General Electric (GE)

Updated July 27th, 2021, by Eli Inkrot

Key Metrics

Current Price:	$13	**5 Year CAGR Estimate:**	-3.7%	**Market Cap:**	$114 B
Fair Value Price:	$7.20	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date[1]:**	09/25/21
% Fair Value:	181%	**5 Year Valuation Multiple Estimate:**	-11.1%	**Dividend Payment Date[1]:**	10/26/21
Dividend Yield:	0.3%	**5 Year Price Target**	$11	**Years Of Dividend Growth:**	0
Dividend Risk Score:	C	**Retirement Suitability Score:**	F	**Last Dividend Increase:**	N/A

Overview & Current Events

Tracing its roots back to Thomas Edison in the 1870's, General Electric is a $114 billion diversified manufacturer headquartered in Boston, MA. The company operates in five segments: Power, Renewable Energy, Aviation, Healthcare and Capital. General Electric continues to work through a major transformation. The company has taken a variety of actions to de-leverage its balance sheet including reducing the quarterly dividend, accelerating the sell down of Baker Hughes (to be fully monetized in three years) and selling industrial and capital assets. Previously GE sold Biopharma and GE Transportation.

On June 18th, 2021, General Electric announced that its 1-for-8 reverse stock split will take effect on August 2nd, 2021.

On July 27th, 2021, General Electric released Q2 2021 results for the period ending June 30th, 2021. For the quarter revenue came in at $18.3 billion, representing an 8.8% increase compared to Q2 2020. A decline in GE Capital was more than offset by gains of 47%, 14%, 7% and 67% in Aviation, Healthcare, Renewable Energy and Power respectively. Reported earnings-per-share equaled a loss of -$0.14 compared to -$0.26 prior. On an adjusted basis, earnings-per-share equaled $0.05 compared to -$0.14 in Q2 2020.

General Electric also updated its 2021 outlook. The company now expects $3.5 billion to $5.0 billion in industrial free cash flow (from $2.5 billion to $4.5 billion previously) and adjusted earnings-per-share of $0.15 to $0.25 (unchanged). We are forecasting $0.20 in earnings for this year, at the midpoint of guidance, but we are using $0.60 in underlying earnings power for fair value calculations.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$1.31	$1.52	$1.64	$1.65	$1.32	$1.49	$1.05	$0.65	$0.65	$0.01	***$0.20***	***$0.88***
DPS	$0.61	$0.70	$0.79	$0.89	$0.92	$0.92	$0.84	$0.48	$0.04	$0.04	***$0.04***	***$0.04***
Shares[2]	10573	10,406	10,061	10,057	9,373	8,742	8,680	8,702	8,724	8,753	***8,800***	***8,700***

GE's growth history leaves much to be desired. Earnings for 2018 and 2019 came in much lower than the company's performance during the last recession, and the company's 2020 pandemic performance was especially poor. General Electric's plan to transform portions of its business, pay down debt and continue to sharpen its focus are generally positive as the company is recognizing that it is too leveraged and is taking direct actions to reduce its debt. However, we are cautious in that it is difficult to cut your way to growth.

GE faces continued challenges in the power business, too much debt, and ongoing liabilities in the GE Capital segment. And this was before the COVID-19 pandemic. After posting barely positive results for 2020, management expects a small uptick in 2021 results. For the purposes of valuation and calculating a fair value estimate, we are using $0.60 in underlying earnings power – in-line with the company's guidance prior to the crisis taking hold. Potential growth of 8% annually appears outsized, due to coming off a reduced base.

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[1] Estimate

[2] In millions.

Disclosure: This analyst is long the security discussed in this research report.

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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	13.9	13.3	14.7	15.7	20.3	20.4	24.8	19.8	15.2	---	***21.7***	***12.0***
Avg. Yld.	3.4%	3.5%	3.3%	3.4%	3.4%	3.0%	3.2%	2.9%	0.4%	0.5%	***0.3%***	***0.4%***

General Electric's average P/E ratio over the last decade has been about 17 times earnings. However, we believe a much lower multiple of 12 times earnings is warranted considering the difficulties the firm has and will continue to face, along with the uncertain growth prospects from this point. With shares trading at nearly 22 times our underlying earnings power estimate (and 65 times the midpoint of management's guidance) this implies a significant valuation headwind.

Don't be fooled by GE's claim of having paid a dividend for more than 100 years. The company has cut its dividend three times in the last decade - in 2009, 2017 and 2019. The company's current dividend is a negligible $0.01 per quarter.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	47%	46%	48%	54%	70%	62%	80%	74%	6%	---	***7%***	***5%***

