# General Electric Co GE (NYSE) | ★★★

| Last Price | Fair Value | Consider Buy | Consider Sell | Uncertainty | Economic Moat™ | Moat Trend™ | Stewardship | Morningstar Credit Rating | Industry Group |
|---|---|---|---|---|---|---|---|---|---|
| 26.99 USD | 29.00 USD | 20.30 USD | 39.15 USD | Medium | Wide | Stable | Standard | AA- | Industrial Products |

## GE Reports Solid Profitability Gains in 3Q; On Track to Achieve 2014 Targets

See Page 2 for the full Analyst Note from 17 Oct 2014

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The primary analyst covering this company does not own its stock.

Research as of 17 Oct 2014
Estimates as of 17 Oct 2014
Pricing data through 21 Nov 2014
Rating updated as of 21 Nov 2014

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.

**Contents**



### Investment Thesis 08 Oct 2013

General Electric positions itself to be a leader in all markets in which it competes. After shedding underperforming businesses during the past few years, the firm has energy infrastructure square in its sights. We believe GE will emerge as a leader in the power infrastructure market, which will be the backbone for the firm's growth.

GE makes its mark by combining businesses with strong synergies and opportunities for information-sharing across business lines. Add to this GE's ability to invest large amounts of money in expanding businesses, and barriers to enter a new market are significantly lower. With its proven ability to drive improvement in operating efficiencies, the firm is able to generate healthy returns on invested capital in many of its markets.

The portfolio of businesses continues to be correlated with industrialization and the needs of growing economies. GE has changed its focus as the world has shifted; it now has a heavy focus on clean-energy products, such as wind and gas turbines. The strength of GE's competitive advantage is most notable in wind turbines, where the company was able to unseat longtime incumbent Vestas with its superior manufacturing execution and better customer satisfaction. Though the wind energy business is currently under margin pressure driven by oversupply, we continue to see GE emerging as one of the dominant players. Underscoring the benefits of a diversified business model, GE has remained agnostic to the fuel source for new power generation, with exposure to gas turbines and steam generation as well as renewable sources.

Since the collapse of the credit markets in 2008, GE has rebuilt its captive finance arm, improving capitalization and general business profitability, while working to pare noncore assets. Areas of focus will remain middle-market commercial and industrial loans, equipment leasing, and aircraft leasing. In each, GE is now competing with a stronger capital base and less competition. With near-term headwinds easing, investors should benefit from a better-capitalized bank with higher asset quality over the long run.

### Vital Statistics

| | |
|---|---|
| Market Cap (USD Mil) | 271,039 |
| 52-Week High (USD) | 28.09 |
| 52-Week Low (USD) | 23.69 |
| 52-Week Total Return % | 3.6 |
| YTD Total Return % | -1.4 |
| Last Fiscal Year End | 31 Dec 2013 |
| 5-Yr Forward Revenue CAGR % | 7.3 |
| 5-Yr Forward EPS CAGR % | 8.6 |
| Price/Fair Value | 0.93 |

### Valuation Summary and Forecasts

| Fiscal Year: | 2012 | 2013 | *2014(E)* | *2015(E)* |
|---|---|---|---|---|
| Price/Earnings | 15.0 | 18.2 | *15.8* | *13.8* |
| EV/EBITDA | 35.1 | 38.0 | *28.7* | *26.4* |
| EV/EBIT | 42.6 | 47.1 | *34.1* | *30.9* |
| Free Cash Flow Yield % | 6.4 | 3.8 | *5.3* | *5.9* |
| Dividend Yield % | 3.3 | 2.8 | *3.3* | *3.3* |

### Financial Summary and Forecasts (USD Mil)

| Fiscal Year: | 2012 | 2013 | *2014(E)* | *2015(E)* |
|---|---|---|---|---|
| Revenue | 100,875 | 101,014 | *108,270* | *116,151* |
| Revenue YoY % | 0.6 | 0.1 | *7.2* | *7.3* |
| EBIT | 10,804 | 10,165 | *13,124* | *14,473* |
| EBIT YoY % | -22.5 | -5.9 | *29.1* | *10.3* |
| Net Income, Adjusted | 14,793 | 15,820 | *17,222* | *18,540* |
| Net Income YoY % | 13.4 | 6.9 | *8.9* | *7.7* |
| Diluted EPS | 1.40 | 1.54 | *1.71* | *1.95* |
| Diluted EPS YoY % | 14.0 | 9.8 | *11.4* | *14.0* |
| Free Cash Flow | 15,510 | 22,411 | *14,369* | *15,364* |
| Free Cash Flow YoY % | 181.2 | 44.5 | *-35.9* | *6.9* |

Historical/forecast data sources are Morningstar Estimates and may reflect adjustments.

### Profile

General Electric is a diversified manufacturer and is organized into four segments: technology infrastructure, energy infrastructure, home and business services, and capital services.

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## Morningstar Analysis

**GE Reports Solid Profitability Gains in 3Q; On Track to Achieve 2014 Targets** 17 Oct 2014

General Electric's third-quarter results reflected progress in the company's efforts to streamline costs and reposition its portfolio in support of core industrial businesses. The industrial segment exhibited 4% year-over-year organic growth, contributing nearly $26 billion in revenue in the quarter. While this represented a sequential decline in organic sales growth, emerging-market distributed power project delays were largely to blame. Nevertheless, assuming fourth-quarter power and water shipments remain robust, GE should still meet its 4%-7% organic growth guidance for 2014.

Operating margins expanded 90 basis points year over year to 16.3% in the quarter, as ongoing corporate cost reductions largely offset the negative impact from weakness in the power and water segment. This year's initiatives to simplify the selling, general, and administrative cost structure have generated nearly 160 basis points of margin improvement, with GE on track to deliver nearly $1 billion savings by the end of 2014. In addition, service margin improvement of nearly 170 basis points year to date supports GE's rationale to invest in analytics, which we believe can drive long-term profitability as service capabilities expand. The quarter's results support our belief that GE's efforts to strengthen its core business are working, and we reiterate our $29 fair value estimate.

With GE's wide moat resting squarely in its industrial business, we're pleased to see that recently announced transactions support the firm's long-term goal of increasing its industrial earnings contribution. In our view, divesting appliances reduces GE's exposure to a notoriously cyclical, consumer-driven business segment. Furthermore, while supporting the growth of a GE Capital business unit appears counterproductive, the Milestone Aviation acquisition increases GECAS exposure to GE-powered helicopters, creating additional synergies between GE Capital's existing aircraft leasing arm and the aviation segment.

**Valuation, Growth and Profitability** 18 Jul 2014

Our fair value estimate is $29 per share. We expect industrial revenue to increase 7% annually over the next five years, led by robust growth in GE's aviation business and energy business. This growth assumption does include recently announced acquisitions supporting the aviation business. We model a long-term operating margin of nearly 16% for the firm, lifted by better service contract penetration in the core industrial businesses. Though the company will be investing further in R&D this year and the turbine and wind energy businesses will remain a drag on profitability, we expect improved results in health care, transportation, and GE Capital (which we're modeling separately from the industrial businesses). All in all, we expect a multiyear run of decent growth from GE's mostly late-cycle portfolio. With share repurchases looming on the horizon, earnings per share should show some decent growth over the next couple of years.

**Scenario Analysis**

Our upside and downside scenarios aren't going to vary greatly from the base case on the industrial side, given GE's long-cycle businesses and high proportion of service revenue inherent in the model. However, we can envision a scenario where the company may be worth as much as $36 per share today. In this scenario, revenue would have to grow by low double digits for the next four years and margins would have to expand to the high teens. Though unlikely, this is possible as GE has significantly upgraded its portfolio over the past couple of years but hasn't yet enjoyed the volume levels of prior years. Operating margins in the industrial business did reach this level in the early 2000s, but this was amid a power bubble that probably powered margins past what we would assume is attainable under current conditions. In addition, a strongly expanding economy is likely to power GECS' earnings past the roughly

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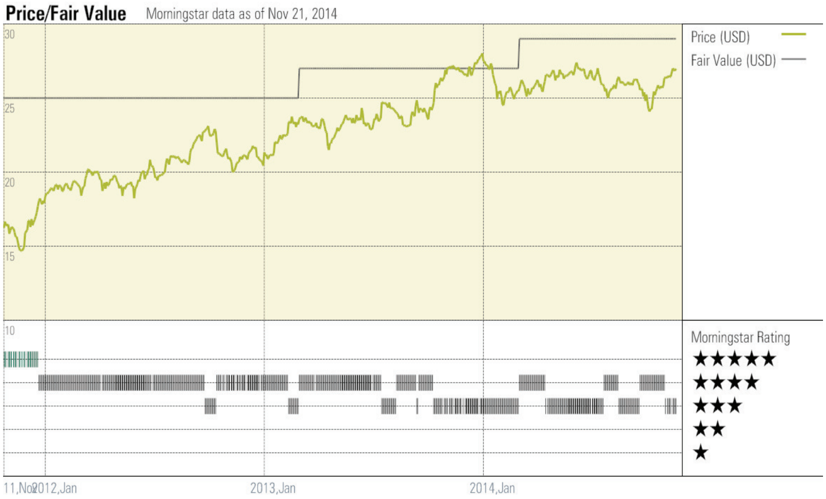
**Price/Fair Value** Morningstar data as of Nov 21, 2014




$7 billion we are assuming is the normalized earning power of the unit in our base case several years hence.

