Evaluating GE: What Would/Did Warren Do?

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Disclaimer

The following discussion of GE is intended as informational in nature. It is based strictly on publicly available information and is not a recommendation to sell, buy or hold GE stock or bonds or any part of GE's capital structure.

Neither I nor Ram Partners LP nor any family members or my dog Charles are short GE through stock, options, debt instruments, credit default swaps or any other financial methodology including those we can't think of right now.

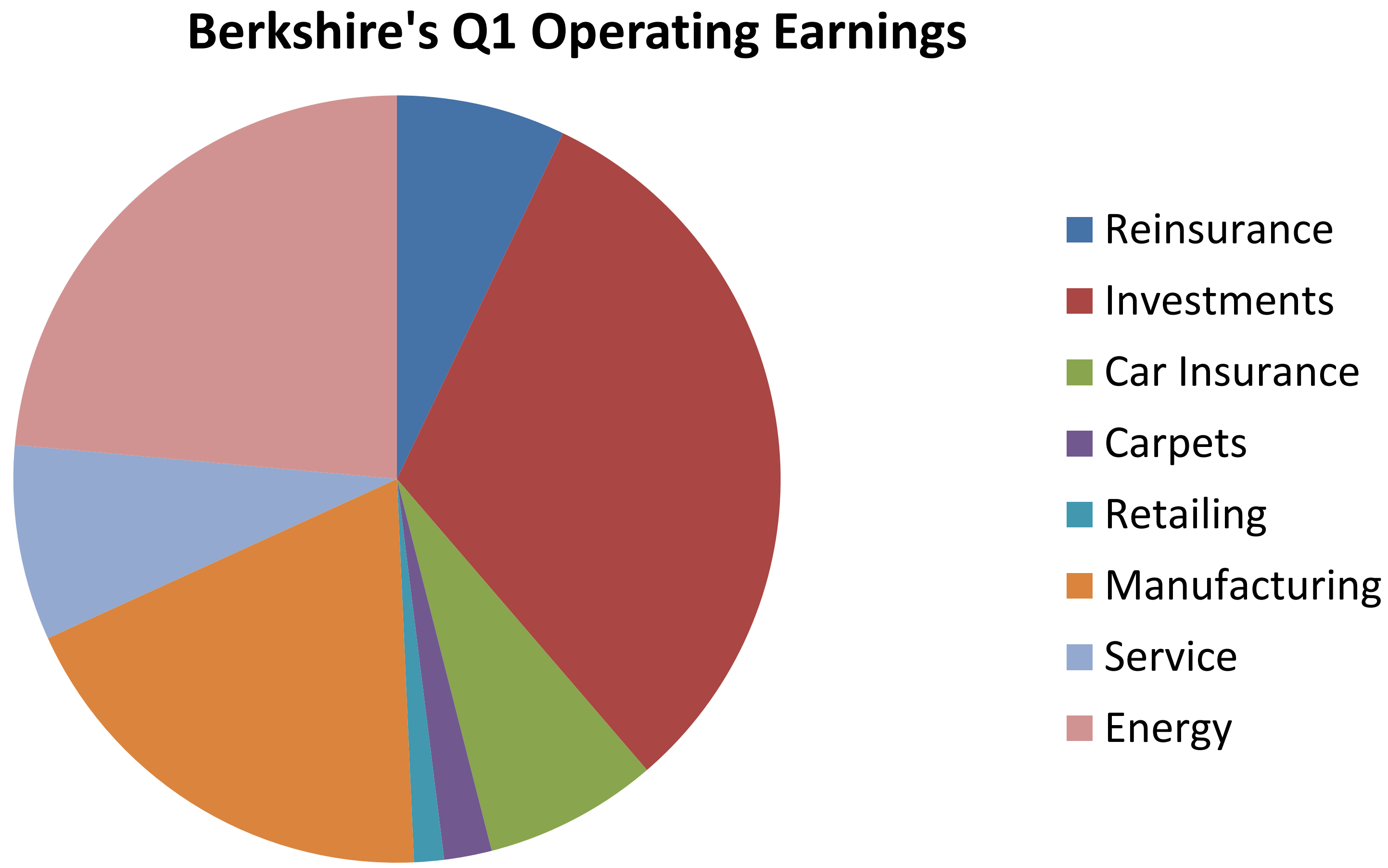
On the contrary, we think GE is a really wonderful company, every bit as great as management says on its conference calls and in its shareholder communications, and on its own TV network.

