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INDIA ON THE MOVE: INFRASTRUCTURE FOR THE 21ST CENTURY

REMARKS BY

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John Flannery is the President and CEO for General Electric India and is directly responsible for all of GE's operations in the country. John has been with GE for over 22 years and has held several senior leadership positions in the company. He has extensive experience in building and leading large teams and growing businesses in global assignments.

Prior to assuming his current role, John was President & CEO of GE Capital Asia Pacific since January 2009. Before that, John was President and CEO of GE Commercial Finance, Asia. Before joining GE Commercial Finance, Asia, John was Managing Director and Business Leader of the Bank Loan Group (BLG) for GE Corporate Financial Services where he managed one of the largest global banks and institutional loan portfolios valued at nearly $10 Billion.

Prior to joining BLG, John was President and CEO of GE Equity, the private equity arm of GE Capital and before that held a number of leadership positions in the leveraged finance and private equity sectors, including two years as President and CEO, GE Capital Argentina and Chile.

John is a 1983 graduate of Fairfield University and holds an MBA from the Wharton School at the University of Pennsylvania.

GE has been in India in one form or another for 110 years. Amazingly, someone ventured out in 1902 from the U.S. and came to India and built a hydroelectric power plant, and no one can account for who that was or why they came to India in 1902, but it was built in Karnataka and GE has been in the country commercially ever since then.

Between 1993 - 2000 GE built up a lot of back-office presence in India, and were one of the first companies to develop the business process outsourcing (BPO) – and you now know that company as Genpact. GE did the same thing with many research and development and engineering activities in Bangalore, so today there are 5,000 scientists, engineers, and others doing work for GE in Bangalore. That was a big phase of GE's development in India, and it was trailblazing.

In the last three years we have been trying to make the company much more commercial. GE India still has back-end activities, but is now much more commercial and especially more local. GE India is now a stand-alone local company with products and manufacturing in India, which is a change from the way we have done things in the past.

The large sectors that GE is involved in are:

- Energy: GE is heavily involved in power generation; renewable energy, specifically the wind business; digital energy, water-related treatment things.
- Health care: health care is a very large and strongly-growing business for us in India; mostly imaging equipment and related services.
- Transportation: GE makes aircraft engines, locomotive engines and all the related services and things that would go with that.
- And lastly, GE Capital: in addition to day-to-day financing, GE Capital finances a number of infrastructure projects. Quite often we might put equity into a project or development company that is also working with GE on the commercial side. GE therefore has a pretty wide-ranging view of the activity in the infrastructure sector in India right now. Overall, we've got about 15,000 employees in the country.

The global economic scenario right now really touches India and the infrastructure space in particular in a few ways. GE, as you know, is thought of as an American company in many ways, but our number one strategic commitment is to grow the company outside of the United States. Currently 62 percent of our total sales come from outside of the U.S. So GE has a very broad international footprint which keeps growing.

Our economic outlook for the U.S. right now is basically flat. It is not in crisis mode, but there is not a lot of economic activity in the United States. Our outlook on Europe is that is very week and will continue to be so for the next couple of years. As for China, GE is quite positive – we are of the view that China has many options to manage through the current economic situation. They are transitioning their broad macroeconomy from being a pure or heavily export-dependent one into more of a domestic consumption model. The outlook for China is pretty stable, with decent growth, and not the precipitator of global crisis, as others would have it.

I would say one common theme across all these markets and India right now is jobs. Jobs are a massive issue for every country around the world. They are very keenly invested in trying to create and retain jobs, and in that context there is also a very raw sense of fairness (or unfairness) in many of these countries right now. This is a very dynamic debate and has ramifications for issues on trade policy and income distribution. This is the global context in which India is being assessed today by investors – both financial investors and businesses like GE. And the factors around how these other economies are doing does affect India in certain ways.

One of the critical things for India and for any country to do, is recognize that infrastructure is a lynchpin and of vital importance to the economy. It is not just one of 10 things that a government needs to work on; we view it as number one, two or three, after national security. And infrastructure really is "a gift that keeps on giving". You get many, many benefits from investing in infrastructure, both short term and long term. So it really is a critical asset and attribute of a country. And alternatively, lack of investment can really starve an economy of basic strength.

We urge countries and policymakers to really put this issue on a level that's quite separate from the dozen other different issues they grapple with – that infrastructure is really a critical issue. Secondly, look at infrastructure in a positive way, in a sense that it means a lot more opportunity for countries. In a number of markets, people view it as a hassle, as a negative thing. But it really is a very positive opportunity for a country. You get a significant amount of jobs and investment in the short term from the project themselves, and then long-term productivity for the economy from the aftermath of these projects.

So in the context of infrastructure being critical and critically important, I will talk a little bit about the energy infrastructure business in India right now, which is not a particularly positive story. And in the sense of criticality, we would like to see some changes.

Good News, Bad News Story

Energy infrastructure in India is a good news, bad news story. The bad news is that many agree that India only really reacts in the face of a crisis. And the good news is that in energy, we absolutely have a crisis right now. This is not an academic issue in any sense; there are very tangible things happening on the ground.

An energy business has three basic components: one is the power generation itself; second is transmitting it and distributing it across the country; and then the third is the price of power. And in India at this point, there are major problems across the whole continuum.

First, in power generation, there is a significant and growing shortage of power. 10 - 13 percent shortages are roughly accurate, but they are rapidly expanding. There have been no large-scale gas or coal-powered projects done in the last year, and probably almost 18 months. There are issues around fuel, the supply of natural gas, the availability of coal, and the price of coal. But in the power-generation side of the industry today, there are major shortfalls. In our own customer base, there are between five and six gigawatts of completed power projects that are not operating due to lack of fuel. To put that in perspective, that is roughly the energy supply for the Delhi metro area. These multi-billion-dollar investments are basically stranded for lack of fuel supply.