On the other hand, if the economy limps along for several years and GE enjoys only GDP-like growth or less, the stock is probably worth less than $17 per share. In this scenario, we estimate the industrial business would only attain margin levels similar to today and GE Capital may again be consumed by net losses, increasing reserve levels, and possibly more capital contributions from the parent. Given the amount of restructuring done at the company level and our relatively upbeat outlook for industrial activity throughout the world, we think the downside scenario is less likely than the other two.

**Economic Moat**

General Electric's wide economic moat stems from three factors that provide a solid foundation for sustainable profitability: strong service support for its installed base, a shift in the portfolio toward more moatworthy assets, and strong economies of scope that are very difficult to replicate quickly.

GE's core energy, health-care, and aviation businesses each benefit heavily from the company's intense effort on increasing service revenue for every piece of equipment that it sells. Although this is nothing new, GE's approach is more aggressive than that of industry peers, and its execution is impressive. In the case of gas turbines, each unit has a set service routine that is embedded in the engineering specifications. If a customer chooses to ignore the service schedule, repairing any malfunction down the road is at the buyer's expense. Downtime and unexpected maintenance expenses result from not using GE's service plan, and customers typically prefer to avoid such consequences. The service component is a big deal because contracts last a long time (more than a decade for energy equipment and five years for health-care equipment) and typically boast operating margins in excess of 25%, whereas equipment sales produce operating margins lower than 10%. High margins on the service side of a deal give GE flexibility on equipment pricing.

GE Capital once was one of the moat pillars for GE. Its valuable AAA credit rating gave it a lower cost of borrowing, producing higher net interest margins on its book of business. The credit rating was lowered in spring 2009, wiping away that benefit. We don't think GE Capital is a wide-moat business, but aspects of it strengthen GE's industrial moats. GE Capital can help finance purchases of GE's jet engines, medical scanners, and power equipment, which we think helps GE capture additional sales opportunities. GE Capital's expansion into different types of loans exposed it to unnecessary risks, which we think it had no fundamental advantage in underwriting. The financial crisis forced the company to rethink and cut the bank down to its bare essentials. Although this will lower the bank's margin contribution down the road, we believe this paring more closely links GECS to GE's other businesses, and this is positive, in our opinion.

Unlike other diversified manufacturers that have few synergies among business units, GE's businesses support one another, lowering operating costs compared with operating as stand-alone entities. This is notable in research and development. New information learned when trying to reduce the weight of a jet engine fan blade can quickly be applied to a gas turbine engine. Spreading R&D costs across a larger base of interested parties means that GE can pursue projects that may be unprofitable for pure-play firms. These economies of scope extend throughout the organization, from leadership development to new market expansion. Even though these softer factors are tough to quantify, we think replicating these advantages is sufficiently difficult, and this gives us confidence that GE has an ability to generate sustainable economic profits.

**Moat Trend**

General Electric's core industrial franchises give the firm its wide economic moat and a stable moat trend. This wide-moat standing is based on sticky, high-margin customer relationships in aerospace and energy infrastructure, protected by long-term contracts and the large capital investments necessary to succeed. Within its health-care segment, GE is able to block out other imaging and diagnostic companies by developing relationships with hospitals that agree to use GE equipment exclusively in return for pricing discounts on equipment. GE's ability to enter new markets and quickly earn solid returns also helps the firm evolve over time, giving it a clear advantage over companies without its size and experience.

Although the industrial operations have established a wide moat for GE, its narrow- to no-moat finance business risks diluting the company's otherwise unyielding competitive stronghold. With a once-stellar AAA credit rating, the financial services group was able overcome the natural cost of funding advantage that deposit-holding banks have. However, the loss of GE's AAA rating increases the firm's cost of funding and diminishes its ability to earn sustainable economic profits in the finance unit. GE has developed solid expertise in aviation lending and debtor-in-possession financing. When combined with a drastically smaller competitive landscape after the recession, we think GE has the ability to earn decent returns within GE Capital. While GE Capital is not a wide-moat franchise, we think the negative risk associated with the business has largely dissipated. Similarly, we don't think its appliance operations possess the impenetrable competitive advantages that are necessary to earn excess returns in their respective markets during an extended period, but should be a solid source of cash for other avenues of growth.

Despite exposure to some less moatworthy businesses than the core industrial operations, the sum of all GE's businesses still equates to a wide moat. We think returns will remain well above its cost of capital, and manageable competitive threats aid our stable moat trend assessment.

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## Bulls Say/Bears Say

**Bulls Say**

- With the problems created by GE Capital further in the rearview mirror, GE now has time to focus efforts on building its wide-moat industrial businesses.

- The disposition of the remaining stake in Comcast boosts GE's cash position and allows the infrastructure businesses to receive more capital and management attention.

- GE's global presence allows access to more information about the direction of economic activity than other firms, giving the company an advantage in getting its feet on the ground in emerging economies.

**Bears Say**

- Efficient manufacturing programs like Six Sigma and lean manufacturing have been around long enough for other firms to successfully implement and catch up to GE, reducing the strength of GE's cost advantage.

- GE's earnings may become more cyclical with the departure of NBC Universal, the shrinking weight of lighting and appliances, and the departure of retail finance from the portfolio. The market typically places a premium on more-stable earnings bases.

- Acquiring Alstom required GE to commit to building European manufacturing capacity, which may be difficult to pare going forward.

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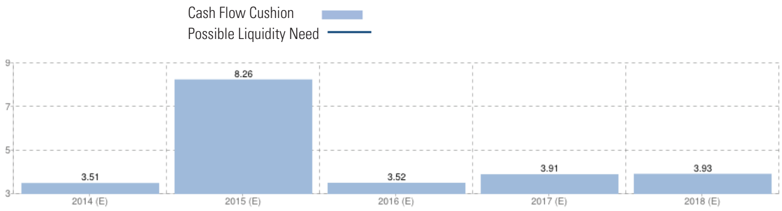
## Credit Analysis

**Five Year Adjusted Cash Flow Forecast** (USD Mil)

| | 2014(E) | 2015(E) | 2016(E) | 2017(E) | 2018(E) |
|---|---|---|---|---|---|
| Cash and Equivalents (beginning of period) | 13,682 | 12,690 | 7,515 | 873 | 81 |
| Adjusted Available Cash Flow | 13,099 | 9,400 | 9,064 | 9,893 | 10,900 |
| Total Cash Available before Debt Service | 26,781 | 22,091 | 16,579 | 10,766 | 10,980 |
| Principal Payments | -5,000 | — | -2,000 | — | — |
| Interest Payments | -1,380 | -1,380 | -1,380 | -1,380 | -1,380 |
| Other Cash Obligations and Commitments | -1,257 | -1,294 | -1,333 | -1,373 | -1,414 |
| Total Cash Obligations and Commitments | -7,637 | -2,674 | -4,713 | -2,753 | -2,794 |

**Cumulative Annual Cash Flow Cushion**




**Adjusted Cash Flow Summary**

| | USD Millions | % of Commitments |
|---|---|---|
| Beginning Cash Balance | 13,682 | 66.5 |
| Sum of 5-Year Adjusted Free Cash Flow | 52,356 | 254.5 |
| Sum of Cash and 5-Year Cash Generation | 66,038 | 321.0 |
| Revolver Availability | — | — |
| Asset Adjusted Borrowings (Repayment) | — | — |
| Sum of Cash, 5-Year Cash Generation, Revolver and Adjustments | 66,038 | 321.0 |
| Sum of 5-Year Cash Commitments | -20,571 | — |

**Credit Rating Pillars–Peer Group Comparison**

| | GE | Sector | Universe |
|---|---|---|---|
| Business Risk | 3 | 5.1 | 5.1 |
| Cash Flow Cushion | 4 | 5.7 | 6.1 |
| Solvency Score | 3 | 4.5 | 4.7 |
| Distance to Default | 4 | 3.5 | 3.7 |
| Credit Rating | AA- | BBB+ | BBB+ |

Source: Morningstar Estimates

Note: Scoring is on a scale 1-10, 1 being Best, 10 being Worst

### Financial Health & Capital Structure

GE's industrial arm uses moderate debt, with TD/EBITDA leverage of 1.3 times as of June 30. The industrial arm's capital structure is composed almost entirely of senior unsecured debt, although the industrial arm has access to $14 billion of revolving credit lines that emanate from GE Capital. The industrial arm held $10.5 billion of cash compared with $16.5 billion in debt as of June 30. GE Capital uses a mix of commercial paper (8%), bonds (62%), bank deposits (14%), and other securitized finances to fund its assets. The company has worked diligently to lower its leverage ratio, though we expect this to rise modestly as the company begins to divest the North America Retail finance business as well as return excess capital to the parent company.