Besides, it's on the "financial" do-not-short list.

Evaluating a Company…the Warren Buffett Way

- Read the annual report, cover to cover, for decades, especially the Chairman's Letter.
- Ask "is this in my circle of competence?" "Is it a good business?" "Easy to understand?" "Does it have a moat?" "Throw off cash?"
- Is management great? Do they manage earnings? Do they manage for the long-term or do they play "gin-rummy" with assets?
- Is the board of directors aligned with shareholders?
- What's the stock worth…and where is it offered today?

Warren Buffett’s Circle of Competence



Is GE Easy to Understand?

GE Business Unit Revenue

2000	Billion		2007	Billion
Engines	$11		Infrastructure	$58
Power Systems	15		Commercial Finance	34
Industrial	12		GE Money	25
NBC	7		Industrial	18
Plastics	8		NBC Universal	17
Appliances	6		Healthcare	17
Technical	8		Plastics	Disc'd
GECS	5 (Net Inc.)			

Is GE a "Good Business"?

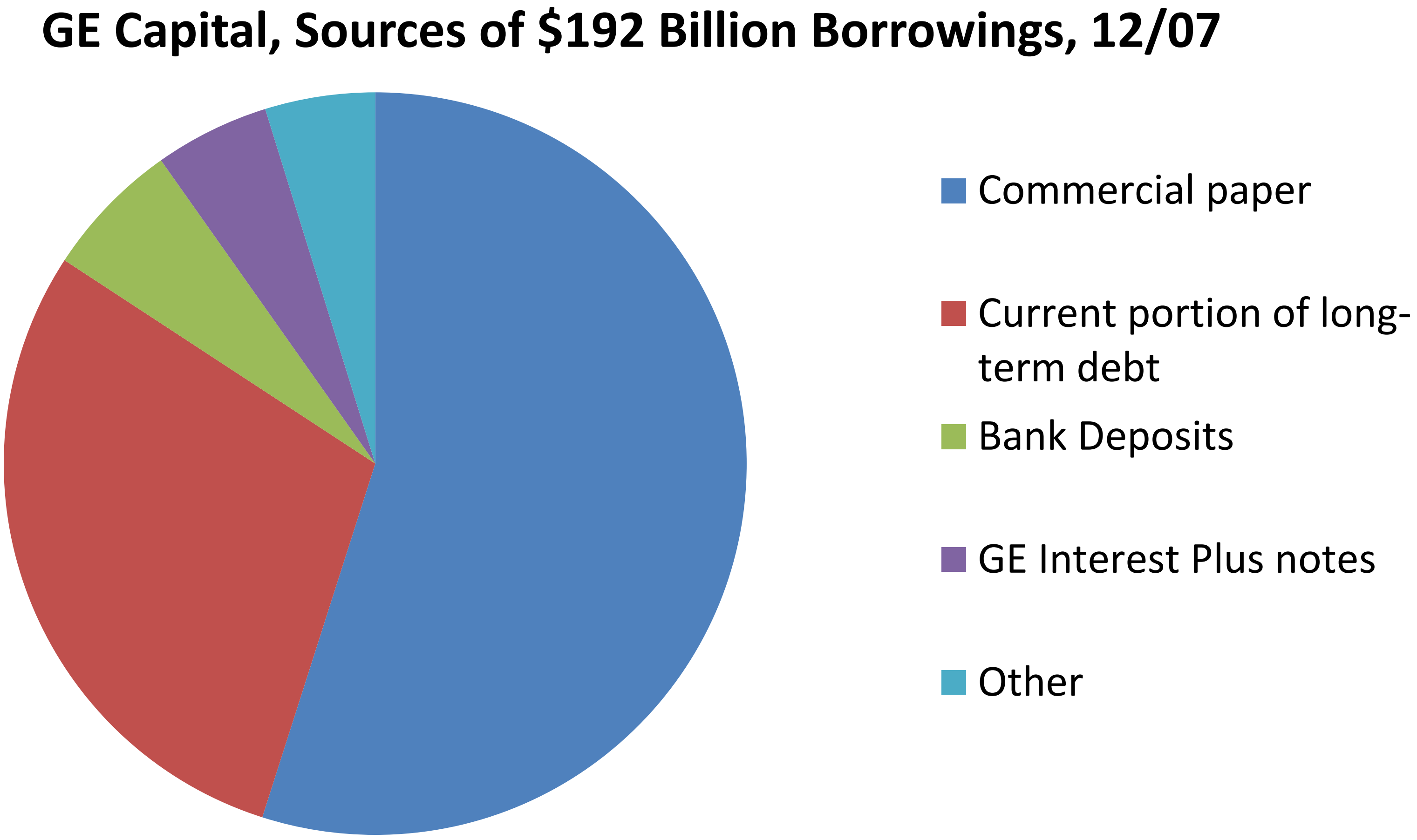
2007	Return on Capital	Return on Assets	Free Cash Flow (Ex-dividends, stock repo, acquisitions)	Free Cash Flow Return on Capital
GE	2.98%	4.17%	$30 billion	5%
MMM	28%	18%	$2.8 billion	14%
HON	18%	7.6%	$3.1 billion	14%

