Edward Jones
MAKING SENSE OF INVESTING

GENERAL ELECTRIC

Investment Category: Income | **Sector:** Industrial

Fixed Income Research Mike Doyle, CFA

March 25, 2019

Company Overview

General Electric (GE) is a diversified services, technology and manufacturing company with operations worldwide. We expect that following announced restructuring actions it will largely operate in the aviation, power and renewable energy industries and potentially health care. GE maintains a financial services segment, but this is now considerably smaller than it was historically and focuses primarily on providing customers financing for purchases of GE equipment.

Parent Credit Ratings

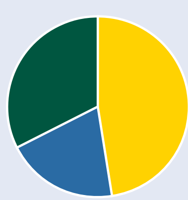
Moody's	Baa1/Stable
S&P	BBB+/Stable
Fitch	BBB+/Negative

Financial Data

Debt/Capital	**70%**
Debt/EBITDA	**4.1x**
EBITDA/Interest Expense	**3.8x**

Canadian Recommended Corporate Sector Weightings

- **Financial** (40%- 55%)
- **Utilities** (10%- 30%)
- **Industrial** (25%- 40%)



Canadian Recommended Bond Ladder

Short-term (up to 5 years)
25%- 35%

Intermediate-term (6- 15 years)
40%- 50%

Long-term (16+ years)
20%- 30%

Appropriate for Income

Recommendation

We consider bonds of General Electric and GE Capital Canada to be an appropriate holding for investors seeking income within a well-diversified portfolio.

Edward Jones Credit Strength Assessment

Low | Below Average | **Average** | Above Average | High

Investment Summary

General Electric remains an industry leader due in large part to its diversity across business lines and its less cyclical earnings profile relative to other industrial companies. However, management turnover, limited guidance, and increased uncertainty around the company's strategic path have led to credit-rating downgrades and heightened concerns about the firm. While continued deterioration in the firm's industrial power division has reduced investor confidence in the company, we believe management's recent actions (significantly reducing the dividend and accelerating the divestiture of its ownership stake in Baker Hughes, the renegotiated terms of the Wabtec deal, the sale of its BioPharma business) have shown both a desire to improve its financial position and a willingness to act decisively to bring about needed change. However, additional work remains to be done if the firm is going to improve the outlook for its future financial position, and there could be bumps along the way.

Bond Strengths

- GE's business lines tend to have strong positions within their industries.
- General Electric provides aftermarket services for most of the large-scale equipment it sells to customers. Services tend to have higher margins than equipment sales, and revenues from services also tend to be more resilient in periods of economic weakness.
- New management has brought a fresh perspective and has prioritized improving its financial position with a number of bondholder-friendly actions.

Bond Weaknesses

- GE's financial measures continue to appear moderately weak for the ratings assigned, though less so following recent downgrades, and its size and diversification do provide some support to ratings.
- Financial targets have been consistently missed. Management has guided toward additional weakness in 2019 followed by improving trends in 2020 and 2021 but we expect investors will be somewhat skeptical given recent trends.
- Diversity of cash flows has decreased and could be reduced further over the next few years due to its large scale asset sales.

Please see important disclosures and certification on page 4 of the report.

Recent News and Analysis

2/25/19: Fixed Income Research has increased its credit strength assessment on GE to Average from Below Average. GE has made a number of bondholder-friendly announcements since late last year, including significantly reducing the common dividend, accelerating the divestiture of Baker Hughes, renegotiating the terms of the merger of GE transportation and Wabtec to generate more cash flow for the firm, and announcing that it has agreed to sell its BioPharma unit to Danaher, along with indicating that it now may keep the rest of its health care business. These moves have all generated additional near-term cash flow, and management has been clear that it plans to use these funds to reduce debt and improve its balance sheet. We believe these have all been credit-positive steps, and we would be more comfortable with the firm's ability to continue to service its outstanding debt if it were to retain the remainder of its health care business, given the strong free cash flow generation of this unit. While we continue to have concerns about the firm's industrial power unit, management's recent actions have been encouraging. There remains a significant amount of work to be done if the firm is going to improve the outlook for its future financial position, and there could be bumps along the way, but we now believe an average credit strength assessment is most appropriate. Overall we continue to believe bonds of GE and its subsidiaries are an appropriate holding for investors seeking Income within a well-diversified portfolio.

1/31/19: GE reported fourth-quarter adjusted earnings per share of $0.17, below the consensus estimate of $0.22. Total revenues of $33.3 billion were modestly above analyst estimates ($32.2 billion). The company also announced it had reached a principal agreement with the Department of Justice to settle its investigation into operations at WMC mortgage (a former subprime-mortgage lending unit) for $1.5 billion, which the firm had already fully reserved for.

