CNBC Squawk Box
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Keith Sherin Interview

Joe: The market is worried about something, obviously. What do you think it is, and is it justified?

Keith Sherin: Well, I think we're getting a lot of speculation about the risk in GE Capital, obviously, and I think it's overdone. I think, first and foremost, I would say we have an incredibly strong liquidity position. You know, yesterday and this week, we've had massive volatility in the stock and in the CDS. But if you look at the actions we've taken to make the company stronger and safer, we have $45 billion in cash. We have no triggers that we can see that would have any call on our cash in the short-term. And if you look at it, we have got $60 billion of additional capacity available under the TLGP program. We've done 70% of the long-term debt we need to do for GE capital this year already. We've refinanced that already. We're going to complete 2009's funding needs in the near future, and we're actually -- we have the capacity under that to complete 2010's funding needs as well.

So we're waiting on looking at what is the government going to do around those programs. Are they going to extend them, are they gonna modify them? Is there an alternative way we can do funding in 2010 and beyond? And we're going to wait and see that but even if there isn't any change, we can fund ourselves all the way through 2010 without any issues, and we don't have any short-term liquidity issues. I think that credit volatility is overdone. You know, we have looked at the actual CDS trades on Monday and Tuesday. It was a total of $35 million over the two-day period. Normally it's only $100 million a day. It's very narrowly traded. We got a lot of input. Is that really market fundamentals, or is it just a disruption based on very narrow trades in a volatile time?

Joe: A lot of mileage out of the credit default. Will GE Capital be profitable in the first quarter?

Keith: GE Capital is going to be profitable in the first quarter. It will be profitable.

Joe: It will be profitable.

David Faber: But is that a result though of not taking losses? This is, again, what critics would say. You will profitable, but you guys are ultimately are not taking the marks you should be on some of these positions.

Keith: Well, I think you have to look at our business model. We have only about 2% of our assets that are subject to mark to market in GE Capital. The majority of our receivables are financing receivables, and you have to provide for the embedded loss that you have in your book. And we do that with our receivable reserves. You have to obviously follow the accounting rules and put up the provisions that we see for what the embedded losses are in the books. Now, as we see higher delinquencies, as we see more defaults on both the commercial and consumer side, we'll put up higher provisions, we've said it over and over, if you look last year we had about $10 billion that we put up for losses plus impairments. In the plan this year that we have we have about $12 billion plus for losses and impairments. Could be higher based on the volatility we're seeing. If you look at 2010, you could probably see a similar level. You look through a three-year period, and we're going to basically deal with $35 billion of losses and impairments while being profitable in GE Capital. We're going to be profitable in 2008. In 2009 that's our current plan. We're going to be profitable in the first quarter, while dealing with a very pressured credit cycle and a lot of losses. So, I don't see a need to put additional capital in GE Capital. As you know, we raised $15 billion last year. We raised that equity primarily because we were sitting in the liquidity crisis. You know the capital markets shut down. The CP markets were frozen, and we raised the $15 billion just to basically make sure we had cash on hand to deal with the liquidity disruption. Now, fortunately, we had that money. We put that money into GE Capital. We put $5.5 billion in last year as you know, and we're putting in $9.5 billion in the first quarter-- with that $9.5 billion in, GE Capital's leverage ratio went to 6-1 at the beginning of the year.

David: Including goodwill, and obviously, and intangibles --

Keith: On the leverage ratio, you look --

David: We know everybody is now talking-- we only care about tangibles--

Keith: Well let's do tangible equity. I think it was important to put the money in to get to the year-end goal leverage in the first quarter. It also helped us with the rating agency both moody's and S&P measurements. But now, let's take tangible capital to tangible assets. If you look at the GE Capital services total capital, you take tangible capital, and you remove all the goodwill and the tangibles, and include the $9.5 billion that you put in. Basically we're going to be in the first quarter around 5% total tangible capital with tangible assets. Which, if you look at the financial institutions, that's at the top end of all the banks, and that assumes that the banks convert their TARP preferred equity into common equity. So we feel good about the capital level in GE Capital, and we are, in a stressed environment, going to deal with more losses.

Michelle: The market does seem very worried, though, still about the asset quality that you have, and the uncertainty about the asset quality, and the market is telling you that.

