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Research Update:

General Electric Co. Downgraded To 'BBB+' From 'A' On Impact From Power; CEO Replaced; Outlook Stable

Primary Credit Analyst:
Robert E Schulz, CFA, New York (1) 212-438-7808; robert.schulz@spglobal.com

Secondary Contacts:
Carissa Schreck, New York (1) 212-438-4634; carissa.schreck@spglobal.com
Ana Lai, CFA, New York (1) 212-438-6895; ana.lai@spglobal.com

Table Of Contents

Overview

Rating Action

Rationale

Outlook

Ratings Score Snapshot

Issue Ratings--Subordination Risk Analysis

Related Criteria

Ratings List

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Research Update:

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Overview

- Industrial conglomerate General Electric Co. (GE) announced that it has replaced its CEO, that operating performance in its power business will again cause cash flow and earnings to be below expectations, and that substantially all power-related goodwill will be written off.
- We believe new CEO H. Lawrence Culp Jr. is committed to deleveraging using a number of levers to accomplish debt reduction, but the timing and magnitude of such actions compared to our previous expectations could take longer as he undertakes his own evaluation. This evaluation could include revisiting the form or timing of a proposed health care transaction, the dividend, and timing and use of Baker Hughes GE (BHGE) sales proceeds.
- The latest news on power performance has led us revise down our view of GE's aggregate competitive positioning, with solid performance in aviation and health care further overshadowed by weakness in the power segment. GE's competitive position remains substantial in aviation and health care, and we believe it is still solid in power, despite deep near-term challenges.
- As a result, we are lowering our long-term issuer credit rating on GE and GE Capital Global Holdings LLC to 'BBB+' from 'A' and removing all ratings from CreditWatch. The outlook is stable. If a health care transaction were to occur and leverage were around 2.5x, our current view is that the rating would remain at the 'BBB+' level, given that struggles in power have been worse than we assumed and led to the replacement of John Flannery as CEO.
- The stable outlook reflects our base-case view that with health care remaining, we expect leverage to be under 4x over the next two years. Our current view is that the outlook would also be stable after a health care spinoff, based on our expectations for deleveraging toward the 2.5x goal through the monetization of the BHGE interest, but would also need to take account of prospects for power.

Rating Action

On Oct. 2, 2018, S&P Global Ratings lowered its long-term issuer credit ratings on General Electric Co. and GE Capital Global Holdings LLC (GECGH) to 'BBB+' from 'A'. The outlook is stable.

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At the same time, we lowered our short-term ratings on both companies to 'A-2' from 'A-1'. We also we lowered our issue-level ratings on GE's debt in conjunction with our downgrade of the company in accordance with our corporate notching methodology.

We removed the ratings from CreditWatch, where we placed them with negative implications on June 26, 2018.

Rationale

The downgrade reflects our assessment that GE's aggregate competitive position no longer supports a rating in the 'A' category, absent leverage coming down far more than we currently assume. For the current rating, we expect leverage to be under 4x. We expect GE's future actions on deleveraging and/or monetization of its investment in BHGE to sustain leverage under 4x in the event of no health care transaction. In the event of the anticipated health care transaction, we expect leverage to reduce below 3x to offset the loss of business diversification from eliminating health care. Financial policy therefore will be the key determinant of the financial risk profile; our base case with or without the health care transaction is a 'BBB+' rating.

The stable outlook reflects our view that leverage will be between 3x-4x over the next two years, assuming the company retains the health care segment, largely through retaining all cash flow from its diverse base of businesses and cash from the substantial and committed asset sale program. To offset power underperformance, more debt reduction may be needed than the previously announced plan related to health care. But we believe the company has a number of sources of cash to do so, including its investment in BHGE.

