Quantitative Highlights:

- We find Baker Hughes to be fairly priced and well positioned relative to its competitors in the industry.
- Our average valuation of Baker Hughes of $67.42 on a discounted cash flow basis found the company slightly undervalued.

Qualitative Highlights:

- The company’s continued focus on its employees and clients maintain it as an efficient and quality organization.
- The company continues to be the leader in oil and gas equipment innovation, currently working on several models of new “electrical submersible pumps” as well as many other new products and technologies that may have a significant affect on the industry, especially Baker Hughes.
- In order to protect market share and cut cost, Baker Hughes has made concerted efforts to trim down to its core businesses by divesting much of its refining and production process capabilities.
- On the other hand, the company remains well-diversified across the industry securing it from normal price volatility within the energy sector.
Company Profile:

Baker Hughes Incorporated supplies wellbore-related products, and technology services and systems to the worldwide oil and natural gas industry. It provides products and services for drilling, formation evaluation, completion, and production of oil and natural gas wells. The company operates in seven divisions: Baker Atlas, Baker Hughes Drilling Fluids (BHDF), Baker Oil Tools (BOT), Baker Petrolite, Centrilift, Hughes Christensen, and INTEQ. Its Baker Atlas division provides formation evaluation and wireline completion, and production services for oil and natural gas wells. The company’s BHDF division provides drilling fluids, completion fluids, and fluids environmental services. BOT division offers downhole completion, workover, and fishing equipment and services. Its Baker Petrolite division provides specialty chemicals primarily to oil and natural gas production, refining, pipeline transportation, petrochemical, agricultural, and iron and steel manufacturing industries. This division also offers polymer-based products to a range of industrial and consumer markets. The company’s Centrilift division manufactures and supplies electrical submersible pump systems and progressing cavity pump systems. Its Hughes Christensen division offers drill bits, primarily Tricone roller cone bits and fixed-cutter polycrystalline diamond compact bits, to the oil and natural gas industry. INTEQ division supplies drilling and evaluation services, which include directional drilling, measurement-while-drilling, and logging-while-drilling services. Baker Hughes Incorporated is headquartered in Houston, Texas.
Industry and Sector Overview:

A greater demand for oil in China and India in conjunction with political turmoil in oil-producing regions have seen oil prices soar (to more than $70 a barrel in 2005, thanks to Hurricane Katrina), causing the industry to rebound. The higher prices have reached most of the industry - producers, refiners, pipeline companies, equipment makers, oil field service providers, and gas station operators - which have all enjoyed new profits. Leading the charge are the world's largest integrated oil companies: Exxon Mobil, BP, and Royal Dutch/Shell. But aggressive independent exploration and production companies such as Apache and Devon Energy are also well-positioned to take advantage of improving prices.

Further Company Information:

Baker Hughes Incorporated (Baker Hughes) is engaged in the oilfield services industry. The Company supplies wellbore-related products and technology services and systems to the oil and natural gas industry on a worldwide basis, including products and services for drilling, formation evaluation, completion and production of oil and natural gas wells. Baker Hughes conducts part or all of its operations through subsidiaries, affiliates, ventures, partnerships or alliances. The Company has seven operating divisions: Baker Atlas, Baker Hughes Drilling Fluids, Baker Oil Tools, Baker Petrolite, Centrilift, Hughes Christensen and INTEQ, which have been aggregated into the Oilfield segment. These operating divisions manufacture and sell products and provide services used in the oil and natural gas industry, including drilling, formation evaluation, completion and production of oil and natural gas wells. They operate in markets, including North America, South America, Europe, Africa, the Middle East and the Far East. The Oilfield segment also includes the Company's 30% interest in WesternGeco, a seismic venture it entered into with Schlumberger Limited (Schlumberger), as well as other investments in affiliates.

Baker Atlas

Baker Atlas is a provider of formation evaluation and perforating services for oil and natural gas wells. Formation evaluation involves measuring and analyzing specific physical properties of the rock (petrophysical properties) in the immediate vicinity of a wellbore to determine an oil or natural gas reservoir's boundaries, volume of hydrocarbons and ability to produce fluids to the surface.

Wireline completion and production services include using wireline instruments to evaluate well integrity, perform mechanical intervention and perform cement evaluations. Wireline instruments can also be run in producing wells to perform production logging. Baker Atlas (and Baker Oil Tools) also provides perforating services, which involve puncturing a well's steel casing and cement sheath with explosive charges.
Baker Atlas competes with Schlumberger, Halliburton Company (Halliburton), Precision Drilling Corporation and Expro International Group PLC, among others.

**Baker Hughes Drilling Fluids**

Baker Hughes Drilling Fluids is a provider of drilling fluids (also called mud), completion fluids (also called brines) and fluids environmental services. Drilling fluids are pumped from the surface through the drill string, exiting nozzles in the drill bit and traveling back up the wellbore where the fluids are recycled. The fluids environmental services of Baker Hughes Drilling Fluids also provide equipment and services to separate the drill cuttings from the drilling fluids and re-inject the processed cuttings into a specially prepared well, or to transport and dispose of the cuttings by other means.

