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GE - Q2 2018 General Electric Co Earnings Call

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OVERVIEW:

Co. reported 2Q18 consolidated revenues of $30.1b and net EPS of $0.07.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the General Electric second-quarter 2018 earnings conference call. (Operator Instructions). My name is Christine and I will be your conference coordinator today. (Operator Instructions). As a reminder, this conference is being recorded. I would now like to turn the program over to your host for today's conference, Matt Cribbins, Vice President of Investor Communications. Please proceed.

Matt Cribbins - *General Electric Company - VP of IR*

Good morning and welcome to GE's second-quarter earnings webcast. I'm joined by our Chairman and CEO, John Flannery; CFO, Jamie Miller; and our new Head of IR, Todd Ernst. Before we start I would like to remind you that the press release, presentation and supplemental have been available since earlier today on our Investor website at www.GE.com/investor.

Please note that some of the statements we are making today are forward-looking and are based on our best view of the world and our businesses as we see them today. As described in our SEC filings and on our website, those elements can change as the world changes. And now I'll turn the call over to John Flannery.

John Flannery - *General Electric Company - Chairman & CEO*

Thanks, Matt. The second quarter was an important one for GE. We've described 2018 as a reset year and in the quarter we made significant progress on that journey. At an overall Company level we laid out our path to a simpler and stronger GE by announcing our broad portfolio strategy going forward to drive shareholder value. The core of GE will consist of our Aviation, Power and Renewables businesses.

We also announced our plans to move our Healthcare, BHGE and Transportation businesses out of the GE core to enable them to pursue more focused growth strategies as standalone companies.

We made significant ongoing progress on our tactical priorities. We have now closed the sale of Industrial Solutions and Value-Based Care. We also announced the merger of our Transportation business with Wabtec and our sale of Distributed Power.

This essentially completes the announcement or actual closing of our target of $20 billion of dispositions. We have moved on with this deliberation, but with an eye for value as well. We are materially shrinking the size of GE Capital with planned asset reductions of $25 billion over the next two years.

We continue to take out structural cost. We have achieved $1.1 billion in cost out through the first six months and we are on track to exceed our goal of $2 billion. We also announced changes in our operating model that will allow us to take out an additional $500-million-plus at corporate by 2020.

The Aviation market continues to be very strong. We had a strong orders quarter and a good week at the Farnborough Airshow with $22.6 billion of wins. The biggest challenge we face continues to be working through the turnaround of our Power business. The market continues to be difficult with softness in orders putting pressure on our cash flow and working capital.

The team continues to focus on rightsizing footprint, reducing base cost, improving quality and maximizing the value of our installed base. This transformation is taking place in the context of a very dynamic macro environment.

Overall economic activity remains solid in most parts of the world. I made trips to Europe and to China and Korea in the past six weeks and we continue to watch the global trade picture carefully. Our businesses see significant opportunities both in Europe and Asia and it was also a chance for me to see the very strong GE teams winning on the ground.

In terms of business performance in the quarter, our overall results were in line with our expectations. Adjusted EPS was $0.19 with particularly strong performances in Aviation and Healthcare and a good performance in Oil & Gas. Free cash flow was $258 million, about what we expected for the quarter.

Through the first half cash is about $1 billion better than last year. I'm pleased that we are executing well on cash, meeting or beating our plan across all businesses except Power. Given the ongoing market challenges and related volatility in Power we anticipate free cash flow will be approximately $6 billion for the year.

Orders were up 1% organically. Organic revenue was down 6% and margins were down 80 basis points organically. And I will share more details on this metrics in the next few pages.

Overall we are executing on our framework and the plan we laid out for you in June. This plan was built around driving shareholder value, by focusing the portfolio for growth, delevering and derisking the Company and operating in a new decentralized manner. The team is energized by our path forward and we've made solid progress in the first half of the year and will continue to execute.

We expect earnings and cash pressure in Power will be offset by strength in Aviation and Healthcare and lower corporate costs. Renewables, Transportation and Oil & Gas should be about as expected. Our current rollup for EPS is at the low end of the range we've guided to of $1.00 to $1.07.

And next on to orders. First-quarter orders totaled $31 billion, up 11% reported and up 1% organically. Equipment and services orders were both up 1% organically. We saw strength in equipment orders in Aviation, Healthcare and Transportation. Power was down 29% and renewables was down 34% on tougher comps. We had good service orders growth in five of seven businesses with strong spares in Aviation and Repower and Renewables. Power Services declined 22%.

I will take you through some of the market highlights on the right. As I said earlier, Power remains challenging. First half trends continue to point to a market less than 30 gigawatts in 2018, which is down from 34 gigawatts last year and 48 gigawatts in 2016. We are planning for the environment to be in this range through 2020.