Our ratings on GE continue to reflect our view of its strong leadership positions across numerous global business platforms, albeit with reduced prospects for improving its cash flow generation in the near term. New CEO Lawrence Culp's stated commitment to bolstering credit quality from the current deteriorated levels is a positive. We consider GE's industrial business strengths to be still very robust as the company has extremely solid market positions in multiple global industries with broad geographic diversity. We do not expect recent and prospective asset sales to diminish GE's global position in its core aviation, health care, and power segments.

Key factors in our rating include:

Business Risk

- Excellent end-market, geographic, and product diversity, with operations exposed to varying degrees of cyclicality, correlation, and price pressures.
- Strong leadership positions across global business platforms, even in the

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weak power segment.

- A track record of profitability in key businesses, albeit with uncertain prospects for correcting execution issues in power.
- A large backlog of profitable services related to an extensive installed base of equipment, subject to fluctuations in asset utilization.
- Negligible customer concentration.
- A greatly reduced financial services unit now closely aligned with the industrial businesses, focused on supporting sales of GE related goods and services, and with overall asset size capped near current levels.

Financial Risk

- Credit measures that will stabilize this year and into 2019 as GE continues to execute its plan to sell assets, reduce costs across the company, and build industrial cash balances. The restructuring of its power business will continue to be a drag on performance.
- Cash generation that will be below expectations, but still large, potentially bolstered by a further reduction in the dividend.
- Current dividend of about $4.2 billion annually.
- Large pension and other postretirement benefit obligations that are likely to decline as significant cash and debt-funded contributions are made and discount rates gradually rise.
- Continuing reduction in financial services debt related to previously disposed financial services businesses, using retained cash from the sale of those assets. We do not expect financial services to borrow until 2020. We also do not expect cash dividends from financial services or the need for GE to contribute material amounts to financial services to fund the large capital contribution expected to be required for the legacy insurance business.
- We see near-term financial policies supporting credit quality with longer-term financial and strategic policies evolving over time.

Our key assumptions include the following:

- Mixed global economic conditions, with GDP growth in developed markets generally around 2%-4% and a gradual recovery in energy markets, with onshore markets recovering well before the offshore and deep-water markets. The potential for volatility will persist given the ongoing geopolitical risks.
- Solid conditions in the company's aviation and health care segments with soft demand in the power, oil and gas, and transportation segments in 2018-2019.
- Oil and gas prices consistent with S&P Global Ratings' assumptions for Brent and West Texas Intermediate (WTI) crude oil.
- A generally flat-to-upward trend in GE's service and equipment order

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backlog, which was $376.7 billion as of the end of the second quarter 2018. The aviation service backlog carries high margins, and we believe that it will provide significant support for GE's cash flow and earnings.

- Limited industrial revenue increases in the low-single-digit percentage area, mainly driven by aviation and health care reflecting new product launches and some services growth.
- Adjusted EBITDA margins of about 12.5%, down from 2017, due to weakness in power. We expect the company's volatility of profitability to be moderated by its service backlog, diverse business segments, and operating capabilities across its individual businesses.
- Our expectation that annual capital spending will moderate, representing less than 4% of industrial sales.

We incorporate a decline in the company's unfunded postretirement obligation during 2018, compared with the end of 2017, based on a large voluntary contribution that will exceed near-term mandatory funding and a modest increase in the discount rate. The company has stated that its pension strategy (including past plan changes) is to continue to focus on having a highly funded primary plan. Our after-tax adjustment to GE's debt for these obligations as of year-end 2017 was about $27 billion, which represents a significant portion of its adjusted industrial debt.

- We expect the company's earnings from the financial services verticals aligned with its industrial businesses to be around 10% of its total earnings, with an eventual ending net investment (ENI) target of about $80 billion or less. We don't expect the company's financial verticals to significantly expand or reduce; we assume capital will be recycled into new assets in the verticals. We believe that the allocation of capital will be determined by GE's systemwide returns and will support the industrial verticals while leveraging GE Capital's competitive strengths.