Keith: Sure.

Michelle: Is there any way to wall off GE Capital so that you can defend the rest of the portfolio against any kind of losses that would be there?

Keith: I think we have to deal with whatever the losses are in GE Capital-- I don't think there's a silver bullet to wall off those losses. I think one thing we have to do, obviously, in this environment is be more transparent, give more disclosure about what's in the book. There's so much speculation. This week we added Eastern Europe to the pile of speculation. We have fantastic businesses in Eastern Europe. We've been in the banks in Hungary, in the Czech Republic, and in Poland since 1995. We've been running those businesses. We have about $27 billion of assets there.

Michelle: But it's precisely because of that. Those economies in Eastern Europe are crumbling before our eyes.

Keith: Sure, they are. You know, last year we made $500 million in the central and Eastern European banks. Our plan this year is to make somewhere around $400 million. We have a stress case against higher losses in those economies, more unemployment, home price depreciation, and at the end of the day our absolute stress case in the central and Eastern

European franchise is about $200 million of pretax higher losses than what's in the base case to make about $400 million. It's not a lightning bolt, cliff event. It's not a time bomb. What I was getting to the point about transparency. We recognize the need to be more transparent here.

David: More than you worry -- even on December 2nd, you gave a very -- a fairly detailed presentation?

Keith: We have to be. It's like December 2nd never happened, David. We had a really great meeting. We got a ton of great feedback about it. Two months later that's not enough. What we're planning on the week of March 16th we're going to have a GE Capital meeting again. Our intent is to do a deep dive around the hot spots in the company, and we'll do a deep dive on real estate. We'll do a deep dive on the U.S. consumer business. We'll do a deep dive on the global mortgage business with a focus on UK home lending, obviously that's a hot spot. And we'll do a deep dive on Central and Eastern Europe.

David: You know that's -- everybody says, oh, they got $20 billion in U.K. subprime mortgages and $45 billion in CMBS--

Keith: We don't have $45 billion in CMBS. We absolutely -- we have $2 billion in CMBS, it's in our investment securities portfolio.

David: Where does that number come from there? Why am I hearing that?

Keith: I have no idea where someone gets that. We have about an $85 billion book in real estate. We have a $50 billion commercial real estate loan book. It's senior secured positions and we underwrite each individual property. It's not participations. We have about $34 billion of equity. Those are -- that's not equity with third party debt on it. That's the actual value of the properties. Over 80% of that has no third party debt. Some has third party debt.

David: That may not be worth quite what it was previously. I mean it's equity and some developments, I assume, that are not doing as well--

Keith: I think today if we had to mark to market it...in the 10k we put an estimate in of what our ultimate value was at December 31st for our real estate equity book. $34 billion. we said we had a $4 billion pre tax embedded loss less than the book value. Now in today's world, if you had to sell those properties, we'd have a bigger loss. We don't have to sell those properties. Our accounting model, these are long life assets and we intend to hold them to maturity, and the accounting tests are if you have a nominal cash flow forecasted at book value, you don't have to write those off. We also depreciate those properties a billion dollars a year, so that helps lower our bases but, you know, we are dealing with an incredibly difficult environment in the financial world, but we do not have a time bomb at GE Capital, and we've stress the our case and been reviewing capital levels, business model, losses, and liquidity with the rating agencies and we've been doing detailed dives, and that's what we'll do the week of march 16th. We'll look at the same information we're sharing with the rating agencies.

Joe: When do you expect to hear from Moody's, and what do you expect to hear? You can't speak for the ratings agencies, but what is GE management discounting in terms of whether there is a downgrade and how many notches?

Keith: We've been working really constructively with the agencies. We've had daily meetings with them. I met with both moody's and S&P myself yesterday with a team and did a recap of where we are. You know, I think they're under incredible stress. I think in today's financial services environment, look in December S&P basically downgraded every financial institution, so the world is really tough. I can't say what they're going to do with the rating. I can say that in my estimation, under any scenario that I can see it's not going to have an operational impact on us. You know, we can fund the company. We can run the company. We're already shrinking GE Capital.

