General Electric (GE)

Updated October 30th, 2018 by Bob Ciura

Key Metrics

Current Price:	$10	**5 Year CAGR Estimate:**	5.4%	**Volatility Percentile:**	55.4%
Fair Value Price:	$10	**5 Year Growth Estimate:**	5.0%	**Momentum Percentile:**	1.3%
% Fair Value:	100%	**5 Year Valuation Multiple Estimate:**	0.0%	**Growth Percentile:**	30.3%
Dividend Yield:	0.4%	**5 Year Price Target**	$13	**Valuation Percentile:**	50.1%
Dividend Risk Score:	D	**Retirement Suitability Score:**	F	**Total Return Percentile:**	22.1%

Overview & Current Events

General Electric (GE) is a large diversified manufacturer that was established 125 years ago. Today, GE has both a market capitalization and annual revenues of ~$87 billion. GE is undergoing a major turnaround. On June 26th, the company announced a new strategic plan, to focus on its Aviation, Power, and Renewable Energy segments. The company announced it will liquidate ~20% of its Healthcare segment, and spin-off the remaining 80% to shareholders in the next 12 to 18 months. The Healthcare segment is the company's second largest by profit (behind only Aviation), responsible for over 20% of GE's profits. Additionally, GE will dispose of its 62.5% ownership in Baker Hughes GE (BHGE), which is worth $22 billion at current prices. The company plans to deleverage and achieve a net debt-to-EBITDA ratio (excluding GE Capital) of 2.5 by 2020.

On 10/30/18, GE announced poor third-quarter earnings results. Revenue declined 3.5% to $29.6 billion. The worst-performing segment last quarter was Power, which saw a 33% revenue decline. Adjusted earnings-per-share of $0.14 declined 33% from the same quarter a year ago. In GAAP terms, GE reported a net loss of $2.63 per share due to a $22 billion goodwill impairment charge. GE also announced it will split its struggling power business in two. It will create a unified Gas business and a separate business which will include the Steam, Grid Solutions, Nuclear, and Power Conversion businesses. Finally, GE announced it will cut its quarterly dividend by 92%, to $0.01 per share, effectively with the next payment.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$1.78	$1.03	$1.15	$1.31	$1.52	$1.64	$1.65	$1.32	$1.49	$1.05	***$1.00***	***$1.28***
DPS	$1.24	$0.61	$0.46	$0.61	$0.70	$0.79	$0.89	$0.92	$0.92	$0.84	***$0.48***	***$0.05***
Shares	10537	10663	10615	10573	10406	10061	10057	9373	8742	8680	***8694***	***8700***

GE's management expects adjusted earnings of $1.00 to $1.07 for fiscal 2018. We are setting our expectations low, at the bottom of this range, due to GE's weak performance over the last decade. GE's growth history leaves much to be desired. Expected EPS for fiscal 2018 *are lower than during the worst of the Great Recession* (2009). General Electric's plan to spin-off portions of its business, pay down debt, and continue to sharpen its focus are positives. We expect the company to return to modest growth of around 5% annually over the next 5 years, barring a major economic downturn. GE's reduced dividend will take effect with the first payment, scheduled in January 2019. We expect GE to maintain a quarterly dividend rate of $0.01 per share until 2021, and increase its dividend at a 10% annual rate from 2021-2023 once the deleveraging process takes effect.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	15.7	13.0	14.4	13.9	13.3	14.7	15.7	20.3	20.4	24.8	***10.0***	***10.0***
Avg. Yld.	4.4%	4.6%	2.8%	3.4%	3.5%	3.3%	3.4%	3.4%	3.0%	3.2%	***0.4%***	***0.5%***

GE stock is currently trading around 2009 level prices, with a P/E ratio of just 10.0 using expected 2018 adjusted EPS. Due to the tremendous (and arguably surprising) dividend cut and continued earnings decline, we have lowered our fair value estimate to a price-to-earnings ratio of 10, meaning the stock is currently fairly valued. Valuation changes are not expected to impact GE's total returns over the next five years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