### Enterprise Risk

We assign a medium uncertainty rating to General Electric, as cyclical earnings volatility is mitigated by diverse product and geographical end markets. GE's industrial businesses are susceptible to economic downturns and are particularly sensitive to changes in infrastructure spending. The health-care business is sensitive to changes in government health-care reimbursement rates. GE Capital Services originates and underwrites loans for its own portfolio, as opposed to securitizing these loans in the open market, reducing potential exposure to liquidity risk. It is, however, exposed to the creditworthiness of its counterparties, and may experience steeper write-downs as delinquencies rise. The firm's credit rating gives it access to lower-cost financing, and losing it could hurt profitability and make growth more difficult to achieve. The company's long-term growth profile closely linked to global GDP growth, our discounted cash flow analysis is also sensitive to changes in GE's operating margins.

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## Management & Ownership

### Management Activity

| Name | Position | Shares Held | Report Date* | InsiderActivity |
|---|---|---|---|---|
| JEFFREY R. IMMELT | CEO/Chairman of the Board/ Director,Director | 1,962,577 | 03 Mar 2014 | — |
| MICHAEL A. NEAL | Vice Chairman | 1,075,800 | 12 Sep 2013 | — |
| JOHN G. RICE | CEO, Divisional/President, Divisional/Vice Chairman | 469,475 | 31 Dec 2013 | — |
| BRACKETT B. DENNISTON,III | General Counsel/Senior VP/ Secretary | 362,525 | 07 Sep 2012 | — |
| KATHRYN A. CASSIDY | Senior VP/Senior VP, Subsidiary/ Treasurer/Treasurer, Subsidiary | 179,054 | 12 Sep 2013 | — |
| MR. DANIEL C. HEINTZELMAN | Vice Chairman, Divisional | 160,020 | 01 Oct 2014 | — |

*Represents the date on which the owner's name, position, and common shares held were reported by the holder or issuer.

### Fund Ownership

| Top Owners | % of Shares Held | % of Fund Assets | Change (k) | Portfolio Date |
|---|---|---|---|---|
| Vanguard Total Stock Mkt Idx | 1.66 | 1.16 | 2,256 | 31 Oct 2014 |
| SPDR® S&P 500 ETF | 1.12 | 1.47 | 45 | 20 Nov 2014 |
| Vanguard Five Hundred Index Fund | 1.05 | 1.44 | 1,705 | 31 Oct 2014 |
| Vanguard Institutional Index Fund | 1.01 | 1.44 | 4 | 31 Oct 2014 |
| VA CollegeAmerica Income Fund of America | 0.75 | 2.13 | 1,800 | 30 Sep 2014 |

| Concentrated Holders | | | | |
|---|---|---|---|---|
| Rural Renta Variable Internacional FI | — | 44.50 | 156 | 30 Jun 2014 |
| Sabadell Urquijo Patrimonio Privado 5 FI | — | 44.42 | 263 | 30 Jun 2014 |
| Tebas Investment FI | — | 43.83 | 108 | 30 Jun 2014 |
| Dux Selector Global FI | — | 23.33 | 138 | 30 Jun 2014 |
| Unifond Audaz FI | — | 22.34 | 104 | 30 Jun 2014 |

### Institutional Transactions

| Top 5 Buyers | % of Shares Held | % of Fund Assets | Shares Bought/ Sold (k) | Portfolio Date |
|---|---|---|---|---|
| GE Savings and Security Program | 4.29 | 40.09 | 457,527 | 31 Dec 2009 |
| BB&T SECURITIES, LLC | 0.26 | 1.59 | 26,056 | 30 Sep 2014 |
| Fidelity Management and Research Company | 1.17 | 0.43 | 15,903 | 30 Sep 2014 |
| T. Rowe Price Associates, Inc. | 1.40 | 0.79 | 12,725 | 30 Sep 2014 |
| Vanguard Group, Inc. | 5.20 | 1.04 | 11,409 | 30 Sep 2014 |

| Top 5 Sellers | | | | |
|---|---|---|---|---|
| D. E. Shaw & Co LP | 0.10 | 0.32 | -8,946 | 30 Sep 2014 |
| Citadel Advisors Llc | 0.01 | 0.02 | -6,455 | 30 Sep 2014 |
| Institutional Capital Corp. | 0.42 | 6.24 | -5,798 | 30 Sep 2014 |
| Northern Trust Investments, N.A. | 1.45 | 1.16 | -5,307 | 30 Sep 2014 |
| Point72 Asset Management, L.P. | 0.01 | 0.10 | -4,903 | 30 Sep 2014 |

**Management** 01 Mar 2013

GE is known for the strength and depth of its management team, which has a long history of creating value for shareholders. As testament to its depth, several former executives have gone on to lead other large companies. CEO Jeff Immelt took the reins from the legendary Jack Welch just days before 9/11, and his tenure to date has been characterized by a stronger balance sheet, significant acquisition spending, and the divestiture of most of the firm's insurance and plastics businesses. Immelt's management style is more collaborative and less transient than his predecessor's. It also keeps managers in jobs longer to take advantage of their expertise. Overall, we're satisfied with GE's corporate-governance practices but would prefer to see Immelt's variable compensation more closely linked to return on invested capital, as that metric provides a better proxy for corporate stewardship than operating cash flow. Our favorable view of the company's stewardship has been tempered by the financial crisis and the company's need to dilute shareholders in the fall of 2008 to support GE Capital.

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## Analyst Notes

**GECAS Adds to Aircraft Leasing Portfolio With $1.8B Acquisition of Milestone Aviation Group** 13 Oct 2014

GE Capital Aviation Services announced on Oct. 13 its intention to acquire Dublin-based Milestone Aviation Group for $1.8 billion. Milestone brings 168 helicopters to GECAS' aircraft portfolio, which historically focused on leasing commercial jets. In our opinion, the move is consistent with General Electric's ongoing efforts to dispose of noncore financing assets and concentrate on its industrial businesses. We believe that adding helicopters to the fleet increases the industrial relevance of the company's legacy aircraft business, allowing GE to further penetrate sectors such as emergency services, mining, and fast-growing oil and gas. With our view that the acquisition largely complements GE's competitive advantages, we reiterate the firm's wide moat rating and don't expect a material impact to our fair value estimate of $29 per share based on this news.

**GE Agrees to Sell Home Appliances Unit to Electrolux for $3.3 Billion in Cash** 08 Sep 2014

On Sept. 8, GE announced the intention to sell its home appliances business to Swedish manufacturer Electrolux for approximately $3.3 billion in cash. In our opinion, the strength of the GE appliances brand combined with favorable expectations for a rebound in housing at this point in the economic cycle both garnered support for a valuation of nearly 8 times trailing 12 month EBITDA. As the deal closes in 2015, GE expects to net a gain of approximately $0.05-$0.07 per share.

In our opinion, the deal makes sense for both parties. Adding GE's storied brand to its portfolio of higher-end appliances broadens Electrolux's reach in the U.S., where it competes head to head with Whirlpool. For GE, shedding the cyclical appliance unit monetizes a valuable consumer-oriented brand, while allowing the company to focus on supporting business segments that serve faster-growing industrial end-markets. We plan to analyze the impact this impending sale will have on our current fair value estimate of $29 per share; however, we don't intend to alter our wide moat rating for GE based on this news.

**GE Delivers Solid Results in the Second Quarter; Anticipates Late July Spin-Off of Synchrony** 15 Aug 2014

General Electric delivered operating earnings of $0.39 per share, up nearly 10% from the prior year. The company's performance in the quarter was on pace with our expectations for the firm and does not alter our wide economic moat rating. The company's year-over-year organic growth rate of 6% and order growth rate of 4% reflect healthy growth in the core business. The diversity of GE's industrial businesses helped stabilize overall growth as strength in the power and aviation businesses offset tepid demand in the U.S. health-care markets. Consolidated industrial operating margins improved 20 basis points versus the prior year. Our current financial forecast is predicated on continued improvement in operating margins due to overhead cost reductions and integration of recent acquisitions in the oil and gas and aviation segments. We reiterate our $29 fair value estimate.

The quarter's result was overshadowed somewhat by updates on portfolio moves by the company regarding Synchrony and Alstom. GE expects to formally spin off Synchrony by the end of July, though the company will retain an 85% stake in the business. As previously indicated, all of the proceeds from the initial spin will be reinvested in Synchrony, giving the company resources to begin to operate as an independent organization. GE received signed approvals from the French government and the Alstom board of directors to proceed with its acquisition of Alstom's power assets and controlling interest in three additional joint ventures in nuclear energy, renewable energy, and grid

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## Analyst Notes

infrastructure. The deal is expected to close in mid-2015. Both the Alstom and Synchrony transactions are consistent with GE's longer-term strategy of increasing the exposure to industrial businesses in the overall earnings mix. The company is now targeting 75% of earnings from industrials by 2016, a stark contrast to the prerecession earnings mix.