Does it Have a “Moat”?

‘Our true "core competency" today is not manufacturing or services, but the global recruiting and nurturing of the world's best people and the cultivation in them of an insatiable desire to learn, to stretch and to do things better every day....’

GE 2000 Chairman’s Letter

Is This a Moat?



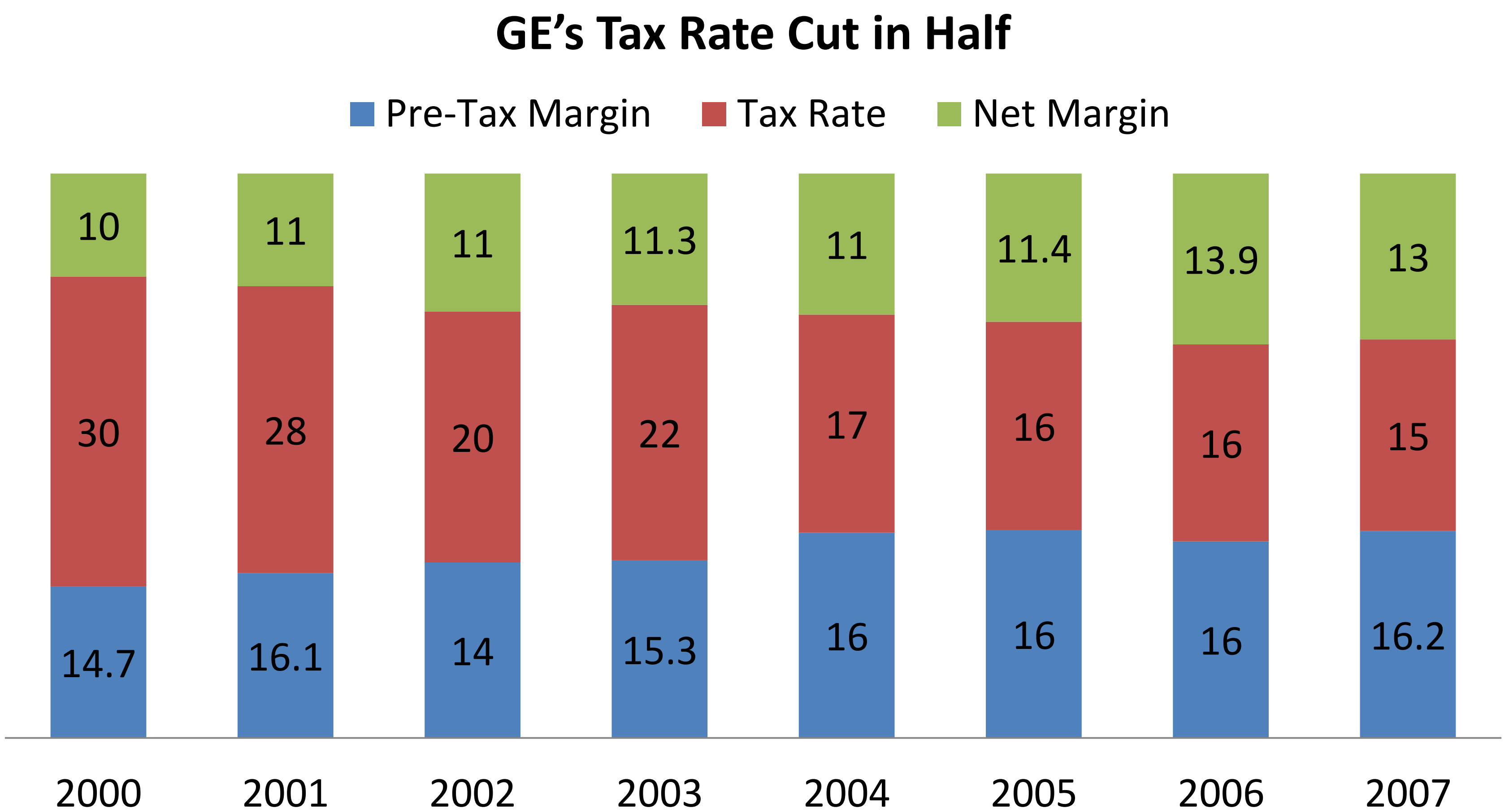
Does GE Throw Off Cash?

Well, Yes, But Look What they Do With it…

- Shares outstanding, 2005: 10.611 billion
- Shares outstanding, 2007: 10.218 billion
- $ spent, 2005-2007: $25 billion
- Stock price range, 2005-2007: $32.06-$42.15
- Average price in that time: $35.80

- Recent offering of 548 mm shares: $22.25

GE Earnings Quality



The GE Culture: "The Four Types"

- “Type I: shares our values; makes the numbers--sky's the limit!”
- “Type II: doesn't share the values; doesn't make the numbers--gone.”
- “Type III: shares the values; misses the numbers--typically, another chance, or two.”
- “Type IV: the manager who doesn't share the values, but delivers the numbers; the "go-to" manager, the hammer, who delivers the bacon but does it on the backs of people, often "kissing up and kicking down" during the process. This type is the toughest to part with...but we have to remove these...”
- Source: 2000 Annual Report

The GE Culture as Math Problem

Numbers + Values = Good

- Numbers - Values = Gone

Values – Numbers = Eventually Gone

Numbers - Values = “Toughest to part with”

Lowest Common Denominator: Makes the Numbers

Is This Long-Term Management?

- 1999: "The contribution of e-Business to GE...is changing this Company to its core."
- 2000: “Digitization is transforming everything we do, energizing every corner of the Company and making us faster, leaner and smarter even as we become bigger.”
- 2001: "We generated $1.9 billion of incremental cost savings through what we call "e-Make" and "e-Buy."

Or This?

- 2002: "Our stock was down 39% for the year, more than the S&P 500, and GE now trades near the same level it did at the end of 1997."
- 2003: "There is proof that you can get out of the "GE Doghouse." Last year, I wrote about our disappointment with Employers Reinsurance Corporation... However, I like the way Ron Pressman and his team are executing.“ (Sold 2006)

How About This?

