

**Recommendation: HOLD**

**Estimated Fair Value: \$17 – \$25**

### **1. Reasons for the Recommendation**

I believe that General Electric is currently priced inline with its fair value, though on the low end. They will have several opportunities to grow in the coming 5 years. GE has some very nice competitive advantages based on its' large size and very diverse business segments. In its' recent 2011 10-k, nearly all of its industrial segments saw large increases in orders and in order backlogs which bode well for future revenues. Total order backlogs at the end of 2011 were \$200 Billion, the largest in GE's history. GE also has \$85 Billion in cash between GE Capital and the GE parent firm which will afford great opportunities for future mergers and acquisitions as well as potentially increasing dividend payouts to shareholders. GE is forecasting double digit growth in its industrial sectors in the coming years. Some key areas GE will see very solid growth is in Transportation, Energy Production both domestic and internationally, Oil and Gas, and Renewable Energy products.

In Transportation GE is poised to take advantage of its' fuel-efficient locomotive market share of approximately 70% in the coming years as more railroad firms will seek to replace and/or upgrade existing locomotive fleets to comply with EPA Tier II fuel efficiency standards. General Electric should be able to gain increased market share as a result of its' long and proven history of locomotive productions and primarily due to their first mover advantage. They already have an established production assembly plant and are bringing another one online at the same time a key rival Caterpillar has stopped production at their sole plant due to labor disagreements and are in the process of building a new plant.

In the early 1<sup>st</sup> and 2<sup>nd</sup> quarter 2012 GE has already established several increased growth and revenue projects in several different Energy components. In the US wind turbine market GE has a 50% market share and expects 2012 to see a large spike in wind turbine delivery with the added potential for a very large one-time volume gain if tax credits are not extended beyond 2012 as firms will likely rush to order and receive the turbines to claim the tax credit. First quarter 2012 results showed 611 wind turbines shipped compared to 366 the prior year (Opalka). In early March GE announced a partnership with Chesapeake Energy Corp. to provide improved access to products and services using domestically produced natural gas (compressed and liquefied). The deal will grant easier access to natural gas recovered from shale formations with GE promising delivery of 250 modular compression stations (i.e. Gas pumps) (Polson).

GE Capital continues to rebound and is going to maintain its' integral place in GE's business going forward. Its' 2011 profit more than doubled and GE has taken steps to reduce and prior leverage and shed any perceived "toxic" assets. Overall GE Capital's Total Assets are down but that was planned and it has seen profit margins grow. GE Capital recently reported a \$1.8 Billion first quarter 2012 profit which on the surface appeared flat compared to 2010 which included a lone time gain from the sale of their Turkish lending unit, when taken in context it would be a nearly 27% increase in profit year on year (Proteus). From the 2011 Letter to Shareholders CEO Jeffrey Immelt has stated his firm belief that GE Capital should be able to resume paying a dividend to the parent company, subject to Federal Reserve review. When and if GE Capital is able to resume paying a dividend to the parent company, this will greatly increase the parent (GE) revenues and earnings and may make it even more likely that a dividend hike

may be in order to return capital to shareholders. GE Capital expects to return any excess capital above and beyond any regulatory stress test requirements to the parent. An excerpt from the 2011 Letter to Shareholders, *“One of our top priorities is to grow dividends. We’ve increased the dividend four times in the last two years, and we have a dedicated focus on increasing the GE dividend in line with future earnings”* (2011 Letter to Shareholders).

GE maintains a 49% ownership stake in NBC Universal, whose overall valuation is \$37 Billion and whose profitability has increased under Comcast. GE will continue to receive revenue streams from NBC Universal and with the coming Summer Olympic games there will be a wonderful chance for increased advertising revenues and exposure for both Comcast and General Electric.

With strong future total earnings growth and a dividend yield already at approximately 3.5%, I believe there is a likely increase to the higher bounds of my Fair Value estimate in the short to intermediate future (1-3 years).

