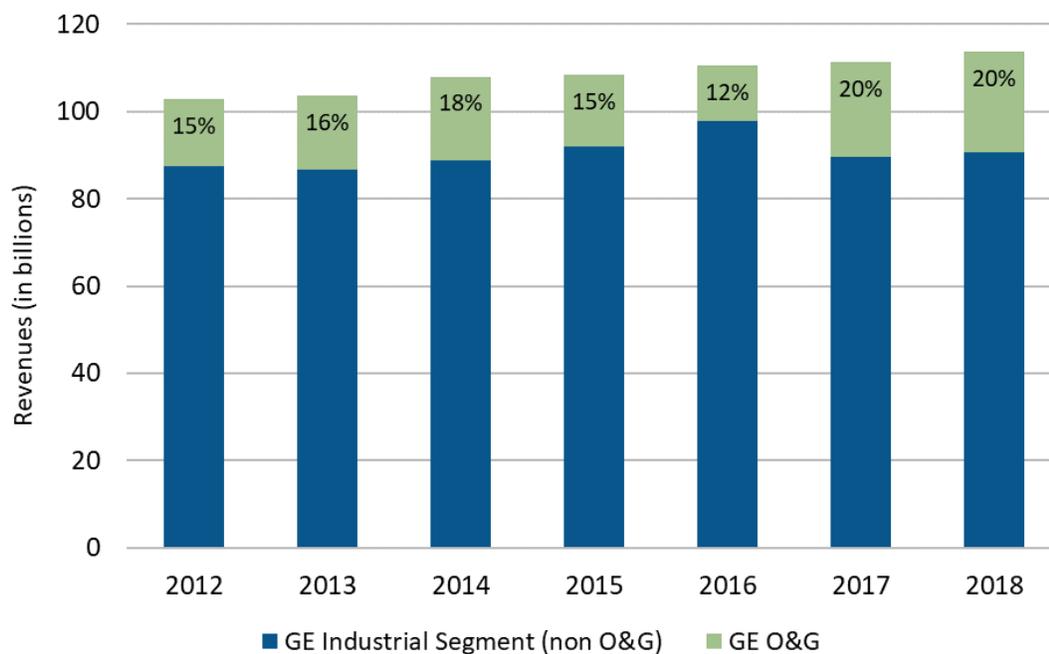
<sup>14</sup> GE. 2014 annual report. p. 31,

<sup>15</sup> SEC.gov. GE 2016 10K,

<sup>16</sup> GE. 2014 annual report. p. 31 and SEC.gov. GE 2015 10K.

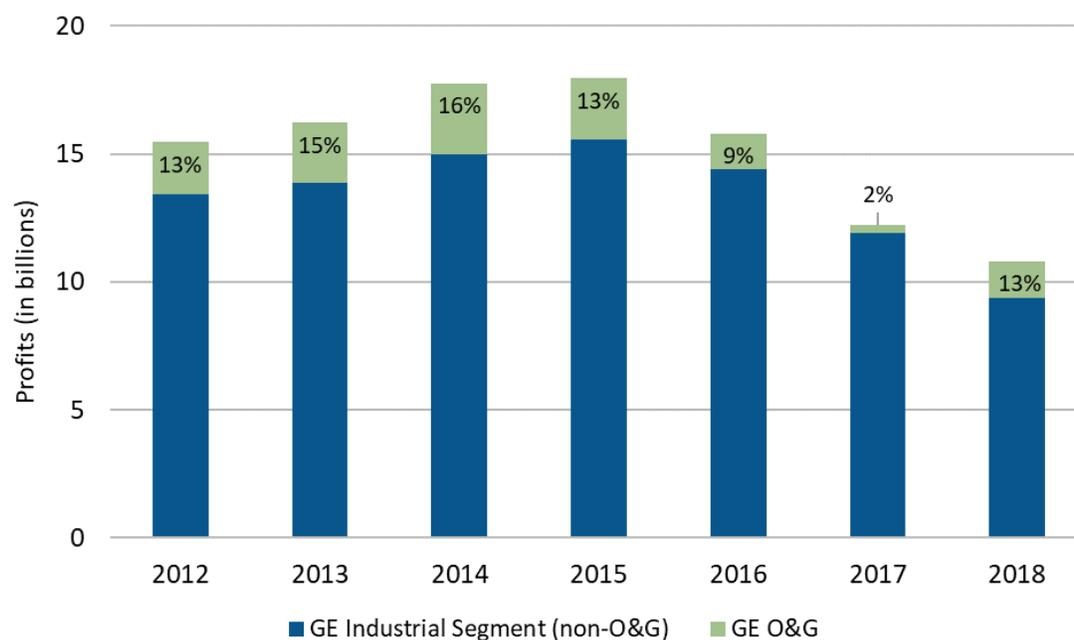
<sup>17</sup> SEC.gov. GE O&G business. And SEC.gov GE 2016 10K.