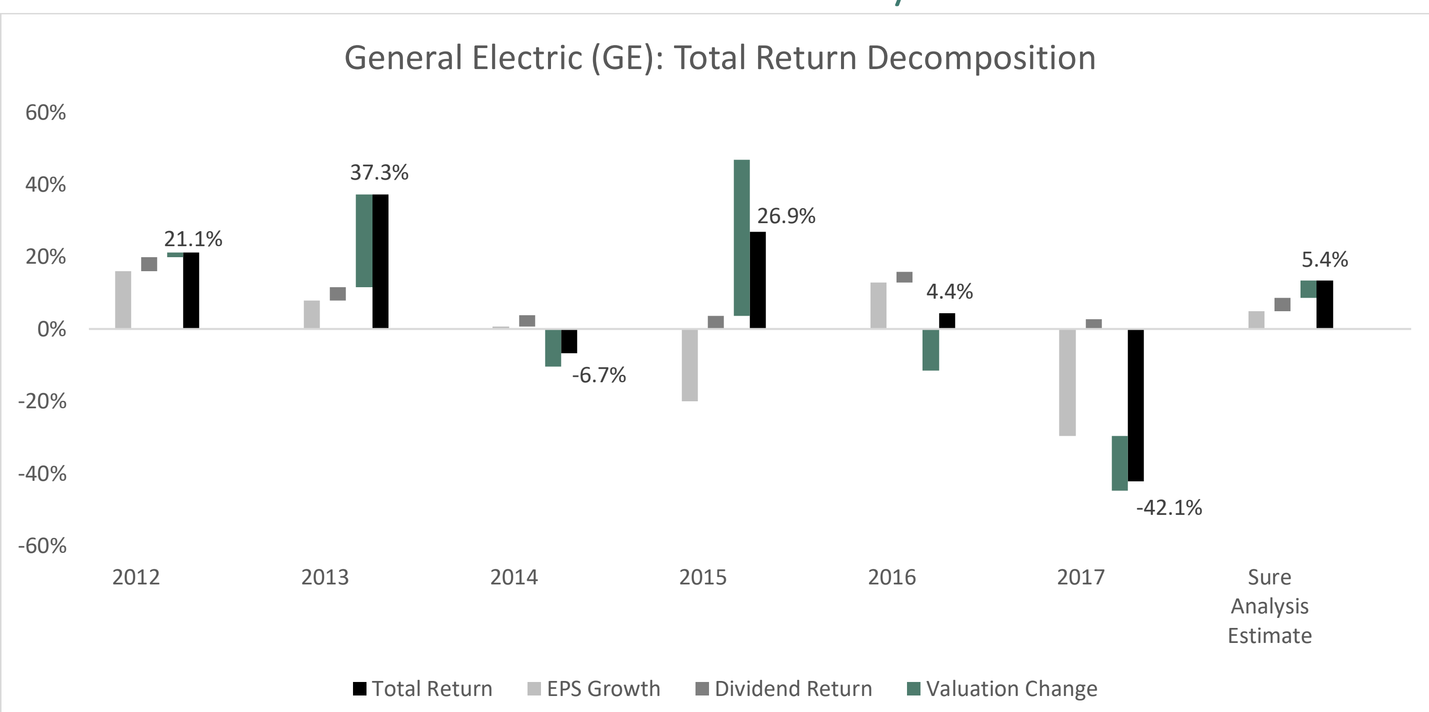
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	12.3%	10.1%	10.3%	10.9%	10.6%	5.1%	5.1%	7.0%	9.9%	8.0%	***8.0%***	***9.0%***
Debt/A	85.8%	84.0%	83.4%	83.6%	81.2%	79.2%	79.1%	79.1%	78.0%	77.4%	***80.0%***	***80.0%***
Int. Cov.	1.8	1.5	1.9	2.4	2.4	4.2	4.8	3.4	2.8	0.8	***2.0***	***2.5***
Payout	69.7%	59.2%	40.0%	46.6%	46.1%	48.2%	53.9%	69.7%	61.7%	80.0%	***48.0%***	***50.0%***
Std. Dev.	35.3%	63.8%	30.0%	29.2%	17.2%	15.4%	13.9%	21.6%	16.7%	19.4%	***18.0%***	***17.0%***

The silver lining of GE's most recent dividend cut is that it will save GE approximately $3.9 billion of cash each year, which the company can use to pay down debt. This is important, since interest rates are rising, and the company's weak interest coverage ratio is especially worrisome. Make no mistake, GE has elevated risk thanks to its high debt levels. The company plans to reduce its interest coverage ratio to a net debt to EBITDA ratio of 2.5x over the next several years.