## **2. Company Analysis**

General Electric is a very large company with a current market cap of approximately \$200 Billion. GE does not have a single line item type of business or company but rather many different and unique subdivisions that make up their total firm. While most people may assume that GE just makes appliances or other industrial products, that is not the case; in fact, their GE Capital arm on its’ own would be considered one of the largest stand-alone banks in the United States. Other areas GE has a history of experience and excellence are aircraft engines, power generation, renewable energy, water processing, and yes household appliances as well as numerous medical imaging services and the aforementioned GE Capital arm among many other divisions.

### **Strengths**

General Electric is one of the largest most well diversified industrial companies in the world. They are poised to take advantage of many different growth opportunities. GE has a large amount of cash, \$85 Billion, which can be used for potential acquisitions or increased dividend payouts at their leisure. They also enjoy quite nice economies of scale and size due to their huge size and long history as an industrial conglomerate.

As an example a recent acquisition GE completed was the purchase of SeqWright for undisclosed amount which will greatly increase GE Healthcares’ exposure to the growing diagnostic sector at the molecular level. This too shows GE’s normal acquisition strategy of smaller firms which can instantly enhance existing GE products or expand the market opportunity for GE to where they can take advantage with their economy of scale.

GE Capital remains a strong area for General Electric and is one of the main reasons why one cannot just compare GE to other industrials; there is really almost nothing like it. GE Capital has vastly deleveraged and is set to resume its dividend to parent. The reason I highlight GE Capital is that it is almost unknown to the average person and investor, one never hears GE Capital mentioned relative to other banks while it really should be.

GE Aviation is a strong performer and has proven to be quite reliable in a very competitive marketplace. They are providing one of two engine types being used in Boeings' Dreamliner aircraft and also were recently awarded a \$2 Billion contract from Qantas to provide engines for over 75 aircraft (Catts).

### **Weakness**

Because of its large size and varied geographic areas of operations GE has been moving similarly to the global markets. Any potential bad global news becomes priced into the stock and instantly becomes the investor perception. Of interesting note in the historical multiples section below one can see that for the past several years GE has had very similar multiples to the S&P 500 so it is not out of the ordinary for GE to move in tandem with the US market.

Again due to its' large size GE has a lot of market exposure but also increased varieties of risk. Because of their large size GE will normally not invest in ideas or products without potential revenue streams in the high \$ millions and low \$ billions. They put themselves at risk for missing new product ideas or not fully realizing product's potential if the initial future earnings estimate is off. A large portion of GE Energy growth in products and services is tied to both BRIC and other emerging market countries.

### **Opportunities**

Another unique opportunity is in the Transportation segment of GE. While it is very modest relative to the other business segments and only made up \$4.8 Billion of \$147 Billion 2011 total revenues I feel that there is a great opportunity for future growth particularly with regards to railroad locomotives. I believe that GE is well ahead of its competitors especially in the US domestic market with gearing up for the next generation of fuel-efficient locomotives. I will discuss further in the following section.

The Energy segment has some very lucrative prospect in the coming years. GE is one of the main producers of heavy duty gas turbine generators for power production. As US utility firms, municipalities, and other power generator consumers look for cost efficiencies as well as EPA compliance GE stands to benefit as coal powered plants shutdown or are phased out by compliance issues. General Electric has several generators which could take the place of coal fired processes for utility firms.

In addition GE also has a partnership with a small specialized renewable energy firm which is solely concerned with the energy storage market pertaining to renewable energy. Mainly, how one can store and efficiently use surplus electrical power generated by wind, solar, thermal etc... The main product being discussed and used is actually a battery which will allow renewable energy producers and consumers to store surplus output without necessarily having access to a large power supply grid (Marcial). If a reliable and proven battery could be brought to market it would drastically alter the energy sector as a whole; it would increase the opportunities and feasibility of renewable power generation at remote locales.