This was a mixed quarter overall, but we believe bondholders should view positively the resolution of the WMC investigation, better than expected free cash flow in the quarter, and a continued effort to reduce leverage. That being said, power continues to struggle, and it dragged down overall operating profit, offsetting better-than-expected results at most other segments, so we continue to have concerns about the length of the turnaround in power. Also, while free cash flow was better than expected, GE stated that it does face a number of cash headwinds in 2019, implying that free cash flow generation will likely decline while not providing any additional color around the size of the pullback on the conference call. The firm also did not provide discrete 2019 guidance, instead implying it would provide more details soon. This was a disappointment, in our view. While we do expect the firm to prioritize improving its balance sheet and reducing leverage, there are still a number of moving parts that will take time to play out, and we do not expect a quick turnaround to occur. Overall we continue to believe bonds of GE and its subsidiaries are an appropriate holding for investors seeking Income within a well-diversified portfolio.

Company Outlook

Business Operations Growing Less Diverse, but Perhaps Not as Much as Feared

GE has announced several actions to reshape the firm over the last few years. One of the more notable actions was the 2015 announcement that it will significantly decrease the size of its financial services segment. Currently, over 80% of the firm's operating profits are generated by its three largest business segments (Aviation, Healthcare and Power). Originally, the firm planned to divest of its healthcare unit through a spinoff or an initial public offering. This unit makes up over a quarter of operating income and is arguably the firm's most consistent unit in terms of free cash flow generation. With the news that the firm will sell its BioPharma unit to Danaher, it has indicated that it may retain healthcare and at a minimum is stretching out the timeframe to exit healthcare. We would view a decision to retain healthcare positively because it would provide greater revenue and earnings diversification overall and help to offset the very cyclical nature of the firm's other businesses (Aviation, Industrial Power and Renewable Power). Plus it would provide solid free cash flow generation to continue servicing its above-average debt load.

Focus on Aftermarket Services Enhances Margins and Stability in Economic Downturns

General Electric provides aftermarket service for the equipment it sells to customers. We view this exposure to services as a significant positive for overall GE credit quality. Sales of services produce much higher profit margins than sales of equipment. Additionally, and perhaps even more importantly for bondholders, services revenue tends to be more resilient in weak economic environments than sales of industrial equipment. GE's equipment sales tend to be comprised of large-ticket goods, the sales of which can be heavily impacted by a poor economic environment in which corporations tend to cut capital spending. On the other hand, sales from services tend to hold up better because these are often required to continue to operate machinery that is already in service.

Power Segment Continues to Underperform Significantly Reduced Expectations

GE's power division has struggled in recent years because it has dealt with an increasingly competitive landscape coupled with slowing demand. In 2015, the company acquired Alstom's Thermal, Renewable and Grid businesses, its largest-ever industrial acquisition. The company believed the strategic fit justified the high price tag because the combination supplemented GE's offering by allowing the company to provide more of the equipment used by power plants, including additional offerings in both turbines and generators. Unfortunately, factors including rising competition that has weighed on pricing power, a faster-than-anticipated move towards renewable power sources, and weakening demand trends have led to significantly weaker profits and much lower free cash flow generation. With its third-quarter 2018 earnings announcement, GE announced a plan to further restructure the unit, but a significant turnaround does not appear imminent, and we continue to have questions about how viable the segment is longer-term.

New Management Has Brought Fresh Perspective

Larry Culp was named chief executive officer on October 1, 2018, replacing John Flannery, who was in the role for only 14 months. This move came after a number of financial targets overall and at specific units of the firm were consistently missed or reduced during his tenure. Mr. Culp has significant past experience and has already engineered a number of bondholder-friendly actions (significant common dividend cut, accelerated exit of Baker Hughes, increased ability to monetize its ownership of Wabtec following its merger with GE Transportation, and selling its BioPharma unit to generate funds which can be used to reduce debt) despite being in the role a very short time.

GE Capital Corporation Debt Has Been Assumed by GE

While GE Capital Corporation previously benefited from a support agreement with GE, the assumption of its debt by GE is an even better arrangement for GE Capital Corporation bondholders and improves the overall credit quality of these bonds, in our view.

Industry Outlook

GE competes in many industries. With the expected restructuring actions over the next few years, its core industrial divisions will be Aviation, Power, and Renewable Energy. Aviation has been a strong performer in recent years as airlines look to upgrade their fleets. While equipment-order growth may slow in coming years, we expect that GE's services revenue will continue to grow. Services have higher profit margins than equipment sales typically, so we view this growth positively. The power division has recently come under pressure, and operating results are expected to be weaker in the near term. Health care is an industry we see growing steadily in coming years as the demographics (aging population and better access to health care across socioeconomic backgrounds) continue to provide a positive industry environment. We expect that the company's innovation, along with its size and breadth of product offering, will help it maintain its solid competitive positioning. GE's solid financial positioning also allows it increased flexibility and the ability to continue to compete aggressively, even in periods of economic weakness.