**Figure 1: GE Revenues: Oil & Gas as a Share of Overall Industrial Segment, 2012-2018**



Source: Amounts from GE and BHGE annual financial reports.

**Figure 2: GE Profits: Oil & Gas as a Share of Overall Industrial Segment, 2012-2018**



Source: Amounts from GE and BHGE annual financial reports.

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## The Biggest Bet: GE's O&G Merges with Baker Hughes

GE's acquisitions of smaller oil services and equipment companies culminated with the 2016 announcement of a merger with Baker Hughes, a global leader in oil services. Called Baker Hughes, a GE company (BHGE), and listed on the New York Stock Exchange, BHGE became the second largest energy services company, behind only Schlumberger and ahead of Halliburton.<sup>18</sup> Upon closing in July 2017, GE paid Baker Hughes' shareholders a cash dividend of \$17.50/share, which cost GE \$7.4 bn.<sup>19</sup>

Baker Hughes had a storied history in oil field services. The Baker Hughes rig count, which it conducted since 1944, has provided the industry with weekly numbers of rigs "actively exploring or developing oil or gas" in various parts of the world.<sup>20</sup> The rig count is closely watched and is an authoritative source for government, business and academic study as a leading indicator of trends in the oil and gas industry.

**Revenues declined 28%  
between November 2016,  
when the BHGE merger was  
announced, and July 2017,  
when the deal closed.**

Despite optimistic company statements about the merger,<sup>21</sup> estimates of combined revenues declined from \$32 bn<sup>22</sup> to \$23 bn,<sup>23</sup> or 28%, between November 2016, when the deal was announced, and in July 2017, when the deal closed.<sup>24</sup>

The rationale for the merger was predicated on the assumption that oil, then trading at approximately \$55 a barrel, would return to \$100 a barrel.<sup>25</sup> But in 2017, even with the partial rebound in oil prices, the segment's revenues had declined 5 percent year on year for the combined company,<sup>26</sup> from \$23.1 bn to \$21.9 bn. The oil and gas market, acknowledged GE in its 2017 10K, "remained challenging,"<sup>27</sup> as

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<sup>18</sup> HoustonChronicle.com. [GE CEO details plans to divest Baker Hughes after owning it one year.](#) June 26, 2018.

<sup>19</sup> GE Reports. [GE announces completion of GE Oil & Gas and Baker Hughes merger.](#) July 3, 2017

<sup>20</sup> BHGE.com. [Baker Hughes Rig Count FAQs.](#) Accessed September 25, 2019

<sup>21</sup> BHGE. [Press release.](#) July 3, 2017.

<sup>22</sup> GE Reports. [GE posts overview of GE Oil & Gas, historical financial details, and supplemental information on the Baker Hughes transaction.](#) November 7, 2016.

<sup>23</sup> BHGE. [Press release and Infographic.](#) July 3, 2017.

<sup>24</sup> BHGE. [Infographic announcing the GE-Baker Hughes merger.](#) July 2017

<sup>25</sup> Forbes.com. [GE's stock down 24% as CEO's first year approaches. But should it trade at \\$15?](#) September 11, 2019.