**Synchrony Financial's IPO Offers Upside to Initial Pricing** 30 Jul 2014

With most retail-focused financial institutions having fully rebounded from the 2008-09 financial crisis, General Electric has decided to spin off its consumer credit operations, Synchrony Financial. We think this IPO presents an opportunity for investors to acquire a narrow moat, high-return financial company that is deeply undervalued if initial pricing holds. Given our fair value estimate of $36 per share, we think there is substantial upside to the $24.50 midpoint of Synchrony's initial pricing range. Our valuation implies a 2015 multiple of 10.3 times, in line with our fair value estimate of the next-largest private label card issuer, Citigroup. With improved asset quality and profitability, we think the timing is right for GE to realize value in a division that was a distraction for its core businesses and management during the crisis. The total offering consists of up 125 million common shares, with an additional 18.75 million shares in the overallotment. GE will retain approximately 85% of the total 830.3 million shares of Synchrony after the IPO. At a proposed range of $23-$26 per common share, the pro forma market capitalization will equal approximately $20 billion. Synchrony will consider both initiating a dividend and repurchasing stock in the future, should it obtain approval from the Federal Reserve Board. Overall, it makes sense that the initial pricing would allow for substantial upside in the post market. GE has committed to returning $90 billion to shareholders by 2016, and the Synchrony asset is a key contributor. We believe by underpricing the initial 15% stake and potentially benefiting from a strong initial stock price performance, GE will draw more attention and investor interest in the value of its remaining 85% stake, making it easier to sell the remaining investment in 2015.

Synchrony Financial was previously known as General Electric Capital Retail Bank, with its roots in the consumer finance business tracing back to 1932. Today, it is the largest provider of private-label credit cards in the U.S. based on purchase volume and receivables. Overall, Synchrony provides a range of credit products through programs established with a diverse group of national and regional retailers, local merchants, manufacturers, industry associations, and health-care providers, which the company refers to as its "partners." Through its partners' 329,000 locations in the U.S. and Canada, their websites and mobile applications, Synchrony offers a variety of credit options to finance the purchase of goods and services through three sales platforms: Retail Card (private-label credit cards), Payment Solutions (consumer financing for major purchases), and CareCredit (financing for elective health-care procedures). The firm generated $11 billion in revenue and $2 billion in net profit in 2013, and about two-thirds of its operations are tied to its retail card platform.

We think Synchrony has a narrow moat as it has built strong switching costs around its ecosystem of partners, and as a result, helping the company earn high yields and margins in its Retail Card business. With more than two-thirds of its revenue from private-label credit cards, Synchrony employs a unique model to retain and nurture retailers which is beneficial to both entities. The primary way that the Retail Card partners stick with Synchrony is through the retailer share arrangements. These arrangements provide payments to retailers from Synchrony once economic performance levels of the program exceed a contractually defined threshold. These shared economics enhance partners' engagement with Synchrony and provides an

# General Electric Co GE (NYSE) | ★★★

| Last Price | Fair Value | Consider Buy | Consider Sell | Uncertainty | Economic Moat™ | Moat Trend™ | Stewardship | Morningstar Credit Rating | Industry Group |
|---|---|---|---|---|---|---|---|---|---|
| 26.99 USD | 29.00 USD | 20.30 USD | 39.15 USD | Medium | Wide | Stable | Standard | AA- | Industrial Products |

## Analyst Notes

incentive for the retailers to support the program through store discounts, as an example. Furthermore, Synchrony maintains deeply integrated technology with their partners' systems and processes enabling them to provide customized credit products and solutions to their partners' customers at the point of sale. Synchrony's online and mobile technologies are capable of being integrated into their partners' systems with little difficulty and enabling customers to check available credit, manage their account, access customer service, and participate in partner loyalty programs. We think that the stickiness of the partner relationship, as demonstrated by the average length of Synchrony's relationship with all of its Retail Card partners of 15 years, gives it a competitive advantage over other bank card issuers, particularly in the private label arena.

**Alstom's Order Book Gains Steam as End Markets Improve** 23 Jul 2014

Alstom provided its first fiscal quarter update and, while an agreement has been finally reached that satisfied Alstom, GE, and France, the company's order book has steadily solidified. Consolidated orders increased 104% versus the prior year, with the South African rail project leading the way. In addition, grid orders were up 40% and renewable energy orders were up over 25% versus the prior year.

As we previously surmised, Alstom's financial concerns were largely a matter of timing as the core business continues to pave the road for future growth. While the current revenue decline of 1% is disconcerting, momentum is improving for Alstom and its end markets, which should bode well for earnings in the medium term.

**Alstom and French Government Back GE's Bid for Power and Grid Assets** 23 Jun 2014

After another round of bidding by suitors, Alstom's board and--perhaps more important--the French government have backed General Electric's bid to acquire Alstom's power and grid business for EUR 12.35 billion. The deal does not change our wide moat rating for General Electric or our no-moat rating for Alstom. GE's previous agreed-upon bid was neutralized by the French government, which erected rules to give it power to reject any acquisition that it determined was not in the best interest of France. This rejection prompted bids from a Siemens/Mitsubishi partnership and a better offer from GE. Once the deal closes, Alstom will receive EUR 12.35 billion of cash from GE as well as three joint venture interests in nuclear energy, renewable energy, and grid. Additionally, Alstom is purchasing GE's rail switching business, which generated roughly $500 million in sales in 2013.

For GE, this deal helps push the company to its targeted goal of increasing exposure to industrial end markets. In our opinion, this also has the potential to enhance GE's already wide moat by allowing the company's strong service organization to take advantage of Alstom's large installed base. Between this deal and the company's spin-off of the North American retail finance business, Synchrony, GE's earnings mix should meaningfully favor industrials by year-end 2015. We maintain our fair value estimates for General Electric and Alstom.

**Bouygues Gives French Government Option to Buy 20% of Alstom to Help Deal With GE** 23 Jun 2014

Over the weekend, Alstom announced it would recommend General Electric's updated proposal, in which GE will acquire Alstom's thermal power, renewable, and grid sectors for a fixed price representing an equity value of EUR 12.35 billion ($16.8 billion) and an enterprise value of EUR 11.4 billion. Additionally, the two firms will form joint ventures in grid and renewable power. The joint ventures will consist of a 50/50 ownership of the combined Alstom Grid and GE Digital Energy. There will also be a 50/50 ownership of Alstom's offshore wind and hydro businesses

# General Electric Co GE (NYSE) | ★★★

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|---|---|---|---|---|---|---|---|---|---|
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## Analyst Notes

and a 50/50 split of the global nuclear and French steam alliance. Finally, GE will sell its signaling business to Alstom.

To help facilitate these plans, Bouygues has agreed to sell the French government as much as 20% of Alstom for a period of 20 months. The government will also have veto and governance rights over issues relating to security and nuclear plant technology in France. The option granted to the government is conditional upon the actual completion of the plans and on a theoretical adjusted price of EUR 35 per share after all the GE deals have been completed. If fully exercised, this would reduce Bouygues' ownership stake in Alstom to below 10%. While Alstom, particularly in signaling, and Bouygues, particularly through Colas, have worked together on some projects, we don't think Bouygues' reduced ownership stake in Alstom would affect the relationship. Even Bouygues' 100%-owned construction businesses don't always partner with a sister company. We expect the two firms will continue to work with each other when it makes economic sense for both. With no assurance that the French state will actually exercise its options, we are maintaining our fair value estimate and moat rating for Bouygues. We are reviewing our fair value estimates for GE and Alstom.

# General Electric Co GE (NYSE) | ★★★

| Last Price | Fair Value | Consider Buy | Consider Sell | Uncertainty | Economic Moat™ | Moat Trend™ | Stewardship | Morningstar Credit Rating | Industry Group |
|---|---|---|---|---|---|---|---|---|---|
| 26.99 USD | 29.00 USD | 20.30 USD | 39.15 USD | Medium | Wide | Stable | Standard | AA- | Industrial Products |

## Morningstar Analyst Forecasts

### Financial Summary and Forecasts

Fiscal Year Ends in December

| Growth (% YoY) | 3-Year Hist. CAGR | 2011 | 2012 | 2013 | Forecast 2014 | Forecast 2015 | 5-Year Proj. CAGR |
|---|---|---|---|---|---|---|---|
| Revenue | -0.2 | -1.2 | 0.6 | 0.1 | 7.2 | 7.3 | 7.3 |
| EBIT | -9.3 | 2.3 | -22.5 | -5.9 | 29.1 | 10.3 | 13.5 |
| EBITDA | -7.4 | 0.7 | -18.2 | -3.7 | 23.5 | 8.7 | 11.3 |
| Net Income | 9.0 | 6.7 | 13.4 | 6.9 | 8.9 | 7.7 | 6.2 |
| Diluted EPS | 10.3 | 7.3 | 14.0 | 9.8 | 11.4 | 14.0 | 8.6 |
| Earnings Before Interest, after Tax | 13.3 | 1.8 | 58.8 | -10.0 | 30.0 | 5.5 | 9.0 |
| Free Cash Flow | 25.0 | -51.9 | 181.2 | 44.5 | -35.9 | 6.9 | -5.4 |

| Profitability | 3-Year Hist. Avg | 2011 | 2012 | 2013 | 2014 | 2015 | 5-Year Proj. Avg |
|---|---|---|---|---|---|---|---|
| Operating Margin % | 11.6 | 13.9 | 10.7 | 10.1 | 12.1 | 12.5 | 12.8 |
| EBITDA Margin % | 13.8 | 16.0 | 13.0 | 12.5 | 14.4 | 14.6 | 14.7 |
| Net Margin % | 14.4 | 13.0 | 14.7 | 15.7 | 15.9 | 16.0 | 15.3 |
| Free Cash Flow Margin % | 14.4 | 5.5 | 15.4 | 22.2 | 13.3 | 13.2 | 12.5 |
| ROIC % | 13.6 | 10.3 | 14.8 | 15.9 | 20.1 | 21.5 | 21.7 |
| Adjusted ROIC % | 14.1 | 11.5 | 15.9 | 14.9 | 18.5 | 18.8 | 18.5 |
| Return on Assets % | 5.6 | 5.8 | 5.6 | 5.5 | 6.5 | 7.1 | 7.4 |
| Return on Equity % | 11.0 | 11.2 | 11.4 | 10.3 | 11.4 | 12.6 | 13.3 |

| Leverage | 3-Year Hist. Avg | 2011 | 2012 | 2013 | 2014 | 2015 | 5-Year Proj. Avg |
|---|---|---|---|---|---|---|---|
| Debt/Capital | 0.10 | 0.09 | 0.12 | 0.09 | 0.10 | 0.11 | 0.11 |
| Total Debt/EBITDA | 1.04 | 0.72 | 1.33 | 1.06 | 0.95 | 0.94 | 0.86 |
| EBITDA/Interest Expense | 10.49 | 12.33 | 9.68 | 9.46 | 11.28 | 12.26 | 13.39 |