Baker Hughes Drilling Fluids' primary competitors include Halliburton, M-I, LLC, Newpark Resources, Inc. and TETRA Technologies, Inc., among others.

**Baker Oil Tools**

Baker Oil Tools is a provider of specialized fishing services and equipment that is used to locate, dislodge and retrieve damaged or stuck pipe, tools or other objects from inside the wellbore, often thousands of feet below the surface. Other fishing services include cleaning wellbores and milling windows in the casing to drill a sidetrack or multilateral well.

Baker Oil Tools' completion systems are matched to the formation and reservoir for optimum production and can employ a variety of products and services, including liner hangers, which suspend a section of steel casing (also called a liner) inside the bottom of the previous section of casing; packers, which seal the annular space between the steel production tubing and the casing, and flow control equipment, which controls and adjusts the flow of downhole fluids. Products and services also include subsurface safety valves, which shut off all flow of fluids to the surface in the event of an emergency, thus saving the well and preventing pollution of the environment; sand control equipment, which includes gravel pack tools, sand screens and fracturing fluids, and advanced completion technologies, which include multilateral systems, intelligent well systems and expandable metal technologies.

Baker Oil Tools' primary competitors in completions are Halliburton, Schlumberger, Weatherford International Ltd. (Weatherford), BJ Services Company and Smith International, Inc. (Smith).

**Baker Petrolite**

Baker Petrolite is a provider of specialty chemicals to a number of industries, primarily oil and natural gas production. Its services also include refining, pipeline transportation, petrochemical, agricultural, and iron and steel manufacturing. In addition, Baker Petrolite provides polymer-based products to a range of industrial and consumer markets. It also
provides oilfield chemical programs for drilling, well stimulation, production, pipeline transportation and maintenance programs.

Through its Pipeline Management Group, Baker Petrolite also offers a variety of products and services for the pipeline transportation industry. To improve efficiency, Baker Petrolite offers custom turnkey cleaning programs that combine chemical treatments with brush and scraper usage. Additional services allow pipelines to operate more safely. These include inspection and internal corrosion assessment technologies, which physically confirm the structural integrity of the pipeline. Baker Petrolite also provides chemical technology solutions to other industrial markets throughout the world, including petrochemicals, fuel additives, plastics, imaging, adhesives, steel and crop protection.

Baker Petrolite's primary oilfield specialty chemical competitors are GE Water Technologies, Nalco Company and Champion Technologies, among others.

**Centrilift**

Centrilift is a manufacturer and supplier of electrical submersible pump systems (ESPs) and progressing cavity pump systems (PCPs). ESPs lift high quantities of oil or oil and water from wells that do not flow under their own pressure. These artificial lift systems consist of a centrifugal pump and electric motor installed in the wellbore, armored electric cabling to provide power to the downhole motor and a surface controller. Centrilift designs, manufactures, markets and installs all the components of ESP systems and also offers modeling software to size ESPs and simulate operating performance. PCPs are a form of artificial lift consisting of a downhole progressing cavity pump powered by either a downhole electric motor or a rod turned by a motor on the surface.

Centrilift's primary competitors are Schlumberger, John Wood Group PLC, Weatherford and Robbins & Myers, Inc.

**Hughes Christensen**

Hughes Christensen is a manufacturer and supplier of drill bit products, primarily Tricone roller cone bits and fixed polycrystalline diamond compact (PDC) cutter bits, to the worldwide oil and natural gas, mining and geothermal industries. The primary objective of drill bits is to create a hole as efficiently as possible. Tricone drill bits employ either hardened steel teeth or tungsten carbide insert cutting structures mounted on three rotating cones. These bits work by crushing and shearing the formation rock as they are turned. Tricone drill bits have a wide application range. PDC (also known as Diamond) bits use fixed position cutters that shear the formation rock with a milling action as they are turned. In many softer and less variable applications, PDC bits offer higher penetration rates and a longer life than Tricone bits.

Hughes Christensen's primary competitors in the oil and natural gas drill bit market are Smith, Halliburton and Grant Prideco, Inc.
**INTEQ**

INTEQ is a supplier of drilling and evaluation services, which include directional drilling, measurement-while-drilling and logging-while-drilling services. In addition, INTEQ supplies drilling fluids and both conventional and rotary-based directional drilling systems. INTEQ's AutoTrak rotary steerable system changes the trajectory of the well using three pads that push against the wellbore from a non-rotating sleeve and is controlled by a downhole guidance system.

INTEQ's primary competitors in drilling and evaluation services are Halliburton and Schlumberger.

**WesternGeco**

WesternGeco is a seismic venture in which the Company owns 30% and Schlumberger owns 70%. WesternGeco provides comprehensive reservoir imaging, monitoring and development services. Services range from three-dimensional (3-D) and time-lapse, four-dimensional (4-D) seismic surveys to multicomponent surveys for delineating prospects and reservoir management. Seismic solutions include the Q-Technology for enhanced reservoir description, characterization and monitoring throughout the life of the field, from exploration through enhanced recovery.

WesternGeco's major competitors are Compagnie Generale de Geophysique, Veritas DGC, Inc. and Petroleum Geo-Services ASA.