Joe: If they went three notches or four notches, it might have an effect. Is there any way that they would go to where some of the debt is trading, commensurate --

Keith: I can't imagine it based on the knowledge I have and the reviews that we've done. I think a four notch downgrade is something that I couldn't contemplate based on all the knowledge I have. I think it's possible we could end up in a Double-a, and it's possible we could end up with a Triple-a with a continued negative outlook, but I think the actions we've taken have certainly helped them with making the company stronger. Clearly, raising capital, cutting the dividend was a tough decision for us, but it's the prudent thing to do. You know, if you look at just the savings on the dividend, cash flow and capital we'll retain in the company over the next 18 months, you know it's $14 billion. So we have a capital cushion building that we can use in the event that losses are higher in GE Capital. I can't foresee anything that would precipitate something like that with them, but, again, we don't control them, and it's up to them to make the ratings decision, and they're doing a very thorough job of looking at the books of GE and GE Capital.

Joe: We haven't even talked about the industrial businesses.

David: We've got you talking about--everybody cares about GE Capital --

Joe: I know. I know they do, but it's not like industrial is going gang busters with the global slowdown, although you would have to think that the industrial businesses, some analysts put that at $12 a share, just industrial.

David: With the annual report, you're still talking about with $15 billion in free cash flow, correct me if I'm wrong.

Keith: Yes. We're looking today for the cash flow of the company to be around $16 billion. I think in our stress case we could be down in the $14 billion level. So you know, we have a lot of cash flow. We can fund the company. I think in the industrial company the environment continues to get worse, but we start off with a really strong position. You know, luckily we've got a big equipment backlog in the infrastructure businesses, and we have a huge services business. We're very global. So we've got an advantage. You know, we see some visibility. I think the problem is how is the economy going to unfold globally, and probably the toughest place, really honestly, is CNBC, or is NBC, because of the advertising market, the local advertising market is very pressured based on the economy and the national advertising market we're seeing some pressure, but, you know, the long cycle energy business should have a very strong year. The technology infrastructure business, I think aviation is in a good position. Mostly driven by the service business. Healthcare probably will be a tough year. I think a real challenging year in the media space.

David: Back to GE Capital services, in terms of funding the company at this point? Obviously, a lot of your funding has been in place for quite some time, but given where the CDS is trading, does that have an impact on your short term borrowings, your ability to borrow, and does it make it somewhat less profitable for the company given you are paying a lot of money for your money, and you're only able to put it out at a certain rate?

Keith: You know that's how we started, right, I think the disruption in the credit markets in the short term has been a lot of volatility without a lot of impact to us. Now, in the secondaries, our bonds spreads have widened, cash spreads, but we're not borrowing money today. Again, in the short-term we're funding ourselves with CP. we've gotten the CP down to about $60 billion. Our funding cost in the CP program is about 1.5% today, including the FDIC guaranteed fee. On the long-term we've already done 70% of the funding we need for the year. The majority that's been done under the FDIC guaranteed program, which is a federally guaranteed debt obligation and it's at a very low rates. So, our total cost of funds estimate for the year even with the disruption in the credit markets, is about 4.6% for GE Capital, a little lower than that last year. And then with the funding that's in place and the government programs, we think we can fund ourselves through 2010 by the end of this year with those existing programs.

Look, I think one of the things the government has done extremely well was put those funding programs in place. Look at what the CPFF did last year to the money market stabilization and a lot of companies who needed to repay the bank lines. I think it was fantastic. We're not in the CPFF today. We have $98 billion of capacity there. We're not using it. That's been extended to October. And then as I said, we've got still $60 billion of capacity in the TLGP, and I think it makes sense to extend that program. Again you don't need to go invent a new program when you are looking at how do you help with confidence in the financial markets. I think extending that program would be terrific.

David: Now $250 billion in long-term debt I believe comes due over the next three years for GE capital. Is that right?

Keith: It's about $60 million in maturities. $60 billion of maturities a year. It's $67 this year, it's around $60 next year.

David: Do you worry that ultimately you're going to have to pay more for that money, and again that the profitability of the unit itself is going to be compressed decidedly over these next few years, especially if things continue as they are?