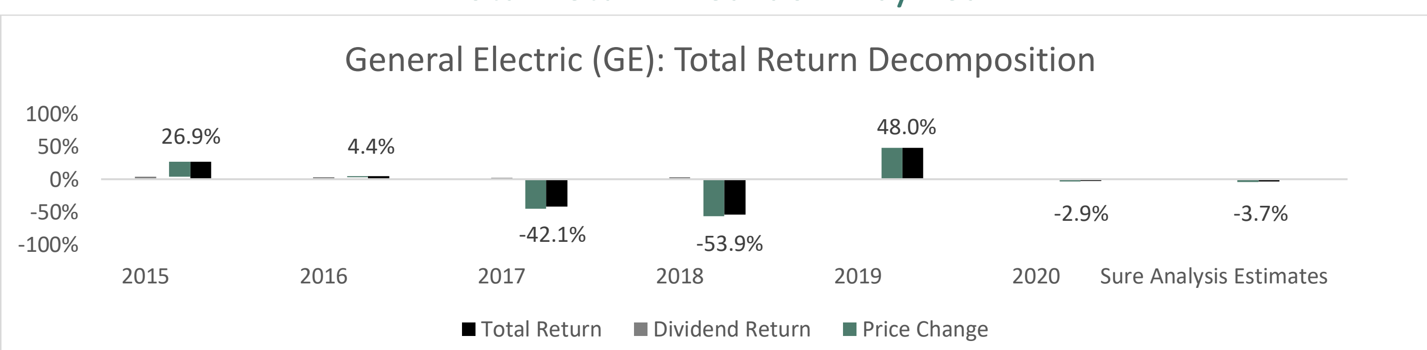
GE has competitive advantages in its Aviation and Healthcare segments, as it offers a best-in-breed product that tends to create sticky customer relationships. However, the problem is that the other segments do not enjoy the same type of advantages and indeed have even been a drag on the business. Moreover, Aviation in particular will be tested during the ongoing COVID-19 pandemic and its aftermath. During the last recession GE posted earnings-per-share of $2.20, $1.78, $1.03 and $1.15 for the 2007 through 2010 stretch and cut its dividend. Then, it faltered again seeing earnings of $1.65 in 2014 erode to $0.65 in 2018 and $0.01 in 2020 and again cutting its dividend, twice more. This is not just a cautionary tale but an example to remember – even the seemingly best businesses in the world can falter.

Still, there are positives. The dividend cuts are not welcome by income investors, but they do make it easier to refocus the company's profits on fixing the business. Moreover, we are encouraged by GE's acknowledgement and plans to attack the debt load at every angle. Still, time will tell whether or not adequate progress is being made.

Final Thoughts & Recommendation

After being up 55% and 17% in our two previous reports, shares are down -4% in the last three months. GE has gone from being a storied business, admired for its industrial conglomerate might, to hoping to be a turn-around story. While there are some bright spots, there are too many unknowns to be enthused. Total return potential comes in at -3.7% per annum, stemming from 8% growth and a 0.3% dividend, offset by a significant valuation headwind. Should GE regain its footing, shares could be attractive as the "snap back" effect related to growth, valuation and the dividend could be substantial. However, that is speculation at this point. Shares earn a sell rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue ($B)	141.5	144.1	110.1	116.4	115.2	119.7	120.5	121.6	95.2	79.6
Gross Profit	59441	58215	28275	31064	30164	28414	25389	23885	22655	19200
Gross Margin	42.0%	40.4%	25.7%	26.7%	26.2%	23.7%	21.1%	19.6%	23.8%	25.1%
SG&A Exp.	36841	35897	18773	17963	20439	19359	21912	18575	17243	15020
D&A Exp.	8986	9192	5202	4953	4847	4997	5139	---	5595	6018
Operating Profit	23733	21049	12609	13879	11952	13060	5102	5310	5412	1615
Op. Margin	16.8%	14.6%	11.4%	11.9%	10.4%	10.9%	4.2%	4.4%	5.7%	2.0%
Net Profit	14151	13641	13057	15233	-6126	8831	-5786	-22B	-4979	5704
Net Margin	10.0%	9.5%	11.9%	13.1%	-5.3%	7.4%	-4.8%	-18%	-5.2%	7.2%
Free Cash Flow	20722	16212	21756	20575	11804	-8192	2506	---	2677	194
Income Tax	5745	2534	1219	773	6485	-464	-3043	583	726	-474

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets ($B)	718.19	685.00	656.56	654.95	493.07	365.18	377.95	309.10	266.05	253.45
Cash & Equivalents	84501	77268	88555	70025	70483	48129	43299	---	36394	36300
Acc. Rec. ($B)	300.40	277.14	263.33	36.68	39.08	36.32	34.77	27.60	15.73	14.72
Inventories	13792	15374	17325	17689	22515	22354	21923	19300	14104	15890
Goodwill/Int. ($B)	84.69	85.09	91.96	66.39	83.33	86.88	104.24	77.80	37.39	35.30
Total Liab. ($B)	600.06	556.53	519.78	518.12	392.93	287.69	295.96	257.60	236.19	75.07
Accounts Payable	16400	15654	16471	12067	13680	14435	15153	N/A	15926	16480
LT Debt ($B)	453.4	413.8	383.0	261.4	197.6	136.2	134.6	110.0	90.9	75.07
Total Equity ($B)	116.4	123.0	130.6	128.2	98.3	75.8	64.3	31.0	28.3	35.55
D/E Ratio	3.89	3.36	2.93	2.04	2.01	1.80	2.09	3.55	3.21	2.11

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	1.9%	1.9%	1.9%	2.3%	-1.1%	2.1%	-1.6%	-6.5%	-1.7%	2.2%
Return on Equity	12.0%	11.4%	10.3%	11.8%	-5.4%	10.1%	-8.3%	-46.9%	-16.8%	17.9%
ROIC	2.4%	2.4%	2.5%	3.3%	-1.8%	3.5%	-2.7%	-11.8%	-3.6%	4.9%
Shares Out.	10573	10,406	10,061	10,057	9,373	8,742	8,680	8,702	8,724	8,761
Revenue/Share	13.32	13.64	10.70	11.50	11.50	13.11	13.87	13.99	10.91	9.09
FCF/Share	1.95	1.53	2.11	2.03	1.18	-0.90	0.29	---	0.31	0.02

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