Financial Strength

While we continue to view General Electric as a solid corporate credit overall, it is clearly experiencing significant disruption in its power segment, which could continue to weigh on the firm's financial results. While we believe management is committed to improving its financial position over time as it targets a credit rating in the "A" range, we believe reaching this goal may require more time than currently anticipated. We would also note that there are a number of potential issues (SEC investigation into its accounting, the potential for increased liabilities from legacy GE Capital activities, the need for additional contributions to fund its pension plan) that could put additional pressure on its financial position. These concerns are partially offset by the firm's large size and market position, which contribute to its credit quality along with the potential to sell sizable noncore assets and use the proceeds to improve its financial position.

Edward Jones Credit Strength Assessment

We believe General Electric's credit strength assessment is Average. GE remains a large, relatively diverse business. Bondholder-friendly actions (significant common dividend cut, accelerated exit of Baker Hughes, increased ability to monetize its ownership of Wabtec following its merger with GE Transportation, and selling its BioPharma unit to generate funds which can be used to reduce debt) provide tangible steps to an improved financial position. These actions have reduced uncertainty around the firm's strategic path. Taking these factors into consideration, we now believe an Average credit strength assessment is appropriate for General Electric.

Required Research Disclosures

March 25, 2019	BUY	HOLD	SELL
Corporate Credits	0%	79%	21%
Investment Banking Services	0%	5%	0%

The table lists the percent of corporate credits we follow globally in each of the equivalent rating categories. We do not assign a "Buy" rating to any corporate credits. Investment banking services indicate the percentage of those subject companies that have been investment banking clients within the last 12 months.

Appropriate for Income	Appropriate for Aggressive Income	Sell	FYI
Appropriate for Income – We consider bonds to be an appropriate holding for investors seeking Income within a well-diversified portfolio. Our time horizon is 3-5 years.	**Appropriate for Aggressive Income –** We consider bonds appropriate only as a small Aggressive Income portion within a well-diversified portfolio. Bonds within this category are riskier, with a higher possibility of loss due to default, than bonds classified as Income. Our time horizon is 3-5 years.	**Sell –** We recommend investors sell these bonds. We believe these bonds are no longer an appropriate fixed-income holding because, in our opinion, they offer an unattractive risk/reward scenario at current prices. Our time horizon is 3-5 years.	FYI - For informational purposes only; factual, no opinion.

Initiated Coverage (Appropriate for Income) 12/14/09

Analyst Certification

- I certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers; and no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report. Mike Doyle, CFA

- Edward Jones has received compensation from this company for providing non-investment banking securities-related services within the past twelve months.
- Analysts receive compensation that is derived from revenues of the firm as a whole which include, but are not limited to, investment banking, sales, and trading revenues.
- Edward Jones trades as principal in the debt securities that are the subject of this research report.

Other Disclosures

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- This opinion is based on information believed reliable but not guaranteed. The foregoing is for INFORMATION ONLY. Additional information is available on request. Past performance is no guarantee of future results.
- This issuer may have issued bonds in both large and small offering sizes. Bonds which are part of small offerings are generally less liquid, which may cause the price you receive in the secondary market to be lower than prices received by investors in large issues of the same issuer's bonds.
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- Diversification does not guarantee a profit or protect against loss in declining markets.
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- Credit ratings generally represent the rating company's opinion of the bond's ability to meet its ongoing contractual obligations. These ratings are estimates and should be one of many factors considered in evaluating fixed income investments. These ratings do not address suitability or future performance. N/A indicates no rating available.
- When investing in issuers incorporated outside your own country of residence, you should consider all other material risks such as currency risk, political risk, liquidity risk and accounting rules differences, which can adversely affect the value of your investment. Please consult your Financial Advisor for more information.
- Edward Jones Credit Strength Assessment: Low –Our opinion is these credits are of low financial quality. We believe these credits are the most likely to default and experience the most financial hardship. Below Average – Our opinion is these credits are of below-average financial quality. We believe these credits are more likely to default or experience financial hardship than the average. Average – Our opinion is these credits are of average financial quality. We believe these credits have a low probability of default or low chance of experiencing financial hardship. Above Average – Our opinion is these credits are of above-average financial quality. We believe these credits are less likely to default or experience financial hardship than the average. High – Our opinion is these credits are of the highest financial quality. We believe these credits have the lowest probability of default and will experience the least financial hardship.
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