Keith: You know are there's a lot of uncertainty, but I think what we're talking about is what's the cost of our funding going to be in 2011. It's a ways out here. I think we're shrinking GE capital. We've brought our assets balances down by $25 billion by having our originations be less than our collections in the fourth quarter. In 2009 we've got another plan to break down another $25 billion by having originations be less than collections. We can dial that down if we had to. We're only refinancing about $45 billion of the $67 billion of long-term debt that comes due this year because we're shrinking GE Capital and also using alternative funding, global deposits, which we've really underleveraged as an unsecured funding model. We haven't had to do as much in alternatives as we could in the past. We have all the central and eastern European banks. We have branches and everything. We just haven't focused on deposits, and we're ramping that up. We'll grow our deposits by another $25 billion this year.

It's really not a function of getting the deposits. It's getting the assets into banks to be able to fund the deposits. That's really what we're working on.

Michelle: Keith, what do you say to folks, though that, are watching -- who saw Jeff Immelt come on here, on CNBC, and say we're not going to cut the dividend. Then he ended up cutting the dividend. And you're trying to give reassurances to people now. There's some lack of credibility out there when it comes to you.

Keith: I think it's a real issue that we're facing. I think if you make a declarative confident statement today, you get second-guessed. If you make a wobbly statement, you get speculated. We recognize that we've made statements about both not raising equity and not cutting the dividend, and we've had to back track on those. I think the only thing I can say is in our defense is that we're trying to run a company for the long-term. We've got a real franchise here. We're proud of it. It's going to around another 100 years, and we're making decisions to make the company safe and secure. We certainly have to be careful about the forward-looking statements we make, and the commitments, because the environment is so uncertain. When we put the dividend plan together, that's the way we thought we were going to have 2009 on hold. we Actually thought 2010 you could see GE Capital growing again. Then you could grow your way back into that payout ratio. As you get into 2009, you say that's probably unrealistic to expect that we aren't going to continue to have stress in the financial system. We shouldn't count on any capital coming out of GE Capital, and we ought to be more prudent about protecting ourselves in the future. So, I think we do have a credibility point, and we've got to earn that trust back, and the only thing that's going to get there is for us to demonstrate that we can manage our way through the cycle, and we're focused on that.

Michelle: Is there anywhere in the forward-looking view that you might have to go to TARP?

Keith: You know I think you might have to have an incredibly disastrous economic situation for us to have that. I think it's a back up if all the other back ups that we have in place couldn't work. We don't anticipate that. We don't have that as a plan. But in today's environment, you know, you have to basically evaluate everything. I think that would be a very near last case option for us.

Joe: Keith, fairly or not, we've seen other companies wait to raise capital as their common shares went down, and down to where they really aren't able to raise a significant amount of capital. Yesterday the company responded to, you know, the notion that a capital raised was imminent or in the offing at some point and said it's pure speculation, not going to happen. We have other ways to increase our capital. What did you mean by that? Intent to get rid of the rest of the dividend? what besides an offering could raise capital if needed?

Keith: First, you have to look at why would you need to raise capital. Again, we went through the tangible common equity measurements. We went through the leverage metrics with the rating agency. You would have to have an environment where the losses far exceeded our estimates even in the stress cases, which we'll show on the week of March 16th. So we don't see that, but even if you got into that situation, and losses in our book are going to come in over time. It's not like we have a mark to market, write it all off today, you gotta sell it. You're forced liquidation, fire sale type of company. We're not. We're going to hold these assets and collect these receivables and deal with the losses over time. So I think if the losses are higher over time, then what we even forecast and we think GE Capital will be profitable and not need additional capital, but if they are higher, one, you have this $14 billion over the next 18 months of the additional capital in cash from cutting the dividend we already did. Two, you can shrink GE Capital even more. I mean, we can cramp down on the originations and the collections to basically shrink the balance sheet even more and need less capital, and we still do have a dividend payment. We're paying about $1 billion a quarter. It's a pretty good yield. That would be, you know, a step we wouldn't want to take, but, obviously, that's cash flow and capital that's available to us from the industrial businesses. And so I think we've got plenty of actions that come in steps before you would have to think about raising capital, and we don't, again -- I make a declarative statement and you say, okay, you're going to back track, we don't see that today. We don't have plans for that today, and I think we have alternatives that enable us to get through doing that today.

David: You mention confidence. Obviously, the market is sorely lacking in that, for obvious reasons. In part because so many people have made commitments they ultimately could not live up to.