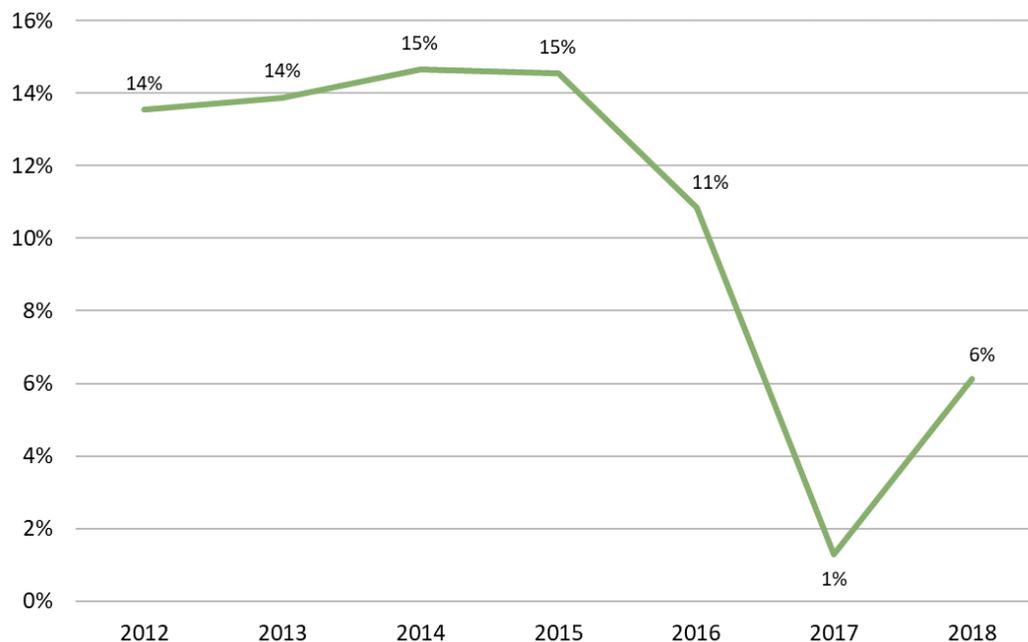
<sup>26</sup> BHGE. [Baker Hughes, a GE company announces fourth quarter and total year 2017 results.](#) January 24, 2018.

<sup>27</sup> GE. [2017 10k.](#)

“revenues further decreased due to low oil prices.”<sup>28</sup> 2018 saw revenues rebound by 5 percent, from \$21.8 bn to \$22.9 bn.<sup>29</sup>

In this challenging environment, O&G's profits declined. For example, in 2015, O&G's profit margin was 15 percent, and declined in 2016 to 11 percent. By 2017, O&G's profit margin was a paltry 1.3 percent, rebounding only to 6 percent in 2018.

**Figure 3: GE Oil & Gas Profit Margin, 2012-2018**



Source: Amounts from GE and BHGE annual financial reports.

O&G's revenues remained significant contributors to GE's top line revenue numbers in 2017 and 2018, even though O&G had become less profitable. A Moody's report deconsolidated revenues from GE's stake in BHGE for 2017 and 2018, which illustrated how much lower GE's overall revenues would have been—and will be—without BHGE's revenues contribution to GE's top line.<sup>30</sup> For example, in 2017, GE's industrial sector revenues were \$100.2 bn without revenues from its stake in BHGE, compared to the \$111.3 bn that GE reported for all industrial sectors. In 2018, GE's revenues, without revenues from its stake in BHGE, dropped to \$90.8 bn, compared to the \$113.6 bn that GE reported.<sup>31</sup> Moody's estimates GE's revenues in 2019, without revenues from Baker Hughes, will be \$85.8 bn.<sup>32</sup>

GE now owns less than 50 percent of BHGE. It must deconsolidate, or remove, revenues from its stake in BHGE from its financial statements. In short, after

<sup>28</sup> Ibid.

<sup>29</sup> BHGE. [Baker Hughes, a GE company announces fourth quarter and total year 2017 results](#). January 31, 2019.

<sup>30</sup> Moody's.com. [General Electric Company. Update to credit analysis](#). May 31, 2019. p. 3.