Our assumptions for the company's credit profile metrics are the following:

- Adjusted debt to EBITDA around 4x as of year-end 2018 before improving during 2019 and approaching 3x by year-end 2020.
- Funds from operations (FFO) to debt in the low- to mid-teens percentages through 2019.
- Free operating cash flow (FOCF) to debt under 10%.

We note that these metrics include $3 billion in GE preferred stock, which is given a 50% equity treatment when calculating financial ratios. Our metrics do not include the debt that GE guaranteed or assumed from General Electric Capital Corp. (GECC) because we view the core purpose of the surviving entity, GECGH, as supporting the industrial businesses, so we exclude this debt under our captive finance methodology.

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Liquidity

We characterize GE's liquidity as strong. The considerations for our current assessment include:

- We expect GE's sources of liquidity to be 1.5x its uses or more over the next 12 months, and we believe that its net sources will remain positive over the subsequent 12 months.
- The company will likely absorb high-impact, low-probability events without refinancing--as it has done previously--because of its broad base of valuable unencumbered assets.
- The company's well-established and solid relationships with its lenders.
- Management's generally prudent risk management, as evidenced by its willingness to reduce dividends to conserve cash (as it did recently and during the financial crisis).
- The company's generally high standing in the credit markets, as evidenced by its market capitalization and ongoing commercial paper issuance.

Principal liquidity sources:

- As of June 30, 2018, GE reported $14.7 billion cash on hand. We expect the industrial parent to retain a minimum of about $8 billion, increasing over the next couple years;
- About $40.3 billion of committed credit lines (net of offset provisions) as of June 30, 2018; and
- FFO over $7 billion in 2018.

Principal liquidity uses:

- Assumed capital expenditures of about $4 billion annually;
- Current dividends of about $4.2 billion in 2018;
- Very limited share repurchases in 2018. We do not assume any share repurchases in 2019;
- Very limited industrial acquisitions in 2018 beyond the roughly $3 billion Alston put transaction and no assumed large acquisitions in 2019; and
- A substantial cash pension contribution in 2018, estimated to be about $6 billion (funded with debt).

Other liquidity considerations

Following the divestiture of the bulk of its financial businesses, which provided the company with cash and maturing assets in excess of its maturing liabilities for the next few years, we believe that GE has become far less reliant on short-term funding. GE's decision to guarantee GECC's debt and subsequently merge with the entity, thereby assuming its debt, demonstrated the parent's support for GE Capital, in our view. Nonetheless, given the size of the company's still-large financial services balance sheet (including cash

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from asset sales that is being used to pay maturing financial services debt over time) relative to GE's, we believe there are limits to the financial support GE could provide, especially in the short term.

Other modifiers

We continue to view GE's diversification as a benefit and believe that GE has good scale and diversity with large, global positions in various capital-goods markets, including power, health care, and aerospace, in addition to energy, transportation markets, and financial verticals.

We now consider GE's management and governance as fair. We believe management's plans are focused on recovering from ongoing operational missteps in light of the current end-market weakness in its power segment. This challenge was at least partly responsible for the replacement of John Flannery as CEO. We see ongoing execution risk related to restructuring its power segment.

We view GECGH and its core financial verticals as a captive finance operation to support GE's industrial businesses. We expect GE Capital to maintain leverage supported by the quality of its assets.

Outlook

The stable outlook reflects our view that credit metrics and cash flow will improve from 2018, notwithstanding key execution risks over the next two years because of cash from asset sales, and no returns of capital to shareholders. We view continued solid performance in aviation and health care and execution on announced asset sales are key milestones over the coming years. We continue to view leverage under 4x as appropriate for the current rating.

Downside scenario

We could lower our ratings on GE if we believe that the company won't maintain leverage under 4x or if its financial policy becomes more aggressive over the next two years. For example, failure to stabilize the performance of its power segment while not building cash, (perhaps by retaining some proceeds from asset sales) could lead to a downgrade if leverage appears on track to be sustained above 4x over the next two years. Another scenario would be if the proposed health care transaction proceeded with less debt reduction than we previously anticipated given the recent news in power.