Keith: Absolutely.

David: And so many have never encountered an environment like this one. What do you think is coming at this point? Do you -- and how do you go about trying to build confidence?

Michelle: What's in that stress test?

David: Other than coming on here and doing whatever you can when, frankly, people don't believe most of what we do.

Keith: I guess what we have to do is we have to be transparent and open. I think the December 2nd meeting you referenced on GE Capital was very well received. We got a lot of good feedback. The 10k, we were very detailed in our disclosure and that obviously gave people a lot of information to create more speculation. The week of the 16th we're going to do a detailed dive of GE Capital. I think being transparent, laying out what the facts are about the assets in our books and laying out our stress case, we'll give you that detail that week, showing what our assumptions are that generate the losses we have. Showing how additional bad news would have to come in to even generate a need for additional capital, and then letting people make their own decision about it, and we're going to have to update it frequently. I think the reality is in this environment with low visibility and a lot of volatility, we're just going to have to have a GE Capital meeting every quarter and go through that, and that's okay, and because you can't just put in the file and say, okay, we put the plan together, and we're going to operate. we got to react and move with the times and the changes, and we've got to adapt. I think we're just going to -- the main thing we do can be is be transparent and show you the details of what we have and the assumptions of what they're based on and show you what the risk levels are that maybe change those assumptions and then let people make their own decision about the equity that's based on that.

David: Do you think GE is a victim of manipulation, and when I talk about that, I mean people blow out the CDS spreads. You mentioned it, very small volume, short the stock, buy the 250 options, and create a perception that ultimately becomes a reality that they benefit from.

Keith: Yeah. Can I say we're in a negative news cycle? I mean, it's just -- there's no good news, right, and it's just incredible. I don't know if there's manipulation. I think people have an investment view, and they can make money on that view, and they do everything they can to do that. We live in that world. That's okay. All we can do is run the company and be as transparent as possible and do as good of a job as we can. I think it's incredible about the news cycle and -- yesterday we had an article that came out that said, you know, if you have a three notch downgrade, you end up with an $8.5 billion liquidity fall on the company. if you just read the 10k, it's as clear as day that you have to go below Double-a, which would be a 4-notch downgrade-- I don't know how you can create the premise of an article off of just an error and create a lot of swirl in the company. So I'm disappointed in the quality of some of the speculation --

Joe: How about the analysts? Have they been -- I guess when you had almost, I think, maybe universal buy ratings at 35 and 40, and I don't know if you have a buy rating at six at this point. Do these guys -- I think some of them feel like they missed it on the way down. Do you think you've been fairly treated by the analyst community at this point?

Keith I think they have a tough job to do. I think today, you know, when I talk to some of the analysts they say I think you're undervalued. I have trouble making that call because my job is on the line. That's a tough spot for people to be in about making, you know, what's their job is to recommend stocks, but they have --

Joe: It's all in a day, Keith. From deutsche bank, you know, the industrial businesses are the worst $12 a share. But I'm going to keep my hold.

David: I'm going to keep my hold.

Keith: I think what we have to do is we have to be really transparent about how we're running the company and what the operations look like, what the risks are, and let people make that investment decision on their own. You can't count on -- I don't think big funds make an investment decision based on whether an analyst has a particular rating on the stock. I think they all do their own fundamental work and their own analysis. They look at that analyst recommendation and use it as a part of their decision making, but, you know, I think to me today it's going to be about people making a fundamental decision about what's the risk in GE Capital? Can we manage our way through it, and I think we can.

Michelle: Have you spoken to Warren Buffett? He bought $3 million worth of preferred. What's his opinion on the state of affairs?

Keith: I haven't. He's a great supporter of the company and we really appreciate him.

Joe: Well, we appreciate all the time you gave us today, Keith, and thanks for coming in the studio.

David: I'm staying.

Joe: You are staying.

David: You buy a GE alarm clock and trying to help out? You are here at 7:30 --

Keith: You told me if I came in, you would tell me how Faber broke the story about our dividend cut. I expected --

Joe: Yeah. I'm getting -- I know. I'm getting emails-- how did you get an exclusive with Keith Sherin? Whatever. Thank you.

Michelle: Thanks, Keith.