- 2003: "Growth is *the* initiative, *the* core competency we are building at GE.... With this in mind, we reshaped GE values around four core actions: *Imagine, Solve, Build* and *Lead*."

- 2004: "GE has 'played hurt' for the past few years. The end of the 'bubble' stock market, the recession and the 9/11 tragedy depressed the markets for our energy and transportation businesses. Our expansion into difficult insurance markets had left us with underperforming businesses and excess leverage. Pension earnings...became a headwind.... We never offered excuses."

- 2004: "We're back at full strength. *This is our time*."

Or This?

- 2004: "We have a broad operating initiative called Simplification. We are targeting a reduction in 'non-growth cost' of $3 billion over three years. **We are measuring reductions in legal entities, headquarters, 'rooftops,' computer systems...anything that is not directly linked with customer satisfaction and growth**." [Emphasis added]

Or This?

- 2004: "Last year we told you that we defined GE in two groups, Growth Engines and Cash Generators. Our aspiration was to increase the Growth Engines.... **The returns of our financial services businesses have expanded so they will be able to dividend 40% of their earnings to GE and maintain their growth rate. The portfolio is poised to begin a prolonged period of double-digit growth, with expanding returns**."

  [Emphasis added]

The Consequences of Growth for Growth's Sake

- "Real Estate assets at December 31, 2007, increased $25.5 billion, or 47%, from December 31, 2006, of which $12.6 billion was real estate investments, also up 47%."

- "Real Estate assets at December 31, 2006, increased $18.5 billion, or 52%, from December 31, 2005, of which $12.4 billion was real estate investments, up 76%...“

Source: 2007 Annual Report

Shuffling the Portfolio
GE Segment Profit, 1997-2007

- Infrastructure: $2.7 B $10.8B
- Commercial Finance: $1.5B $6.0B
- NBC Universal: $1.1B $3.1B
- GE Money: $0.6B $4.3B
- GE Industrial: $1.5B $1.7B
- GE Healthcare: $0.7B $3.1B

Recent GE Acquisitions

- 11/07 Acquired Bradford & Bingley PLC Commercial Ppty Loans 2B GBP
- 2/07 Acquired Vetco Gray oil service equipment $1.9B
- 1/07 Agreed to acquire Abbott Labs diagnostics business $8.1B; dropped out 7/07.
- 5/06 iVillage dot com $592mm (35x EBITDA)

‘We cultivate the hatred of bureaucracy in our Company and never for a moment hesitate to use that awful word "hate." Bureaucrats must be ridiculed and removed. They multiply in organizational layers and behind functional walls...’

2000 Annual Report

This is a company that has a “Chief Learning Officer”!

GE’s Board Compensation

- “In 2007, annual compensation of $250,000 was paid to each non-management director.” $100,000 cash, $150,000 in deferred stock units.
- “Non-management directors participate in our **Executive Products and Lighting Program**…. Under this program, upon request, directors can receive GE appliances or other products…”
- Note: the annual cost of D&O insurance in 2007 was approximately $20.7 million.

A Tale of Two Triple-A's

At December 31, 2007 **Source: Bloomberg LP**	**Company 1**	**Company 2**
Cash and Near Cash	$44B	$16
Marketable Securities & Short Term Investments	$107B	$45B
Short Term Borrowings	$22B	$195B
Net Liquid Assets	$129B	($134B)
Gross Shareholder Equity	$125B	$115B
Intangibles	$30B	$97B
Tangible Equity	$95B	$18B
Tangible Equity as % of Net Liabilities	80%	13%

So, What Would Warren Do?

- Buy $3 billion GE *preferred* stock, 10% dividend callable after 3 years at 10% premium.
- Gets warrants to buy $3 billion of GE common at $22.25 for five years.