### **Threats**

Continued global economic uncertainty will threaten near term growth prospects for GE and may be grounds for lowering future forecasts. The potential for increased government regulations is possible particularly in the case of GE Capital. Long term US tax reform, change, or regulation is possible and will be a likely topic in the coming US election cycle. The possibility of overseas earnings being taxed at

US corporate tax rates is very small but it still remains a possibility. Drastic changes to the Affordable Care Act could also lead to increased uncertainty in the Healthcare sector and could limit growth.

### **3. Industry Analysis**

As stated previously, General Electric has many different business segments which can be looked at over several different industries. General Electric's segments include Energy Infrastructure, GE Capital, Aviation, Healthcare, Transportation, and Home and Business Solutions.

#### **Energy**

The Energy segment is responsible for electric power, nuclear energy, wind energy, solar energy, and general power transmission and distribution services for efficient electric grids. In Energy Infrastructure GE primarily provides a plethora of power generation sources to power plants both private and municipal, governments, and industrial clients to name a few. In recent years GE has also taken very decisive actions to become more involved in Oil and Gas and has business opportunities throughout the entire Oil value chain. In 2011 GE was very aggressive with three acquisitions in unique areas of the Oil and Gas industry to obtain added value in subsea oil extraction, more pumping capability at mature oil fields, and gaining added expertise in the production of relief valves.

GE's main competitor in Energy on an industrial basis is Siemens AG, which produces many of the same products GE makes. It should be noted that Siemens is the one competitor whom may come closest to matching GE as far as scope and size but that GE still has almost twice the market cap of Siemens. Considering the Oil and Gas portion of the Energy segment I feel that the most similar competitor in its total scope of operations is National Oilwell Varco. For reason previously stated I feel the outlook of the Energy sector is extremely positive and GE expects double digit revenue growth over the coming years. With the varied business and growth opportunities previously discussed GE should be poised to capitalize.

#### **Aviation**

The Aviation segment manufactures, sells and services jet engines, turboprop and turbo shafts predominantly for use in military and commercial aircraft. This segment is very competitive yet GE has excelled with its' most recent achievement being their selection to design and produce one of the engines for Boeings 787 Dreamliner which should help insure guaranteed future contracts for the next several years. In addition to aircraft, GE also is one of the sole providers of maritime gas turbine engines to the US Navy. Specifically, the LM2500 is one of the most widely produced and popular maritime engines for both military and mercantile consumers.

General Electric's main competitors in the aviation segment are United Technologies and Safran SA. An interesting note is that while the 10-k for GE discusses just how competitive the worldwide market is, they also mention two Joint Ventures each with a subsidiary of their main aforementioned competitor. There are several revenue and product sharing agreements in place across the industry for GE and the previously mentioned \$2 Billion Qantas contract is through a JV with Safran. With many domestic airlines, international airlines, and countries upgrading their aviation fleets there will be continued increased demand for GE Aviation services and products, especially their engines.

## **Healthcare**

GE's Healthcare segment is mainly producing medical items for use in hospitals such as imaging and diagnostic equipment to help doctors get as clear a picture as possible and often in the least invasive manner. They also assist in biopharmaceutical manufacturing and purification for academic research and pharmaceutical use. The main customers are, "hospitals, medical facilities, pharmaceutical and biotechnology companies, and to the life science research market" (2011 10-k). Their main competitors are Varian Medical Systems and Koninklijke Philips Electronics NV among others.

## **Transportation**

General Electric's transportation segment primarily deals with railroad locomotives and mining equipment. GE has been extremely proactive in getting new products out to market, most specifically the Evolution Series of locomotives, which has been designed to meet or exceed the current US EPA Tier II emission standards. They build very modern fuel-efficient locomotives and are very well positioned to pick up most of if not the entire US market. Their main competitor is Electro-motive Diesel which was recently bought by Caterpillar and now they are in essence the only 2 US public companies producing locomotive engines. CAT has had issue however in that they recently closed down their sole locomotive plant in Ontario and is in the process of getting a new plant up and running in the Indiana. GE on the other hand already has a well-established locomotive plant in Erie, PA and is building another plant in Texas. A recent WSJ article (12 April 2012) highlights the expectation that US railroad firms are expected to greatly increase buying new locomotives ahead on the increased emission standards. It also highlights that historically GE has had about a 70% share of the North American large locomotives most commonly used by railroads. If they maintain a 70% share, or as I suspect gain an even larger majority I think there is tremendous growth opportunities for GE Transportation in the next 3-5 years.