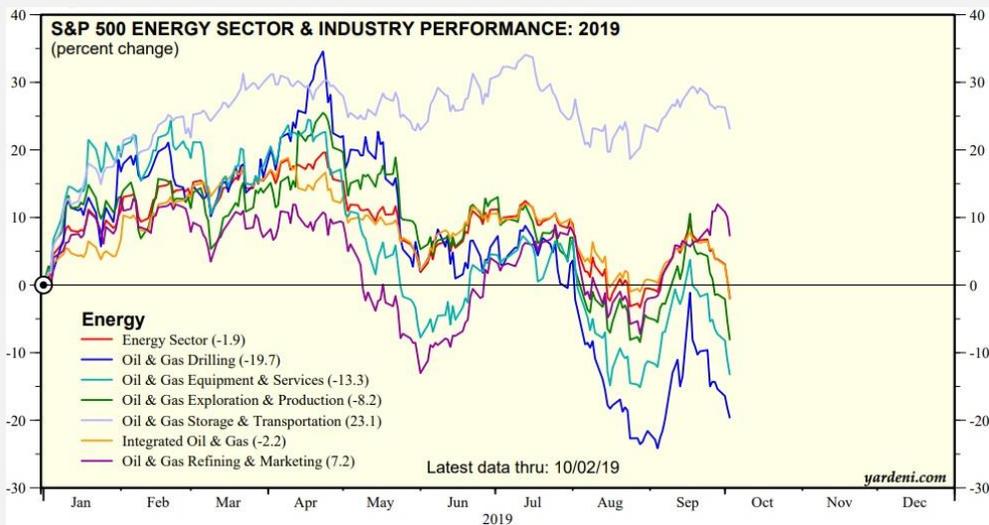
<sup>31</sup> GE 2018 Annual report.

<sup>32</sup> Moody's.com. [General Electric Company. Update to credit analysis](#). May 31, 2019. p. 3.

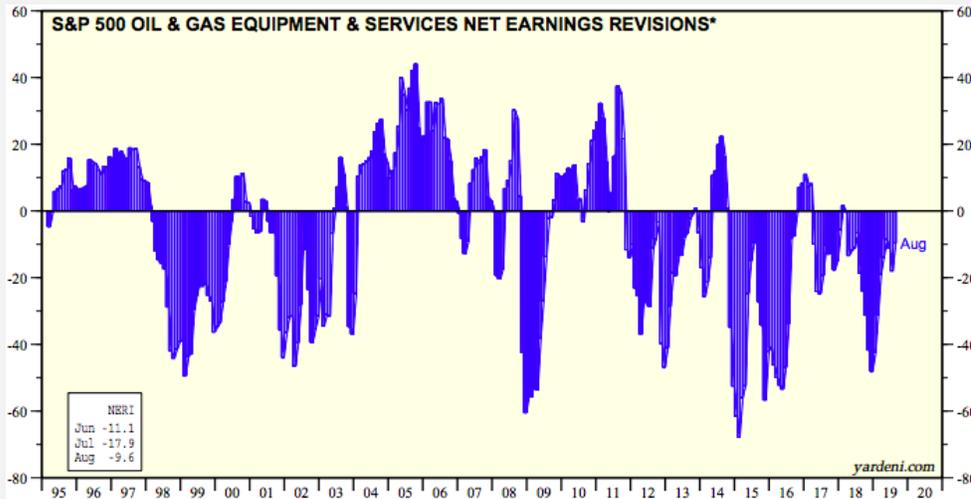
reducing its stake in BHGE in 2019, GE's revenues will be sharply lower.

### Challenges Within Oilfield Services and Equipment Sector

GE's O&G division is largely centered on oil field services and equipment. O&G's slide has been hurt by lower oil and gas prices, which have particularly affected the oil field services sector. This sector has been among the worst-performing subset of the energy sector for the first three quarters of 2019, declining by 13.3 percent while the Standard & Poor's 500 increased by 15 percent.<sup>i</sup> The broader energy sector (which does not include renewable energy) has vied for last place among the S&P sectors in 2018 and to date in 2019.<sup>ii</sup>



Since the downturn in oil prices, oil service companies have consistently revised their earnings projections downwards.<sup>iii</sup>



\* Three-month moving average of the number of forward earnings estimates up less number of estimates down, expressed as a percentage of the total number of forward earnings estimates.  
Source: I/B/E/S data by Refinitiv.