Final Thoughts & Recommendation

General Electric *used to be* an iconic blue-chip stock. With the significant recent dividend cut, eroding performance in multiple business lines, and a high level of debt, the company is far from a safe dividend growth stock today. Investors looking for a stable, 'sleep well at night' stock should avoid General Electric. With that said, there are some positives to a GE investment at current prices. The company still has a valuable brand and competitive advantages. Investors will need to have a long-term focus to own GE, because the turnaround is going to take time. While GE stock has potential for positive total returns, only the most risk-tolerant investors should consider investing in GE. We rate GE as a sell.

Total Return Breakdown by Year



Click here to rate and review this research report. Your feedback is important to us.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

General Electric (GE)

Updated October 30th, 2018 by Bob Ciura

Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue ($B)	181.58	155.28	148.42	141.48	144.12	110.14	116.41	115.16	119.69	120.47
Gross Profit	97809	79357	62193	59441	58215	28275	31064	30164	28414	25389
Gross Margin	53.9%	51.1%	41.9%	42.0%	40.4%	25.7%	26.7%	26.2%	23.7%	21.1%
SG&A Exp.	45048	40426	38033	36841	35897	18773	17963	20439	19359	21912
D&A Exp.	11481	10619	9786	8986	9192	5202	4953	4847	4997	5139
Operating Profit	45528	28304	18226	23733	21049	12609	13879	11952	13060	5102
Op. Margin	25.1%	18.2%	12.3%	16.8%	14.6%	11.4%	11.9%	10.4%	10.9%	4.2%
Net Profit	17410	11025	11644	14151	13641	13057	15233	-6126	8831	-5786
Net Margin	9.6%	7.1%	7.8%	10.0%	9.5%	11.9%	13.1%	-5.3%	7.4%	-4.8%
Free Cash Flow	32643	15783	26324	20722	16212	21756	20575	11804	-8192	2506
Income Tax	1102	-1148	1039	5745	2534	1219	773	6485	-464	-3043

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets ($B)	797.77	781.90	747.79	718.19	685.00	656.56	654.95	493.07	365.18	377.95
Cash & Equivalents	48187	70488	78943	84501	77268	88555	70025	70483	48129	43299
Acc. Rec. ($B)	21.41	16.46	18.62	300.40	277.14	263.33	36.68	39.08	36.32	34.77
Inventories	13674	11987	11526	13792	15374	17325	17689	22515	22354	21923
Goodwill ($B)	96.74	76.83	74.36	84.69	85.09	91.96	66.39	83.33	86.88	104.24
Total Liab. ($B)	684.16	656.77	623.60	600.06	556.53	519.78	518.12	392.93	287.69	295.96
Accounts Payable	20819	19527	14656	16400	15654	16471	12067	13680	14435	15153
LT Debt ($B)	486.91	469.92	478.60	453.44	413.80	383.04	261.42	197.60	136.21	134.59
Total Equity ($B)	104.67	117.29	118.94	116.44	123.03	130.57	128.16	98.27	75.82	64.26
D/E Ratio	4.65	4.01	4.02	3.89	3.36	2.93	2.04	2.01	1.80	2.09

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	2.2%	1.4%	1.5%	1.9%	1.9%	1.9%	2.3%	-1.1%	2.1%	-1.6%
Return on Equity	15.8%	9.9%	9.9%	12.0%	11.4%	10.3%	11.8%	-5.4%	10.1%	-8.3%
ROIC	2.8%	1.8%	1.9%	2.4%	2.4%	2.5%	3.3%	-1.8%	3.5%	-2.7%
Shares Out.	10537	10663	10615	10573	10406	10061	10057	9373	8742	8680
Revenue/Share	17.98	14.63	13.90	13.32	13.64	10.70	11.50	11.50	13.11	13.87
FCF/Share	3.23	1.49	2.47	1.95	1.53	2.11	2.03	1.18	-0.90	0.29

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.