## **Home and Business Solutions**

The Home and Business Solutions segment of General Electric produces predominantly household appliances as well as lighting products for commercial and industrial applications. This segment has been a relatively steady and reliable performer normally averaging about 5% of GE's total revenues. They provide just about all of the major appliances from dishwashers, stoves, refrigerators, washers, dryers, microwaves, to air conditioning units. The main customers are individual consumers and they compete in this segment against mainly Whirlpool and Electrolux AB. There are not many large growth opportunities in this segment, although with any increase in new homes being built domestically there would be a strong chance of improved revenues for this segment as many homebuilders such as DR Horton have agreements to provide GE appliances in their model and spec homes.

## **GE Capital**

GE Capital businesses offer a broad range of financial services and products worldwide for businesses of all sizes; Services include commercial loans and leases, fleet management, financial programs, home loans, credit cards, personal loans and other financial services (2011 10-k .Segment profile pg. 9). General Electric's Capital segment provides financing to numerous companies and cities as well as to general U.S consumers. GE Capital's main internal areas of business are Commercial Lending and

Leasing, Real Estate, and Consumer. GE Capital's competitors are a legion and include many domestic US Banks, Investment Banks, and Credit Card companies.

**Appendix A: Inputs into the Discounted Cash Flow Valuation**

**Only multiples valuation was used. DCF was not feasible or viable due mainly to the size and complexity of GE's business segments but most notably GE Capital.**

**Appendix A: Inputs into valuation using multiples**

**Comparable Firms**

<b>Energy Infrastructure</b>	
	EV/EBITDA
Global Power Equipment Group	12.11
Siemens AG	7.04
Honeywell International Inc	13.73
Schlumberger	9.67
Halliburton	5.28
Baker Hughes	4.95
National Oilwell Varco	8.82
<b>Aviation</b>	
	EV/EBITDA
United Technologies	8.13
Spirit Aerosystems Holdings	9.51
Teledyne Technologies	8.69
Woodward Inc	10.88
Rolls Royce Holdings	11.1
Safran SA	7.85
<b>Healthcare</b>	
	EV/EBITDA
Varian Medical Systems	11.15
Koninklijke Philips Electronics NV	5.77
PerkinElmer	16.19
Hologic	9.96

<b>Transportation</b>	
	EV/EBITDA
Caterpillar Inc	10.46
Siemens AG	7.04
Westinghouse Air Brake Technologies Corporation	11.25
<b>GE Capital</b>	
	P/E
American Express	13.88
Ford Motor	2.47
Visa	21.27
Mastercard	29.73
Fidelity National Information Services	21.10
<b>Home &amp; Business Solutions (appliances)</b>	
	EV/EBITDA
Whirlpool Corp	4.71
Electrolux AB	7.89

\*Source: Yahoo! Finance, 10-K

### Historical Multiples

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM
<b>P/E</b>											
GE	16.1	20	22.9	22.8	18.7	16.9	9.1	14.7	15.9	14.6	15.4
S&P 500	19.7	21.1	19.2	17.2	16.8	16.5	10.9	18.6	15.5	13.7	15.5
<b>P/B</b>											
GE	3.8	3.9	3.5	3.4	3.4	3.2	1.5	1.4	1.6	1.6	1.7
S&P 500	2.5	3.1	3.1	2.9	2.9	2.7	1.7	2.2	2.2	2	2.3
<b>P/S</b>											
GE	1.9	2.3	2.5	2.5	2.4	2.2	0.9	1	1.3	1.3	1.4
S&P 500	1.3	1.6	1.6	1.5	1.6	1.5	0.9	1.2	1.3	1.2	1.4

\*Source: Morningstar, Inc.



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