In Aviation, Healthcare and Renewables we see a lot of opportunity for growth. Aviation markets are robust. Global revenue passenger kilometers grew 6.8% year to date with strong growth both domestically and internationally. Air freight volumes grew 5.3%; load factors continue to be strong.

As I mentioned earlier, we had another very successful week in Farnborough. David and the team lead the airshow with $22.6 billion of orders and commitments.

In Healthcare, we saw strength in the US up 6% organically and emerging markets up 5%. Europe continues to see modest growth up 2%. I was with our Healthcare team in China last week and they had another strong quarter with orders up 10%. The market continues to be robust and the team recently launched the Pioneer MR that helped contribute to 19% MR growth in China.

Our Renewables orders were down in the quarter, but we continue to see strong global demand for onshore wind. Our onshore backlog is up 43% year-over-year and, although pricing remains challenging, it is improving. Overall the majority of the markets we are in are strong and growing and we see good opportunity for growth.

Next I'll go through our results on revenue, margins and costs. Industrial segment revenues were $29 billion, up 4% reported and down 6% organic. The difference is due mainly to the impact of the Baker Hughes acquisition. Aviation saw very strong growth of 13% and Healthcare was up 4%. As expected, Power, Oil & Gas, Transportation and Renewables had negative organic revenues. Jamie will walk through each of the businesses in more detail.

Industrial margins were 10.4% in the second quarter, down 160 basis points. Organically margins were down 80 basis points in the quarter but are up 40 basis points for the half on strong cost out. Aviation margins were down 110 basis points on higher LEAP shipments but are up 110 basis points at the half. We expect Aviation margins will expand in the year. Power margins were down 500 basis points in the quarter primarily due to lower volume and price.

Structural cost reduction remains on track. We reduced costs an additional $300 million in the second quarter, bringing the total for the first half to $1.1 billion versus our full-year target of $2 billion. We continue to look aggressively at all cost out opportunities.

We've begun implementing the actions we outlined in June to run the Company with the businesses as the center of gravity. This will result in at least $500 million of incremental corporate cost out through 2020. And with that I will hand it over to Jamie.

Jamie Miller - *General Electric Company - SVP & CFO*

Thanks, John. On the consolidated results, second-quarter revenues were $30.1 billion, up 3% reported. Industrial revenues were $27.7 billion, up 4% reported, with the industrial segments also up 4% but down 6% organically.

For the quarter adjusted EPS was $0.19, down 10% from the second quarter of 2017. The industrial businesses delivered $0.21 of EPS, down 9%, driven by continued softness in Power, partially offset by strength in Aviation and Healthcare. GE Capital contributed negative $0.02 in the quarter, which I will cover later in the GE Capital results.

Continuing EPS was $0.08 and included $0.15 of costs related to restructuring and other non-operating pension and benefit costs and tax charges related to the planned separation of GE Healthcare. It also includes $0.05 of gains and other marks, which I will cover more detail on the next page. Net EPS of $0.07 includes discontinued operations.

Adjusted industrial free cash flow was $258 million for the quarter, down by about $100 million from prior year. I'll walk through more details on our cash performance on the next couple of pages.

The reported GE tax rate was 39%, which was higher than previously expected due to the approximate $200 million tax charge to restructure our operations related to the planned separation of GE Healthcare. The adjusted industrial tax rate was 18%.

On the right side of the segment results, Industrial segment op profit was down 10% driven by double-digit declines in Power, Renewables and Transportation, partially offset by solid growth in Aviation and Healthcare. Industrial operating profit, which includes corporate, was down 11%. Through the half Industrial segment op profit was down 3%.

Next I'll go through a walk of earnings per share. Net EPS was $0.07 including losses and discontinued operations of $0.01 related to trailing costs from the GE Capital exit plan and to reserve for an unfavorable tax resolution related to a prior disposition.

EPS from continuing operations was $0.08. This included $0.02 of gains primarily related to the sale of Industrial Solutions to ABB. On industrial restructuring and other items we incurred $0.08 of charges; $0.05 was related to ongoing cost out actions at Corporate, Power and Renewables.

We also incurred a $0.01 charge in our Oil & Gas segment, which represents our portion of Baker Hughes GE's restructuring, and $0.03 related to the planned separation of GE Healthcare and a small impact related to other tax reform adjustments. For the year we expect restructuring to be about $2.7 billion pretax ex Baker Hughes GE.

In the quarter we also had a $0.02 favorable mark-to-market related to our equity investment in Pivotal. The company IPOed in April and, as required by GAAP accounting for equity securities, we marked our investment to fair value based on the publicly traded share price as of the end of June. This non-operating item is not included in our $1.00 to $1.07 EPS guidance for the year. Any future marks for this investment will continue to be backed out of our adjusted EPS each quarter in 2018.