### Valuation Summary and Forecasts

| | 2012 | 2013 | 2014(E) | 2015(E) |
|---|---|---|---|---|
| Price/Fair Value | 0.84 | 1.04 | — | — |
| Price/Earnings | 15.0 | 18.2 | 15.8 | 13.8 |
| EV/EBITDA | 35.1 | 38.0 | 28.7 | 26.4 |
| EV/EBIT | 42.6 | 47.1 | 34.1 | 30.9 |
| Free Cash Flow Yield % | 6.4 | 3.8 | 5.3 | 5.9 |
| Dividend Yield % | 3.3 | 2.8 | 3.3 | 3.3 |

### Key Valuation Drivers

| | |
|---|---|
| Cost of Equity % | 10.0 |
| Pre-Tax Cost of Debt % | 3.5 |
| Weighted Average Cost of Capital % | 7.8 |
| Long-Run Tax Rate % | 22.8 |
| Stage II EBI Growth Rate % | 4.0 |
| Stage II Investment Rate % | 33.3 |
| Perpetuity Year | 20 |

Additional estimates and scenarios available for download at http://select.morningstar.com.

### Discounted Cash Flow Valuation

| | USD Mil | Firm Value (%) | Per Share Value |
|---|---|---|---|
| Present Value Stage I | 61,938 | 19.9 | 6.21 |
| Present Value Stage II | 123,450 | 39.6 | 12.38 |
| Present Value Stage III | 126,236 | 40.5 | 12.66 |
| **Total Firm Value** | **311,624** | **100.0** | **31.26** |
| Cash and Equivalents | 14,005 | — | 1.40 |
| Debt | -13,356 | — | -1.34 |
| Preferred Stock | — | — | — |
| Other Adjustments | -27,023 | — | -2.71 |
| **Equity Value** | **285,250** | **—** | **28.61** |
| Projected Diluted Shares | 9,970 | | |
| **Fair Value per Share** (USD) | — | | |

The data in the table above represent base-case forecasts in the company's reporting currency as of the beginning of the current year. Our fair value estimate may differ from the equity value per share shown above due to our time value of money adjustment and in cases where probability-weighted scenario analysis is performed.

# General Electric Co GE (NYSE) | ★★★

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## Morningstar Analyst Forecasts

**Income Statement** (USD Mil)
Fiscal Year Ends in December

| | 2011 | 2012 | 2013 | *Forecast* 2014 | *Forecast* 2015 |
|---|---|---|---|---|---|
| **Revenue** | **100,305** | **100,875** | **101,014** | ***108,270*** | ***116,151*** |
| Cost of Goods Sold | 68,804 | 70,536 | 72,880 | *78,115* | *83,801* |
| **Gross Profit** | **31,501** | **30,339** | **28,134** | ***30,155*** | ***32,350*** |
| Selling, General & Administrative Expenses | 12,955 | 17,672 | 16,105 | *17,262* | *18,518* |
| Research & Development | 4,601 | 4,520 | 4,750 | *5,091* | *5,462* |
| Other Operating Expense (Income) | — | -2,657 | -2,886 | *-5,322* | *-6,104* |
| Depreciation & Amortization (if reported separately) | — | — | — | — | — |
| **Operating Income (ex charges)** | **13,945** | **10,804** | **10,165** | ***13,124*** | ***14,473*** |
| Restructuring & Other Cash Charges | — | — | — | — | — |
| Impairment Charges (if reported separately) | — | — | — | — | — |
| Other Non-Cash (Income)/Charges | — | — | — | — | — |
| **Operating Income (incl charges)** | **13,945** | **10,804** | **10,165** | ***13,124*** | ***14,473*** |
| Interest Expense | 1,299 | 1,353 | 1,333 | *1,380* | *1,380* |
| Interest Income | — | — | — | — | — |
| **Pre-Tax Income** | **12,646** | **9,451** | **8,832** | ***11,744*** | ***13,093*** |
| Income Tax Expense | 4,839 | 2,013 | 1,668 | *2,680* | *2,985* |
| Other After-Tax Cash Gains (Losses) | — | — | — | *5,922* | *6,348* |
| Other After-Tax Non-Cash Gains (Losses) | 6,509 | 6,363 | 6,138 | — | — |
| (Minority Interest) | -165 | -160 | -245 | — | — |
| (Preferred Dividends) | -1,031 | — | — | — | — |
| **Net Income** | **13,120** | **13,641** | **13,057** | ***14,986*** | ***16,456*** |
| Weighted Average Diluted Shares Outstanding | 10,620 | 10,564 | 10,289 | *10,058* | *9,500* |
| **Diluted Earnings Per Share** | **1.24** | **1.29** | **1.27** | ***1.49*** | ***1.73*** |
| Adjusted Net Income | 13,043 | 14,793 | 15,820 | *17,222* | *18,540* |
| **Diluted Earnings Per Share (Adjusted)** | **1.23** | **1.40** | **1.54** | ***1.71*** | ***1.95*** |
| Dividends Per Common Share | 0.61 | 0.68 | 0.76 | *0.88* | *0.94* |
| **EBITDA** | **16,013** | **13,095** | **12,614** | ***15,573*** | ***16,922*** |
| **Adjusted EBITDA** | **16,013** | **13,095** | **12,614** | ***15,573*** | ***16,922*** |

# General Electric Co GE (NYSE) | ★★★

| Last Price | Fair Value | Consider Buy | Consider Sell | Uncertainty | Economic Moat™ | Moat Trend™ | Stewardship | Morningstar Credit Rating | Industry Group |
|---|---|---|---|---|---|---|---|---|---|
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## Morningstar Analyst Forecasts

**Balance Sheet** (USD Mil)

| Fiscal Year Ends in December | 2011 | 2012 | 2013 | *Forecast 2014* | *2015* |
|---|---|---|---|---|---|
| Cash and Equivalents | 8,382 | 15,509 | 13,682 | *12,690* | *7,515* |
| Investments | — | — | 323 | *323* | *323* |
| Accounts Receivable | 11,807 | 10,872 | 10,970 | *11,865* | *12,729* |
| Inventory | 13,741 | 15,295 | 17,257 | *16,051* | *17,219* |
| Deferred Tax Assets (Current) | — | — | — | — | — |
| Other Short Term Assets | 18 | 74 | — | — | — |
| **Current Assets** | **33,948** | **41,750** | **42,232** | ***40,930*** | ***37,786*** |
| | | | | | |
| Net Property Plant, and Equipment | 14,283 | 16,033 | 17,574 | *19,442* | *21,395* |
| Goodwill | 45,395 | 46,143 | 51,453 | *52,953* | *54,528* |
| Other Intangibles | 10,522 | 10,700 | 13,180 | *12,669* | *12,218* |
| Deferred Tax Assets (Long-Term) | 18,433 | 17,858 | 5,061 | *5,061* | *5,061* |
| Other Long-Term Operating Assets | 36,675 | 37,936 | 23,717 | *23,717* | *23,717* |
| Long-Term Non-Operating Assets | 77,162 | 77,939 | 77,745 | *77,745* | *77,745* |
| **Total Assets** | **236,418** | **248,359** | **230,962** | ***232,517*** | ***232,450*** |
| | | | | | |
| Accounts Payable | 14,209 | 14,259 | 16,353 | *14,981* | *16,071* |
| Short-Term Debt | 2,184 | 6,041 | 1,841 | *1,841* | *1,841* |
| Deferred Tax Liabilities (Current) | — | — | — | — | — |
| Other Short-Term Liabilities | 27,942 | 27,753 | 28,753 | *28,753* | *28,753* |
| **Current Liabilities** | **44,335** | **48,053** | **46,947** | ***45,575*** | ***46,665*** |
| | | | | | |
| Long-Term Debt | 9,405 | 11,428 | 11,515 | *13,000* | *14,000* |
| Deferred Tax Liabilities (Long-Term) | 11,250 | 11,912 | 10,233 | *10,540* | *10,856* |
| Other Long-Term Operating Liabilities | — | — | — | — | — |
| Long-Term Non-Operating Liabilities | 53,984 | 53,163 | 30,865 | *30,865* | *30,865* |
| **Total Liabilities** | **118,974** | **124,556** | **99,560** | ***99,980*** | ***102,387*** |
| | | | | | |
| Preferred Stock | — | — | — | — | — |
| Common Stock | 702 | 702 | 702 | *702* | *702* |
| Additional Paid-in Capital | 33,693 | 33,070 | 32,494 | *32,494* | *32,494* |
| Retained Earnings (Deficit) | 137,786 | 144,055 | 149,051 | *155,186* | *162,712* |
| (Treasury Stock) | -31,769 | -34,571 | -42,561 | *-47,561* | *-57,561* |
| Other Equity | -23,974 | -20,230 | -9,120 | *-9,120* | *-9,120* |
| **Shareholder's Equity** | **116,438** | **123,026** | **130,566** | ***131,701*** | ***129,227*** |
| | | | | | |
| Minority Interest | 1,006 | 777 | 836 | *836* | *836* |
| **Total Equity** | **117,444** | **123,803** | **131,402** | ***132,537*** | ***130,063*** |