Upside scenario

Although unlikely over the next two years, given the company's stated leverage target, limited visibility into the power segment's results, and uncertainty around the timing of any transactions involving GE's stake in BHGE, we could raise our ratings if the company's performance and financial policies lead to improved credit measures. For instance, if we expected debt to EBITDA of 2x or

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less and FOCF to debt over 15%, with no prospects of deterioration in the coming years, we could raise the rating. At the same time, we would need to believe that management's financial and strategic policies would support these improved credit metrics.

Ratings Score Snapshot

Issuer Credit Rating: BBB+/Stable/A-2

Business risk: Strong

- Country risk: Low
- Industry risk: Intermediate
- Competitive position: Strong

Financial risk: Significant

- Cash flow/leverage: Significant

Anchor: bbb

Modifiers:

- Diversification/portfolio effect: Moderate (+1 notch)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Strong (no impact)
- Management and governance: Fair (no impact)
- Captive finance modifier: Neutral (no impact)
- Comparable rating analysis: Neutral (no impact)

Issue Ratings--Subordination Risk Analysis

Capital structure

GE's capital structure (not including debt issued by its captive finance subsidiaries) consists primarily of senior unsecured debt issued at the parent level. There is no material secured debt.

Analytical conclusions

- We rate GE's unsecured debt the same as our issuer credit rating because the issuer has very little secured debt.
- The priority debt ratio is far less than 50%, so we rate the debt at the same level as our issuer credit rating. We rate GECGH's unsecured debt the same as our issuer credit rating on GE based upon the guarantee or assumption of this debt.

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Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria - Corporates - General: Methodology: The Impact Of Captive Finance Operations On Nonfinancial Corporate Issuers, Dec. 14, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Financial Institutions - General: Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- Criteria - Financial Institutions - General: Issue Credit Rating Methodology For Nonbank Financial Institutions And Nonbank Financial Services Companies, Dec. 9, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Oilfield Services And Equipment Industry, April 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Aerospace And Defense Industry, March 25, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Health Care Equipment Industry, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Capital Goods Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

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Ratings List

Downgraded; CreditWatch/Outlook Action		
	To	From
General Electric Co.		
GE Capital Global Holdings LLC		
Trinity Plus Funding Co. LLC		
Issuer Credit Rating	BBB+/Stable/A-2	A/Watch Neg/A-1
Employers Reassurance Corp.		
Financial Strength Rating		
Local Currency	BBB+/Stable/--	A/Watch Neg/--
GE Capital EFS Financing, Inc.		
Issuer Credit Rating	BBB+/Stable/--	A/Watch Neg/--
Ratings Lowered; Off CreditWatch		
General Electric Co.		
Senior Secured	BBB+	A/Watch Neg
Senior Unsecured	BBB+	A/Watch Neg
Subordinated	BBB+	A/Watch Neg
Subordinated	BBB	A-/Watch Neg
Junior Subordinated	BBB-	BBB+/Watch Neg
Preferred Stock	BBB-	BBB+/Watch Neg
Commercial Paper	A-2	A-1/Watch Neg
GE Capital Australia Funding Pty Ltd.		
GE Capital Canada Funding Co.		
GE Capital Franchise Finance Corp.		
GE Capital International Funding Co		
SUSA Partnership L.P.		
Security Capital Group Inc.		
Senior Unsecured	BBB+	A/Watch Neg
GE Capital European Funding		
Senior Unsecured	BBB+	A/Watch Neg
Commercial Paper	A-2	A-1/Watch Neg
GE Capital Treasury Services (U.S.) LLC		
Commercial Paper	A-2	A-1/Watch Neg
GE Capital UK Funding		
Senior Unsecured	BBB+	A/Watch Neg
Commercial Paper	A-2	A-1/Watch Neg
General Electric Capital Services Inc.		
Subordinated	BBB+	A/Watch Neg

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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