Finally, non-operating pension and benefit costs were $0.06 which gets you to an adjusted EPS of $0.19.

Next I will cover cash. Our total industrial free cash flow was negative $600 million in the quarter. This represents total GE including 100% of Baker Hughes GE free cash flow.

Adjusting for pension plan contributions, deal taxes and Baker Hughes GE on a dividend basis, our adjusted industrial free cash flow was $258 million. This was up significantly from the negative cash flow of $1.7 billion that we reported last quarter. Adjusted industrial free cash flow year to date was negative $1.4 billion and that is up $1 billion compared to last year.

Overall second-quarter free cash flow performance was in line with expectations. Continued weakness in Power was offset by strength in other business segments. If we continue on the right, you can see the drivers of the second quarter cash performance.

Income, depreciation and amortization totaled $2.2 billion; working capital usage was negative $900 million for the quarter. The primary driver was net liquidation of progress collections in our Power segment reflecting a challenging new orders dynamic.

Excluding Power working capital was flat, indicative of a normal business cycle in the other businesses. We saw cash usage in his businesses through buildup of receivables and inventory, which was funded by a similar increase in payables and progress collections.

Contract assets were a cash usage of $500 million this quarter driven by $400 million of deferred inventory build in our Renewables segment due to timing of units that were shipped but not rev rec'd. We expect to recognize these units in the second half.

In addition, we had about $300 million of usage in our long-term services agreements portfolio, primarily driven by revenue in excess of billing. This was partially offset by $200 million of cash collections ahead of revenue on equipment contracts. Other cash flows were flat in the period.

We spent $800 million in capital expenditures to support growth in our business segments. This was down $300 million versus prior year, reflecting our focus on right-sizing investment spend. For the year, the continued challenges we are seeing in Power are putting pressure on our total year adjusted industrial free cash flow outlook. We currently expect it to be about $6 billion, reflecting the tougher Power market dynamics which is offsetting strength in other businesses.

Cash on hand ex Baker Hughes GE of $8.9 billion is down $2.9 billion versus year-end. At the half we have used $1.4 billion of adjusted industrial free cash flow and have paid out $2.1 billion in quarterly dividends. We received $2.3 billion in cash from business dispositions, primarily from the sale of our Industrial Solutions business to ABB that closed this quarter.

Additionally, we had $1.1 billion of investing activity primarily related to $900 million of activity in our Aviation business in the first quarter where we acquired IP assets for $700 million, as well as a minority shareholding in Arcam for $200 million, one of our additive businesses. Debt went up by $800 million primarily driven by debt related to pension funding.

And as we had previously disclosed, we will be making total contributions of $6 billion in 2018 to our US principal pension plan, which includes contributions in the first half of $900 million. These contributions are being funded by utilizing excess debt in GE Capital. The $1.3 billion change in other is comprised of $900 million of pension plan funding made this year that I previously mentioned, as well as other timing items during the year.

We plan to end the year and more $15 billion of cash. The principal drivers in the second half are free cash flow and dividends for the remainder of the year. In addition, we are expecting to receive approximately $5 billion from disposition proceeds and will have cash usage from the exercise of the $3 billion of Alstom puts in the fourth quarter.

Now I'll take you through the second-quarter results by segment. For Power, orders of $7.4 billion were down 26% with equipment down 29% and services down 22%. Equipment was down primarily in gas power systems which was down 78%. This was driven by lower gas turbine orders of seven units versus 24 last year, lower balance of plant down $600 million, and less aero derivatives orders of three versus 12 last year. We have 82 gas turbine units in backlog including 33 H units.

Services orders were down 22% and down 17% excluding the water disposition. Contractual orders were down 5% principally on lower upgrades and outages. Transactional orders were down 30% driven by lower upgrades in parts. Revenue of $7.6 billion was down 19% with both equipment and services down double digits.

Lower equipment revenues were driven by gas turbine shipments of seven versus 21 units and aero units of five versus 17 in the prior year. We expect to ship about 50 gas turbines this year with 90% in backlog today. Aero shipments are estimated to be around 30 units with about 55% in backlog. Shipments for both are in-line with total year expectations.

Services revenues were down 15% and down 8% excluding Water. CSA revenue was down 8% on lower outages, unfavorable mix of contract scope and lower long-term service agreement gains. Utilization on CSA units continues to perform as expected and in line with last year.

Transactional service revenues were down 21% on fewer upgrades and outages. Transactional revenues were also impacted by several large transactions of about $200 million where commercial closure moved to the second half. In total, services revenue should be stronger in the second half. However we will continue to have year-over-year pressure from CSA outage and contract mix.