The oilfield services business has been hit especially hard by difficulties in the shale business over the past two years.<sup>iv</sup> Exploration and production (E&P) companies focused on hydraulic fracturing (fracking) that created the production boom in both oil and gas have faced a rash of bankruptcies<sup>v</sup> after a decade of negative cash flows.<sup>vi</sup> More bankruptcies are on the horizon for oil and gas companies as \$150 bn of bonds mature<sup>vii</sup> between now and 2024.

The headwinds facing the oilfield services sector worsened in Q3 2019, according to the Dallas Fed, which wrote: "Among oilfield services firms, the equipment utilization index plummeted 27 points to -24.0 in the third quarter, its lowest reading since 2016 and suggestive of a large contraction in equipment utilization."<sup>viii</sup> And Rystad Energy, a consulting firm, warned the sector could be pushed into a recession in 2020 if oil prices remain at current levels.<sup>ix</sup>

<sup>i</sup> Yardeni. [Performance Derby: S&P 500 Sectors & Industries Year-To-Date Change](#). October 2, 2019. Only six other subsectors in the S&P 500 lost more than the oil equipment and services subsector. One of them was oil and gas drilling.

<sup>ii</sup> Yardeni Research. [Performance 2019 S&P 500 Sectors and Industries](#). October 2, 2019.

<sup>iii</sup> Yardeni. [S&P 500 Industry Briefing: Oil & Gas Equipment & Services](#). September 25, 2019.

<sup>iv</sup> WSJ.com. [Oil Services companies may have dug enough](#). July 22, 2019.

<sup>v</sup> Haynes&Boone.com. [Oil Patch bankruptcy monitor](#). August 12, 2019.

<sup>vi</sup> IEEFA.org. [Sightline/IEEFA update: US fracking sector disappoints again](#). August 19, 2019.

<sup>vii</sup> S&P Global. [Another brick in the wall for U.S. oil and gas industry as debt maturities build through 2024](#). July 18, 2019.

<sup>viii</sup> DallasFed.org. [Oil and gas activity contracts as uncertainty remains heightened](#). September 25, 2019.

<sup>ix</sup> RystadEnergy.com. [Growth in service industry set to take a hit](#). September 11, 2019.

### **The acquisition was ill-timed and assumed oil would trade at \$100 a barrel.<sup>33</sup>**

Conditions of the GE-Baker merger included a provision that GE would hold the stock for at least two years. But buyer's remorse set in early, along with an urgent need to raise money and reduce its more than \$100 bn debt load. In November 2018,<sup>34</sup> a year ahead of schedule, GE unloaded 12% of BHGE, selling its shares at \$23/share,<sup>35</sup> roughly a third less than what it had paid one year earlier. Net proceeds from the sale of the stake were \$3.7 bn.<sup>36</sup> GE recorded a \$2.2 bn<sup>37</sup> pre-tax loss on the transaction, prompting some analysts to wonder if GE was "desperate," and whether GE was in worse shape than investors suspected.<sup>38</sup>

GE retained 50.4 percent of BHGE, post-closing in November 2018. Based on its

<sup>33</sup> WSJ.com. [GE to give up majority control of Baker Hughes](#). September 10, 2019.

<sup>34</sup> Moody's. [General Electric Company. Update to credit analysis](#). May 31, 2019 and [General Electric Company: Baker Hughes share sale contributes to \\$26 billion in net proceeds from asset sales that could be used to reduce debt](#).

<sup>35</sup> GE Reports.com. [GE announces pricing of secondary offering of shares of Baker Hughes, a GE Company, and concurrent private sale of ownership interests in BHGE](#). November 14, 2018.

<sup>36</sup> [GE 2018 Annual report](#). p. 9.

<sup>37</sup> *Ibid.*

<sup>38</sup> MotleyFool.com. [Is GE getting desperate with its Baker Hughes stake sale?](#) Adam Levine-Weinberg. November 15, 2018.

interpretation of accounting rules.<sup>39</sup> GE remained a majority shareholder, and was not required to recognize the loss on its remaining BHGE holdings and was entitled to consolidate BHGE's revenues and cash flow into its own numbers.<sup>40</sup> BHGE's 2018 revenue, \$22.9 bn, and cash flow from operations, \$1.8 bn,<sup>41</sup> made significant contributions to GE's overall revenue and cash flow numbers.