# General Electric Co GE (NYSE) | ★★★

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|---|---|---|---|---|---|---|---|---|---|
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## Morningstar Analyst Forecasts

**Cash Flow** (USD Mil)

| Fiscal Year Ends in December | 2011 | 2012 | 2013 | *Forecast 2014* | *Forecast 2015* |
|---|---|---|---|---|---|
| Net Income | 14,151 | 13,641 | 13,302 | *14,986* | *16,456* |
| Depreciation | 324 | 679 | 738 | *738* | *738* |
| Amortization | 1,744 | 1,612 | 1,711 | *1,711* | *1,711* |
| Stock-Based Compensation | — | — | — | — | — |
| Impairment of Goodwill | — | — | — | — | — |
| Impairment of Other Intangibles | — | — | — | — | — |
| Deferred Taxes | -327 | -294 | -2,571 | *307* | *316* |
| Other Non-Cash Adjustments | -6,432 | -975 | -398 | — | — |
| (Increase) Decrease in Accounts Receivable | -390 | 1,210 | -1,432 | *-895* | *-864* |
| (Increase) Decrease in Inventory | -1,122 | -1,204 | -1,351 | *1,206* | *-1,168* |
| Change in Other Short-Term Assets | — | — | — | *150* | *158* |
| Increase (Decrease) in Accounts Payable | 1,938 | 158 | 809 | *-1,372* | *1,090* |
| Change in Other Short-Term Liabilities | 2,248 | 2,999 | 3,445 | — | — |
| **Cash From Operations** | **12,134** | **17,826** | **14,253** | ***16,831*** | ***18,438*** |
| (Capital Expenditures) | -2,957 | -3,937 | -3,680 | *-2,456* | *-2,533* |
| Net (Acquisitions), Asset Sales, and Disposals | -4,898 | -916 | 9,989 | *-3,000* | *-3,150* |
| Net Sales (Purchases) of Investments | — | — | — | — | — |
| Other Investing Cash Flows | -384 | -564 | -1,486 | — | — |
| **Cash From Investing** | **-8,239** | **-5,417** | **4,823** | ***-5,456*** | ***-5,683*** |
| Common Stock Issuance (or Repurchase) | -1,456 | -4,164 | -9,278 | *-5,000* | *-10,000* |
| Common Stock (Dividends) | -6,458 | -7,189 | -7,821 | *-8,851* | *-8,930* |
| Short-Term Debt Issuance (or Retirement) | 1,058 | -890 | -3,571 | — | — |
| Long-Term Debt Issuance (or Retirement) | -93 | 6,927 | — | *1,485* | *1,000* |
| Other Financing Cash Flows | -7,678 | 32 | -211 | — | — |
| **Cash From Financing** | **-14,627** | **-5,284** | **-20,881** | ***-12,366*** | ***-17,930*** |
| Exchange Rates, Discontinued Ops, etc. (net) | -127 | 2 | -22 | — | — |
| **Net Change in Cash** | **-10,859** | **7,127** | **-1,827** | ***-992*** | ***-5,176*** |

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|---|---|---|---|---|---|---|---|---|---|
| 26.99 USD | 29.00 USD | 20.30 USD | 39.15 USD | Medium | Wide | Stable | Standard | AA- | Industrial Products |

## Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

### Valuation Analysis

| | | Price/Earnings | | | EV/EBITDA | | | Price/Free Cash Flow | | | Price/Book | | | Price/Sales | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Company/Ticker | Price/Fair Value | 2013 | 2014(E) | 2015(E) | 2013 | 2014(E) | 2015(E) | 2013 | 2014(E) | 2015(E) | 2013 | 2014(E) | 2015(E) | 2013 | 2014(E) | 2015(E) |
| United Technologies Corp UTX USA | 0.96 | 18.2 | 16.1 | 14.7 | 10.9 | 9.7 | 9.2 | 17.9 | 14.5 | 10.9 | 3.3 | 2.9 | 2.6 | 1.7 | 1.5 | 1.5 |
| Royal Philips NV PHG USA | 0.85 | 28.0 | 53.7 | 21.6 | 7.9 | 10.4 | 7.2 | 45.7 | 13.6 | 11.7 | 2.2 | 2.1 | 2.1 | 1.1 | 1.0 | 0.9 |
| Average | | 23.1 | 34.9 | 18.2 | 9.4 | 10.1 | 8.2 | 31.8 | 14.1 | 11.3 | 2.8 | 2.5 | 2.4 | 1.4 | 1.3 | 1.2 |
| **General Electric Co GE US** | **0.93** | **18.2** | **15.8** | **13.8** | **38.0** | **28.7** | **26.4** | **26.7** | **18.9** | **17.0** | **2.2** | **2.1** | **2.1** | **2.8** | **2.5** | **2.3** |

### Returns Analysis

| | | ROIC % | | | Adjusted ROIC % | | | Return on Equity % | | | Return on Assets % | | | Dividend Yield % | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Company/Ticker | Last Historical Year Total Assets (Mil) | 2013 | 2014(E) | 2015(E) | 2013 | 2014(E) | 2015(E) | 2013 | 2014(E) | 2015(E) | 2013 | 2014(E) | 2015(E) | 2013 | 2014(E) | 2015(E) |
| United Technologies Corp UTX USA | 90,594 USD | 12.4 | 13.5 | 13.9 | 13.5 | 14.9 | 15.9 | 19.8 | 18.8 | 18.6 | 6.4 | 6.8 | 7.2 | 1.8 | 2.2 | 2.3 |
| Royal Philips NV PHG USA | 26,559 EUR | 12.9 | 9.2 | 13.9 | 13.3 | 9.6 | 14.2 | 10.5 | 4.7 | 12.1 | 4.2 | 2.0 | 4.9 | 1.1 | 3.4 | 3.4 |
| Average | | 12.7 | 11.4 | 13.9 | 13.4 | 12.3 | 15.1 | 15.2 | 11.8 | 15.4 | 5.3 | 4.4 | 6.1 | 1.5 | 2.8 | 2.9 |
| **General Electric Co GE US** | **230,962** USD | **15.9** | **20.1** | **21.5** | **14.9** | **18.5** | **18.8** | **10.3** | **11.4** | **12.6** | **5.5** | **6.5** | **7.1** | **2.8** | **3.3** | **3.3** |

### Growth Analysis

| | | Revenue Growth % | | | EBIT Growth % | | | EPS Growth % | | | Free Cash Flow Growth % | | | Dividend/Share Growth % | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Company/Ticker | Last Historical Year Revenue (Mil) | 2013 | 2014(E) | 2015(E) | 2013 | 2014(E) | 2015(E) | 2013 | 2014(E) | 2015(E) | 2013 | 2014(E) | 2015(E) | 2013 | 2014(E) | 2015(E) |
| United Technologies Corp UTX USA | 62,626 USD | 8.5 | 4.6 | 5.2 | 19.9 | 9.0 | 6.5 | 10.5 | 9.6 | 9.8 | -152.7 | -3.8 | 38.6 | 7.9 | 13.2 | 7.6 |
| Royal Philips NV PHG USA | 23,329 EUR | -5.9 | -3.7 | 2.7 | 96.0 | -51.3 | 107.9 | 159.8 | -59.1 | 148.7 | -76.4 | 297.2 | 17.1 | — | 6.7 | — |
| Average | | 1.3 | 0.4 | 4.0 | 58.0 | -21.2 | 57.2 | 85.2 | -24.8 | 79.3 | -114.6 | 146.7 | 27.9 | 7.9 | 10.0 | 7.6 |
| **General Electric Co GE US** | **101,014** USD | **0.1** | **7.2** | **7.3** | **-5.9** | **29.1** | **10.3** | **9.8** | **11.4** | **14.0** | **44.5** | **-35.9** | **6.9** | **11.7** | **15.8** | **6.8** |

# General Electric Co GE (NYSE) | ★★★

| Last Price | Fair Value | Consider Buy | Consider Sell | Uncertainty | Economic Moat™ | Moat Trend™ | Stewardship | Morningstar Credit Rating | Industry Group |
|---|---|---|---|---|---|---|---|---|---|
| 26.99 USD | 29.00 USD | 20.30 USD | 39.15 USD | Medium | Wide | Stable | Standard | AA- | Industrial Products |

## Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

### Profitability Analysis

| | | Gross Margin % | | | EBITDA Margin % | | | Operating Margin % | | | Net Margin % | | | Free Cash Flow Margin % | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Company/Ticker | Last Historical Year Net Income (Mil) | 2013 | *2014(E)* | *2015(E)* | 2013 | *2014(E)* | *2015(E)* | 2013 | *2014(E)* | *2015(E)* | 2013 | *2014(E)* | *2015(E)* | 2013 | *2014(E)* | *2015(E)* |
| United Technologies Corp UTX USA | 5,721 USD | 27.6 | *27.6* | *27.6* | 17.6 | *18.1* | *18.2* | 14.7 | *15.3* | *15.5* | 9.1 | *9.6* | *9.8* | 9.3 | *10.6* | *13.4* |
| Royal Philips NV PHG USA | 1,217 EUR | 41.5 | *41.5* | *41.5* | 14.4 | *10.3* | *14.5* | 8.7 | *4.4* | *8.9* | 5.2 | *2.2* | *5.4* | 2.4 | *7.0* | *8.0* |
| Average | | 34.6 | *34.6* | *34.6* | 16.0 | *14.2* | *16.4* | 11.7 | *9.9* | *12.2* | 7.2 | *5.9* | *7.6* | 5.9 | *8.8* | *10.7* |
| **General Electric Co GE US** | **15,820** USD | **27.9** | ***27.9*** | ***27.9*** | **12.5** | ***14.4*** | ***14.6*** | **10.1** | ***12.1*** | ***12.5*** | **15.7** | ***15.9*** | ***16.0*** | **10.5** | ***13.3*** | ***13.7*** |

### Leverage Analysis

| | | Debt/Equity % | | | Debt/Total Cap % | | | EBITDA/Interest Exp. | | | Total Debt/EBITDA | | | Assets/Equity | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Company/Ticker | Last Historical Year Total Debt (Mil) | 2013 | *2014(E)* | *2015(E)* | 2013 | *2014(E)* | *2015(E)* | 2013 | *2014(E)* | *2015(E)* | 2013 | *2014(E)* | *2015(E)* | 2013 | *2014(E)* | *2015(E)* |
| United Technologies Corp UTX USA | 20,241 USD | 63.5 | *57.2* | *48.7* | 38.9 | *36.4* | *32.8* | 12.3 | *13.6* | *14.3* | 1.8 | *1.7* | *1.5* | 2.8 | *2.7* | *2.5* |
| Royal Philips NV PHG USA | 3,901 EUR | 34.8 | *38.1* | *38.1* | 25.8 | *27.6* | *27.6* | 8.4 | *7.7* | *11.1* | 1.2 | *1.7* | *1.2* | 2.4 | *2.5* | *2.5* |
| Average | | 49.2 | *47.7* | *43.4* | 32.4 | *32.0* | *30.2* | 10.4 | *10.7* | *12.7* | 1.5 | *1.7* | *1.4* | 2.6 | *2.6* | *2.5* |
| **General Electric Co GE US** | **13,356** USD | **10.2** | ***11.3*** | ***12.3*** | **9.3** | ***10.1*** | ***10.9*** | **9.5** | ***11.3*** | ***12.3*** | **1.1** | ***1.0*** | ***0.9*** | **1.8** | ***1.8*** | ***1.8*** |

### Liquidity Analysis

| | | Cash per Share | | | Current Ratio | | | Quick Ratio | | | Cash/Short-Term Debt | | | Payout Ratio % | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Company/Ticker | Market Cap (Mil) | 2013 | *2014(E)* | *2015(E)* | 2013 | *2014(E)* | *2015(E)* | 2013 | *2014(E)* | *2015(E)* | 2013 | *2014(E)* | *2015(E)* | 2013 | *2014(E)* | *2015(E)* |
| United Technologies Corp UTX USA | 100,556 USD | 5.05 | *7.04* | *9.69* | 1.29 | *1.39* | *1.43* | 0.84 | *0.94* | *1.00* | 9.24 | *12.88* | *17.39* | 33.4 | *34.5* | *33.6* |
| Royal Philips NV PHG USA | 26,661 USD | 2.67 | *2.46* | *2.81* | 1.35 | *1.30* | *1.35* | 0.97 | *0.92* | *0.96* | 4.16 | *3.84* | *4.39* | 59.0 | *145.7* | *59.6* |
| Average | | 3.86 | *4.75* | *6.25* | 1.32 | *1.35* | *1.39* | 0.91 | *0.93* | *0.98* | 6.70 | *8.36* | *10.89* | 46.2 | *90.1* | *46.6* |
| **General Electric Co GE US** | **271,039** USD | **1.33** | ***1.26*** | ***0.79*** | **0.90** | ***0.90*** | ***0.81*** | **0.53** | ***0.55*** | ***0.44*** | **7.43** | ***6.89*** | ***4.08*** | **59.9** | ***59.1*** | ***54.3*** |

# Research Methodology for Valuing Companies

**Components of Our Methodology**
- Economic Moat™ Rating
- Moat Trend™ Rating
- Moat Valuation
- Three-Stage Discounted Cash Flow
- Weighted Average Cost of Capital
- Fair Value Estimate
- Scenario Analysis
- Uncertainty Ratings
- Margin of Safety
- Consider Buying/Selling
- Stewardship Rating

The Morningstar Rating for stocks identifies companies trading at a discount or premium to our analysts' assessment of their fair value. A number of components drive this rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's intrinsic value based on a discounted cash-flow model, (3) the margin of safety bands we apply to our Fair Value Estimate, and (4) the current stock price relative to our fair value estimate.

The concept of the Morningstar Economic Moat™ Rating plays a vital role not only in our qualitative assessment of a firm's investment potential, but also in our valuation process. We assign three moat ratings—none, narrow, or wide—as well as the Morningstar Moat Trend™ Rating—positive, stable, or negative—to each company we cover. There are two major requirements for firms to earn either a narrow or wide moat rating: (1) the prospect of earning above-average returns on capital; and (2) some competitive edge that prevents these returns from quickly eroding. The assumptions we make about a firm's moat determine the length of "economic outperformance" that we assume in the latter stages of our valuation model. We also quantify the value of each firm's moat, which represents the difference between a firm's enterprise value and the value of the firm if no future net investment were to occur. Said differently, moat value identifies the value generated by the firm as a result of any future net new investment. Our Moat Trend Rating reflects our assessment of whether each firm's competitive advantage is either getting stronger or weaker, since we think of moats as dynamic, rather than static.

At the heart of our valuation system is a detailed projection of a company's future cash flows. The first stage of our three-stage discounted cash flow model can last from 5 to 10 years and contains numerous detailed assumptions about various financial and operating items. The second stage of our model—where a firm's return on new invested capital (RONIC) and earnings growth rate implicitly fade until the perpetuity year—can last anywhere from 0 years (for no-moat firms) to 20 years (for wide-moat companies). In our third stage, we assume the firm's RONIC equals its weighted average cost of capital, and we calculate a continuing value using a standard

**Morningstar Research Methodology for Valuing Companies**

| Fundamental Analysis | Economic Moat™ Rating | Company Valuation | Fair Value Estimate | Uncertainty Assessment | ★★★★★ ★★★★ ★★★ ★★ ★ |
|---|---|---|---|---|---|
| Analyst conducts company and industry research:<br>► Financial statement analysis<br>► Channel checks<br>► Trade-show visits<br>► Industry and company reports and journals<br>► Conference calls<br>► Management and site visits | Strength of competitive advantage is rated: None, Narrow, or Wide<br>Advantages that confer an economic moat:<br>**High Switching Costs** (Microsoft)<br>**Cost advantage** (Wal-Mart)<br>**Intangible assets** (Johnson & Johnson)<br>**Network Effect** (Mastercard)<br>**Efficient Scale** (Lockheed Martin) | Analyst considers past financial results and focuses on competitive position and future prospects to forecast future cash flows.<br>Assumptions are entered into Morningstar's proprietary discounted cash-flow model. | Analyst uses a discounted cash-flow model to develop a Fair Value Estimate, which serves as the foundation for the Morningstar Rating for stocks. | The analyst then evaluates the range of potential intrinsic values for the company and assigns an Uncertainty Rating: Low, Medium, High, Very High, or Extreme.<br>The Uncertainty Rating determines the margin of safety required before we would recommend the stock. The higher the uncertainty, the wider the margin of safety. | The current stock price relative to Morningstar's Fair Value Estimate, adjusted for uncertainty, determines the Morningstar Rating for stocks.<br>The Morningstar Rating for stocks is updated each evening after the market closes. |

# Research Methodology for Valuing Companies

**Detailed Methodology Documents and Materials***

- Comprehensive Equity Research Methodology
- Uncertainty Methodology
- Cost of Equity Methodology
- Morningstar DCF Valuation Model
- Stewardship Rating Methodology

* Please contact a sales representative for more information.

