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MARKETS

The Investors Who Bet Big on GE

Value investors piled into GE in the fourth quarter, potentially giving new CEO a steadier support base

A GEnx jet engine, manufactured by General Electric, at the 2018 Farnborough International Airshow in Farnborough, U.K.
PHOTO: MARY TURNER/BLOOMBERG NEWS

By David Benoit
Updated March 6, 2019 11:45 a.m. ET

For the newest investors in General Electric Co. GE **-7.89%** ▼ , the proof is in the $21 billion biotechnology deal.

The conglomerate's agreement last week to sell that small but fast-growing business to Danaher Corp. DHR **-0.57%** ▼ provided a moment of validation to a group of value-seeking stock buyers who plowed into the stock at the end of 2018 amid fears the company was collapsing.

In the fourth quarter, investors who seek undervalued or misunderstood stocks turned toward GE for the first time in years, buying some $4 billion in aggregate, according to S&P Global Market Intelligence and using average prices from the period. Those investments are a change from the recent past when GE's biggest buyers were hedge funds, which made quick trades in a stock going through upheaval.

As of the latest disclosures, 10 of the top 25 GE shareholders manage value-leaning funds and own 12.6% of the stock, more than double a year earlier. Given their belief in GE, their low purchasing costs and tendency to hang around through weakness, these new investors could provide an important base for the company's new chief executive Larry Culp to execute a turnaround even the supporters believe will be challenging.

That challenge will keep the stock volatile and was on display this week as Mr. Culp said 2019 would remain a tough year for GE, emboldening the company's detractors and sending the stock down about 10% over Tuesday and Wednesday.

The biotechnology deal was fresh evidence their major unifying belief was correct: The market's concerns that GE wouldn't be able to handle its debt load and be forced into fire-sale mode were overdone. After a period of worrying they were missing a problem, or even crazy, value-oriented investors are emboldened in their bets and settling in for a long haul.

"It was trading well below the sum of the value of its businesses, so to the extent you are able to sell businesses, it highlights the total value," said David Green, co-portfolio manager of Hotchkis & Wiley's Value Opportunities Fund. His firm bought more than $450 million of GE stock at fourth-quarter prices after largely ignoring GE for years. "It takes a huge risk off the table."

General Electric chief executive Larry Culp said on Tuesday that GE's industrial business wouldn't create positive free cash flow this year. **PHOTO:** CLINT SPAULDING/PATRICK MCMULLAN

In interviews, some of the investors placed their faith in Mr. Culp, arguing GE's aviation and health-care units are worth more than the current stock price. But most see a turnaround for the beaten-down power business taking years. They also warn that the run-up in the stock this year has been faster than warranted.

Their concerns were borne out Tuesday when Mr. Culp told a conference that GE's industrial business wouldn't create positive free cash flow this year. He said the problem was the power business, which has struggled with a glut of supply for its gas-powered turbines. GE's shares dropped 6% and slipped again Wednesday to $9.35. They remain up about 28% for the year.

Three investment firms—Adage Capital Management LP, Harris Associates LP and Pzena Investment Management Inc. —each bought more than $250 million in shares. Southeastern Asset Management Inc. padded its position with another $150 million. Meanwhile, Fidelity's funds bought roughly $1 billion at fourth-quarter prices, including a big wager by its flagship Contrafund and other value-leaning funds.

No firm bought more stock than T. Rowe Price Group Inc., which acquired some $1.9 billion in stock, enough to make it the fifth biggest investor. Mr. Culp had been a director at T. Rowe before stepping down to take the GE job.

When Mr. Culp took over in October, T. Rowe's chief investment officer for equities and multi-asset David Giroux started looking at a stock he'd shunned for a decade. He spent two weeks focused on little else. By the end of the year, Mr. Giroux's $30 billion Capital Appreciation Fund bought $550 million of shares.

Mr. Culp was a key draw. Value investors tend to seek strong businesses that generate cash flow and a management team they trust to manage the cash. Mr. Culp, who has spoken to some of these investors, has long been something of a cult hero to the crowd from his time running Danaher, whose stock was usually too expensive for them.

"I had no interest in GE before Larry," Mr. Giroux said.

There remain questions about GE beyond the power business. Most pressing is the long-term care insurance GE sold decades ago and investors struggled to understand. In January 2018, the company announced it needed to put $15 billion aside for future claims from that business, spooking investors about an asset few had even realized was there.

The new investors say they believe GE's $15 billion decision gave it more of a safety cushion than rivals. This year, GE said it found it only needed a relatively small amount of additional reserves. It also added more disclosure around the assets and will give a presentation about the business Thursday.

This year's stock gains, despite the turbulence, have put investors in a better mental state than they were in December.

"I was looking for whether I was missing something," said Daniel Babkes, senior research analyst at Pzena. "When the market is giving you negative feedback, you start to wonder if you're crazy."

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