## **GE Announces Sale of More BHGE Stock**

In September 2019, GE announced the sale of another block of its BHGE stock. Moody's called the proposed sale "credit positive," but did not announce an improvement in the credit rating.<sup>42</sup> The sale closed on September 16, 2019, leaving GE holding only 38.4 percent of BHGE. No longer a majority owner, GE must mark to market its remaining stake in BHGE in its Q3 2019 financial statements.<sup>43</sup>

GE's Q3 2019 earnings report is expected to include the realized loss of its partial sale of BHGE stock, along with a write-down to market value of its remaining stake. GE has estimated this loss and write-off will be \$7.4 bn,<sup>44</sup> based on a \$24.84/share price for BHGE. The sale closed at \$21.50, however. The \$7.4 bn was, therefore, an under-estimate of its loss and write-off. (Prior to the September sale, GE held more than 500 million shares of the stock and acknowledged that each \$1 decline in the stock would result in an additional \$500 million loss.) IEEFA estimates that GE's Q3 2019 pre-tax loss and write-off will be close to \$9.1 bn, rather than the company's estimate of \$7.4 bn.<sup>45</sup>

Recently, Harry Markopolos, who alerted the SEC that Bernie Madoff was running a Ponzi scheme,<sup>46</sup> suggested GE is engaging in a \$38 bn fraud, \$9.1 bn of which is tied to its misrepresentation of Q3 2019 losses<sup>47</sup> from its stake in Baker Hughes, and that the company's prior sale of BHGE stock was represented in financial statements.

Markopolos' claim is unrelated to ongoing Securities and Exchange Commission

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<sup>39</sup> Harry Markopolos, in GE Whistleblower Report, *GE, a bigger fraud than Enron*, (August 15, 2019) has contested GE's interpretation of that accounting rule.

<sup>40</sup> MarketRealist.com. *GE's Q3 earnings may look bad after BHGE deal*. September 11, 2019.

<sup>41</sup> BHGE.com. *BHGE announces fourth quarter and total year 2018 results*. January 21, 2019.

<sup>42</sup> Moody's.com. *Moody's says General Electric's sale of a portion of its Baker Hughes shares is credit positive but does not affect ratings*. September 12, 2019.

<sup>43</sup> FASB.org. *Noncontrolling interests in consolidated financial statements – amendment of ARG No. 51*.

<sup>44</sup> GE Reports.com. *GE announces \$2.7 bn in net proceeds from reduction of its ownership of Baker Hughes, a GE company to approximately 38.4%*. September 11, 2019.

<sup>45</sup> Ibid. The company's report noted that the estimated \$7.4 bn write-off was "based upon BHGE's share price of \$24.84 as of July 26, 2019. A change in the BHGE share price of \$1, as of the relevant determination date, would increase or decrease the estimated loss by approximately \$500 million." GE ultimately closed the sale on 9/16/2019. The sale of the 132 million shares of the stock was at \$21.50, according to Baker Hughes Investor Center. BHGE. *Baker Hughes, a GE company announces closing of secondary offering by GE and its share repurchase*. September 16, 2019.

<sup>46</sup> Harry Markopolos. *No one would listen: A true financial thriller*. Wiley. 2010.