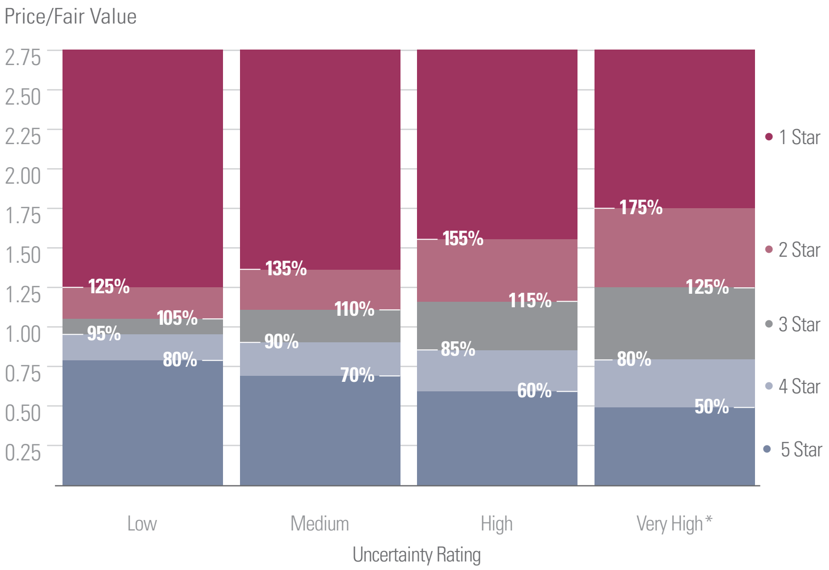
perpetuity formula. In deciding on the rate at which to discount future cash flows, we ignore stock-price volatility. Instead, we rely on a system that measures the estimated volatility of a firm's underlying future free cash flows, taking into account fundamental factors such as the diversity of revenue sources and the firm's fixed cost structure.

We also employ a number of other tools to augment our valuation process, including scenario analysis, where we assess the likelihood and performance of a business under different economic and firm-specific conditions. Our analysts typically model three to five scenarios for each company we cover, stress-testing the model and examining the distribution of resulting fair values.

The Morningstar Uncertainty Rating captures the range of these potential fair values, based on an assessment of a company's future sales range, the firm's operating and financial leverage, and any other contingent events that may impact the business. Our analysts use this range to assign an appropriate margin of safety—or the discount/premium to a fair value we apply in setting our consider buying/consider selling prices. Firms trading below our consider-buying prices receive our highest rating of five stars, whereas firms trading above our consider-selling prices receive our lowest rating of one star.

Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

**Morningstar Margin of Safety and Star Rating Bands**




* Occasionally a stock's uncertainty will be too high for us to estimate, in which case we label it Extreme.

# Morningstar's Approach to Rating Corporate Credit

- Offers a proprietary measure of the credit quality of companies on our coverage list.
- Encapsulates our in-depth modeling and quantitative work in one letter grade.
- Allows investors to rank companies by each of the four underlying components of our credit ratings, including both analyst-driven and quantitative measures.
- Provides access to all the underlying forecasts that go into the rating, available through our institutional service.

**Purpose**

The Morningstar Corporate Credit Rating measures the ability of a firm to satisfy its debt and debt-like obligations. The higher the rating, the less likely we think the company is to default on these obligations.

The Morningstar Corporate Credit Rating builds on the modeling expertise of our securities research team. For each company, we publish:

- Five years of detailed pro-forma financial statements
- Annual estimates of free cash flow
- Annual forecasts of return on invested capital
- Scenario analyses, including upside and downside cases
- Forecasts of leverage, coverage, and liquidity ratios for five years
- Estimates of off balance sheet liabilities

These forecasts are key inputs into the Morningstar Corporate Credit Rating and are available to subscribers at select.morningstar.com.

**Methodology**

We feel it's important to perform credit analysis through different lenses—qualitative and quantitative, as well as fundamental and market-driven. We therefore evaluate each company in four broad categories.

*Business Risk*

Business Risk captures the fundamental uncertainty around a firm's business operations and the cash flow generated by those operations. Key components of the Business Risk rating include the Morningstar Economic Moat™ Rating and the Morningstar Uncertainty Rating.

*Cash Flow Cushion™*

Morningstar's proprietary Cash Flow Cushion™ ratio is a fundamental indicator of a firm's future financial health The measure reveals how many times a company's internal cash generation plus total excess liquid cash will cover its debt-like contractual commitments over the next five years. The Cash Flow Cushion acts as a predictor of financial distress, bringing to light potential refinancing, operational, and liquidity risks inherent to the firm.

**Morningstar Research Methodology for Determining Corporate Credit Ratings**


**Competitive Analysis**

Analyst conducts company and industry research:

- Management interviews
- Conference calls
- Trade show visits
- Competitor, supplier, distributor, and customer interviews
- Assign Economic Moat™ Rating

**Cash-Flow Forecasts**

Analyst considers company financial statements and competitive dynamics to forecast future free cash flows to the firm.

Analyst derives estimate of Cash-Flow Cushion™.

**Scenario Analysis**

Analysts run bull and bear cases through the model to derive alternate estimates of enterprise value.

Based on competitive analysis, cash-flow forecasts, and scenario analysis, the analyst assigns Business Risk.

**Quantitative Checks**

We gauge a firm's health using quantitative tools supported by our own backtesting and academic research.

- Morningstar Solvency Score™
- Distance to Default

**Rating Committee**

Senior personnel review each company to determine the appropriate final credit rating.

- Review modeling assumptions
- Approve company-specific adjustments

| | |
|---|---|
| **AAA** | Extremely Low Default Risk |
| **AA** | Very Low Default Risk |
| **A** | Low Default Risk |
| **BBB** | Moderate Default Risk |
| **BB** | Above Average Default Risk |
| **B** | High Default Risk |
| **CCC** | Currently Very High Default Risk |
| **CC** | Currently Extreme Default Risk |
| **C** | Imminent Payment Default |
| **D** | Payment Default |
| **UR** | Under Review |
| **UR+** | Positive Credit Implication |
| **UR-** | Negative Credit Implication |

# Morningstar's Approach to Rating Corporate Credit

The advantage of the Cash Flow Cushion ratio relative to other fundamental indicators of credit health is that the measure focuses on the future cash-generating performance of the firm derived from Morningstar's proprietary discounted cash flow model. By making standardized adjustments for certain expenses to reflect their debt-like characteristics, we can compare future projected free cash flows with debt-like cash commitments coming due in any particular year. The forward-looking nature of this metric allows us to anticipate changes in a firm's financial health and pinpoint periods where cash shortfalls are likely to occur.

*Morningstar Solvency Score™*

The Morningstar Solvency Score™ is a quantitative score derived from both historical and forecasted financial ratios. It includes ratios that focus on liquidity (a company's ability to meet short term cash outflows), profitability (a company's ability to generate profit per unit of input), capital structure (how does the company finance its operations), and interest coverage (how much of profit is used up by interest payments).

*Distance to Default*

Morningstar's quantitative Distance to Default measure ranks companies on the likelihood that they will tumble into financial distress. The measure is a linear model of the percentile of a firm's leverage (ratio of Enterprise Value to Market Value), the percentile of a firm's equity volatility relative to the rest of the universe and the interaction of these two percentiles. This is a proxy methodology for the common definition of Distance to Default which relies on option-based pricing models. The proxy has the benefit of increased breadth of coverage, greater simplicity of calculation, and more predictive power.

For each of these four categories, we assign a score, which we then translate into a descriptive rating along the scale of Very Good / Good / Fair / Poor / Very Poor.

**Overall Credit Rating**

The four component ratings roll up into a single preliminary credit rating. To determine the final credit rating, a credit committee of at least five senior research personnel reviews each preliminary rating.

We review credit ratings on a regular basis and as events warrant. Any change in rating must be approved by the Credit Rating Committee.

**Investor Access**

Morningstar Corporate Credit Ratings are available on Morningstar.com. Our credit research, including detailed cash-flow models that contain all of the components of the Morningstar Corporate Credit Rating, is available to subscribers at select.morningstar.com.

# General Electric Co GE (NYSE) | ★★★

| Last Price | Fair Value | Consider Buy | Consider Sell | Uncertainty | Economic Moat™ | Moat Trend™ | Stewardship | Morningstar Credit Rating | Industry Group |
|---|---|---|---|---|---|---|---|---|---|
| 26.99 USD | 29.00 USD | 20.30 USD | 39.15 USD | Medium | Wide | Stable | Standard | AA- | Industrial Products |

**Price/Fair Value** Morningstar data as of Nov 21, 2014




The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic value.

Five-star stocks sell for the biggest risk-adjusted discount whereas one-star stocks trade at premiums to their intrinsic value. Based on a fundamentally focused methodology and a robust, standardized set of procedures and core valuation tools used by Morningstar's Equity Analysts, four key components drive the Morningstar Rating: 1. Assessment of the firm's economic moat, 2. Estimate of the stock's fair value, 3. Uncertainty around that fair value estimate and 4. Current market price. Further information on Morningstar's methodology is available from http://global.morningstar.com/equitydisclosures.

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# General Electric Co GE (NYSE) | ★★★

| Last Price | Fair Value | Consider Buy | Consider Sell | Uncertainty | Economic Moat™ | Moat Trend™ | Stewardship | Morningstar Credit Rating | Industry Group |
|---|---|---|---|---|---|---|---|---|---|
| 26.99 USD | 29.00 USD | 20.30 USD | 39.15 USD | Medium | Wide | Stable | Standard | AA- | Industrial Products |

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