Secondly, the distribution network is very troubled in a couple of ways. One is the efficiency of the network - it is referred to as a "lost percentage", and is very high in India. There is a large gap between the percentage of electricity that is generated and what is ultimately paid for: this is leakage, in one sense and theft, in many circumstances. India would be quite high in any global ranking of the dissipation of power production to actual consumption of it. And that has created a lot of financial stress in the distribution companies. Today most of them (and arguably all of them) are financially stressed at a minimum, or altogether financially unviable, whether through excessive debt or inability to make payments.

Those are the major issues in power generation and distribution. Ultimately that translates to the fact that tariff rates have to increase. If you step back and wonder whether the energy business is viable from A to Z, you cannot say that about energy in India today.

The GDP growth rate that came out in the last quarter – 5.3 percent – was an interesting number. We had been pretty bearish on GDP in India over the last few quarters, mostly from watching our own customers and our own portfolio, and watching our own levels of activities and orders. But one of the things in particular we were seeing was how the energy sector was affecting other parts of the Indian economy. For example, in some of our supply chains, a lot of customers were coming to us saying that while in the newspaper it is called load shedding or a power holiday (or some other innocuous-sounding term), "I don't have power three days a week. I can't turn my plant on and off every other day and have a viable business." While it is difficult to determine exactly how much of India's GDP contraction is power-related, I would argue that it is a very significant amount and that the trend will probably accelerate in the next quarter or two.

So the bottom line is that the power business is in a "best of times, worst of times" situation. It is a fundamentally attractive space and will continue to be, but it has some issues in the short term.

Recommendations

Change the Mindset

First, and most significantly, change in the mindset is more important than a change in the policies. But if I had to pick just one – if policies are implemented and acted on in a timely manner, in general they can work. Yes, there are issues around land acquisition, et cetera; there are a number of policies that could be better. What we see right now is a lack of implementation of existing policies.

We have expressed our concern with the lack of urgency, what we call a "man on the moon mentality", which demands picking a certain amount of projects and focusing on them. In the last few weeks I have been encouraged; the prime minister's office and the planning commission have started an attempt at ring-fencing a number of projects – 15 to 20 projects which they feel have got to get done. But this should be replicated in the rest of the country, with a sense of unity – forget the political squabbling, forget the opposition-this and UPA -that, we have got to get into a mode where people agree that for the common good of the country, the economy, every person in the country, certain things just have to happen. I think a mindset change is needed to get a few deals under way.

Another example is the locomotive business; GE has been waiting for years for a tender to invest in locomotive production. It is shovel-ready – if the government pushed a button tomorrow, there would be people showing up to make proposals, to invest hundreds of millions (and more) in India to build factories and to create jobs. The people are ready to go if [the government] could just clear the debris and get them going.

One thing you would see is that the mood would snap back extremely quickly. As depressed and negative as sentiment has been in the last three to six months, I think you would find that just the sense that there are a couple of projects underway would have a very profound impact on business confidence and business conditions in the country. Again, that is less of a policy change and more of a can-do attitude. In the last few weeks we have seen some more of that, and I hope that is a trend that continues.

Long-term financing

In terms of specific policies that would benefit from change, one is long-term financing. These projects - whether a road, port or a power plant – have a long-term horizon. 10 to 30 years might be the time-frame for financing. It's quite risky for a developer to take two-, five-, seven-year loans and have to risk the availability or cost of financing.

It is not an insurmountable issue. Even with the constraints around financing today, we still see a lot of people willing to do projects if they could get them permitted and green-lighted. There is a basic shortage of long-term financing, but there is no shortage of suggestions: whether it is allowing pension funds and other long-term pools of capital to invest in infrastructure. There are plenty of remedies, but progress on this issue is critical. It would facilitate the magnitude of investment in India.

Tax Policy

The tax policies of India need a very serious re-examination, and I think the prime minister made some references to that in the last few days. As bullish as we are on India long-term, we were very concerned and disturbed by some of the proposals in the tax components of the budget in March. These are things that do not sound like they are directly related to infrastructure, but they are closely related to the mindset of investors and the risks that they perceive about the country.

For example, the retroactive tax in particular sent shockwaves through GE at the highest levels and I think many other companies felt the same way. Without even debating the peculiarities of the tax codes, the reaction was that there is a willingness to change the basic rules of the game well after the game has started, and there is an apparent willingness to circumvent or overrule the Supreme Court. One of the hallmarks of India for investors all along has been that it is a fair place to do business. It may take time to get things through the judicial system, but you know what the law is; the law is ultimately applied in a way that you can rely on.

We met with a number of people in the government to explain that they should at least understand the potential ramifications of this particular route, in that a lot of investors will likely pull their money out of India – financial investors in particular. And as a result, there will be a lot of pressure on the currency of the country right away. That unfortunately has happened, and we hope to see some of those things addressed in a different fashion.

To summarize, GE is a long-term investor in India, has been here for a long time, and have very significant investments in the country. We continue to increase our investments in the country. So we are fundamentally big fans of India – we have a big, bullish view on India especially in the infrastructure space.

With the right mindset being broadly adopted across government, multinational companies and Indian companies, that it is a critical space for the country to support, that it has very clear short-term and long-term benefits for the country and just getting to this implementation mentality, we think there is going to be a lot of upside and quick rebound. For all the back-and-forth on the issue, companies are still have lots of interest in investing in India. And I think we would all be surprised at the degree to which this thing can bounce back from where the gloom is today.

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