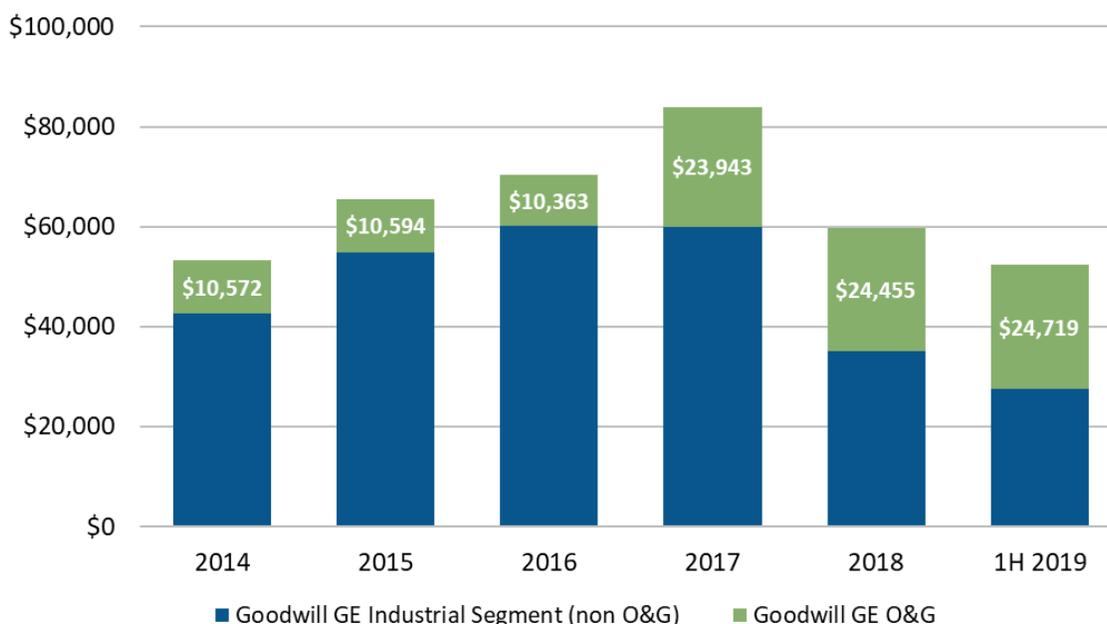
<sup>47</sup> GE Whistleblower Report. *GE, a bigger fraud than Enron*. Harry Markopolos.

(SEC) and Department of Justice (DOJ) investigations.<sup>48</sup> GE has rejected his claims.<sup>49</sup>

## O&G \$24.7 bn Goodwill May Be a Ticking Time Bomb

The goodwill on GE's balance sheet for O&G, as of June 30, 2019, was \$24.7 bn, the highest of any of GE's divisions.<sup>50</sup> GE's total goodwill, as of June 30, 2019, was \$52.3 bn. O&G had approximately \$10.5 bn of goodwill on its balance sheet between 2014 and 2016, resulting from prior acquisitions. Once it merged with Baker Hughes, an additional "\$13.4 bn to O&G in 2017 related to acquisitions,"<sup>51</sup> increased O&G's goodwill to \$23.9 bn.<sup>52</sup> In 2018, GE increased O&G's goodwill to \$14.1 bn related to the BHGE merger, helping to boost O&G's total goodwill to \$24.5 bn.

**Figure 4: Goodwill: Oil & Gas Share of Overall GE Industrial Segment, 2012-1H 2019**



Source: Amounts from GE and BHGE annual financial reports.

GE conducts annual tests for impairment in its goodwill in the third quarter of each year, based on data through July 1.<sup>53</sup> Given the size of the goodwill and the

<sup>48</sup> GE's massive write-down—23 bn in 2018, largely in connection with its purchase of Alstom to expand its Power division—has come under scrutiny by the Securities and Exchange Commission (SEC) and the Department of Justice (DOJ). And, according to company filings, it was specifically the \$23 bn Q4 2018 write-off in the Power division that the SEC and DOJ are scrutinizing.

<sup>49</sup> GE Reports.com. [Follow-up from last week's notes](#). August 19, 2019.

<sup>50</sup> GE.com. [GE Q2 2019 10Q](#), p. 54.

<sup>51</sup> GE.com. [GE 2017 10K](#) p. 145.

<sup>52</sup> Ibid.

<sup>53</sup> From [GE's 2018 10K](#), "We test goodwill for impairment annually in the third quarter of each year using data as of July 1 of that year. The impairment test consists of two steps: in step one, the

challenging conditions facing oilfield services companies, O&G-related write-offs in Q3 2019 may be announced if GE and its auditors determine the fair value of BHGE is less than GE's carrying cost. The company may take goodwill impairment in excess of the losses and write-offs of \$7.4 bn in Q3 2019 that GE has already announced in connection with sales of its stake in the BHGE merger, or the additional \$1.7 bn IEEFA estimates for Q3 2019 losses and write-offs in connection with that same sale.

In its Q2 2019 report, GE warned, "While the goodwill in our reporting units within our Oil & Gas segment is not currently impaired, the oil and gas markets continue to be volatile. While the long-term outlook for the industry remains strong, any future declines in macroeconomic or business conditions affecting these reporting units or sustained declines in BHGE's share price in future periods could result in a goodwill impairment in one or more of our Oil & Gas reporting units."<sup>54</sup>

**While the long-term outlook for the O&G industry 'remains strong,' any future declines in macroeconomic or business conditions could result in goodwill impairment.**

The oil and gas market continues to be difficult for oilfield service companies. GE's quarterly earnings statement for 2Q 2019 says O&G is "dependent on spending by our customers for oil and natural gas exploration, field development and production. This spending is driven by a number of factors, including our customers' forecasts of future energy supply and demand, their access to resources to develop and produce oil and natural gas, their ability to fund their capital programs, the impact of new government regulations and most importantly, their expectations for oil and natural gas prices as a key driver of their cash flows...Oil and gas markets remained dynamic in the second quarter of 2019. Commodity prices increased 9% as compared to the first quarter of 2019. However, Brent and WTI oil prices remained 7% and 12%, respectively, lower than the same quarter last year. Within the quarter, Brent oil prices fluctuated from a high of \$74.94 to a low of \$61.66, and WTI oil prices fluctuated from a high of \$66.24 to a low of \$51.13."<sup>55</sup>

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carrying value of the reporting unit is compared with its fair value; in step two, which is applied when the carrying value is more than its fair value, the amount of goodwill impairment, if any, is derived by deducting the fair value of the reporting unit's assets and liabilities from the fair value of its equity, and comparing that amount with the carrying amount of goodwill."

<sup>54</sup> GE.com. [GE Q2 2019 10Q](#), p. 55

<sup>55</sup> Ibid. p. 15

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## Conclusion

GE's losses and write-offs in 2018 and 2019 from the GE-Baker Hughes merger illustrates the financial fall-out from GE's losing bets on fossil fuels, particularly in the oilfield services and equipment sector. These Baker-related write-offs and losses in 2018 and 2019, which IEEFA estimates will be approximately \$11 bn, are significant. But they are likely only part of the story of GE's losing bet on the oil and gas industry.

Post-sale of part of its stake in BHGE in Q3 2019, GE will hold nearly 40 percent of that company. GE's Oil and Gas division (O&G) also has nearly \$25 bn of goodwill on its balance sheet, an amount that represents nearly half the company's overall goodwill.

The company has indicated the oilfield services and equipment sector continues to be a challenging environment, especially in a period of price volatility, which GE acknowledged in its Q2 2019 report: "Oil and gas markets remained dynamic in the second quarter of 2019."<sup>56</sup> Given the ongoing volatility of oil prices, the oilfield services sector is likely to remain under pressure. Further losses and write-offs in GE's O&G division are likely.

GE's investments in oil and gas, particularly its merger with Baker Hughes, demonstrate the financial risk for a company that misreads the energy transition. When it merged its O&G with Baker Hughes, GE was betting on a return to \$100 oil prices. It was looking in the rearview mirror, instead of looking at the road ahead.

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<sup>56</sup> Ibid.

## About IEEFA

The Institute for Energy Economics and Financial Analysis conducts research and analyses on financial and economic issues related to energy and the environment. The Institute's mission is to accelerate the transition to a diverse, sustainable and profitable energy economy. [www.ieefa.org](http://www.ieefa.org)

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Tom Sanzillo, director of finance for IEEFA, is the author of several studies on coal plants, rate impacts, credit analyses and public and private financial structures for the coal industry. He has testified as an expert witness, taught energy-industry finance training sessions, and is quoted frequently by the media. Sanzillo has 17 years of experience with the City and the State of New York in various senior financial and policy management positions. He is a former first deputy comptroller for the State of New York, where he oversaw the finances of 1,300 units of local government, the annual management of 44,000 government contracts, and where he had oversight of over \$200 billion in state and local municipal bond programs and a \$156 billion pension fund.

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