Operating profit of $421 million was down on lower volume, price and unfavorable productivity and mix. Structural cost out totaled $212 million in the quarter and $566 million for the first half. We are on track for $1 billion of cost out for the total year.

The Power business had another challenging quarter. As John mentioned, the market continues to be soft and we have seen new orders in both gas turbines and aero derivatives moving out to the second half. We have visibility to a solid pipeline of activity in the second half. However, the timing of closing on these orders remains difficult to forecast. We expect orders to be better in the second half versus the first half and about flat with last year.

We are making progress on operational improvements but this is a multi-year process. Our lead time on H turbines is down about 15%, and we have implemented ERP systems that will provide greater visibility earlier on cost positions and scheduling issues in our project business.

We continue to make progress on upgrading our transactional service technical sales and capabilities. We have visibility to 90% of the non-CSA GE units over the last year and have initiated commercial actions on 80% of these units. We are focused on gaining traction and winning new business with transactional revenues up 5% for the first half. We expect to see improvement in the second half especially as we move into the fourth quarter.

As is typical with this business, as we look to the second half we are backend loaded to the fourth quarter. No change to our prior comments on Power performance for the year, but clearly we are very focused on operational change and improvement.

On Renewables orders were down 15% in the quarter driven principally by onshore wind down 18% on lower wind turbine volume and down 44% on units. This was partially offset by higher onshore service orders, up 2.6 times versus last year. The decline in wind turbine orders is principally driven by timing.

Year to date onshore wind orders are flat with last year. Pricing for new units in the quarter improved sequentially but was still lower than last year. Backlog for the total business grew 32% to $16.5 billion with onshore up 43%.

Revenues were down 29% principally on lower onshore wind turbine deliveries, down 54% on units. This was partially offset by onshore services up 44%. Operating profit was down 48% driven by lower volume and unfavorable pricing, partially offset by better cost performance.

Backlog continues to expand in this business based on strength in onshore wind. The team is investing in building capacity and is very focused on ensuring we have the capability to deliver on a large second half ramp up in shipments.

The Onshore Wind business has about 70% of the expected second half new units in Repower sales in backlog today with good visibility to the remaining 30%. This along with continued strong service growth should put us on track for revenue growth in line with our prior guidance, 7% to 10% organic. We continue to bring product costs down and we expect to see benefit from those actions as we deliver volume in the second half.

Next on Aviation, orders in the quarter were up 29% to $9.5 billion. Equipment orders grew 62% driven by commercial engine orders, which were up 90% as a result of key wins in GEnx up 9 times and continued LEAP momentum up 37%.

Military engine orders were up 19% largely driven by a U.S. Navy 414 order. Service orders grew 9%. Not included in orders are $22.6 billion of wins at list price for GE and CFM from the Farnborough Airshow with engines of about $19 billion and services of about $4 billion. We saw significant activity in key commercial engine segments including LEAP with $12 billion of wins and GEnx and GE90 of $5 billion.

Revenues in the quarter grew 13% to $7.5 billion. Equipment revenue was up 24% on higher commercial and military engine shipments. We shipped 250 LEAP engines this quarter with improving cost positions versus 69 a year ago and 186 in the prior quarter. Services revenues grew 8% with a spares rate of $26.6 million per day, up 23% versus prior year. This was partially offset by lower CSA revenue.

Operating profit of $1.5 billion was up 7% on higher volume, improved year-over-year price and operating productivity. Operating profit margins were pressured by 110 basis points in the quarter, principally due to unfavorable mix on higher LEAP shipments.

As I said earlier, we shipped 250 LEAP engines in the quarter and for the first half we have delivered 436 versus 459 for all of 2017. We are about four weeks behind schedule but are making good progress on our commitment to recover on LEAP deliveries by year-end and remain on track for 1,100 to 1,200 engines in 2018. For the year, David and the team are on track to deliver 15% plus op profit growth.

Next on Healthcare, orders of $5.3 billion were up 7% and 5% organically. Geographically organic orders were up 6% in the US and 2% in Europe. Emerging market organic orders were up 5% with China up 10%. On a product line basis Life Sciences orders were up 12% reported and 9% organic with Bioprocess strong, up 14% organic.

Healthcare Systems orders were up 6% reported and 4% organically. Healthcare revenues of $5 billion grew 6% reported and 4% on an organic basis with Healthcare Systems up 4% and Life Sciences up 5%. Emerging markets continue to be strong, up 10% organically, while developed markets were up 2%.

Operating profit of $926 million was up 12% reported and 10% organic driven by continued volume growth and productivity. Margins expanded 100 basis points in the quarter as material deflation and cost productivity more than offset price pressure. The Healthcare team is making progress on portfolio actions. The sale of the Value-Based care portfolio of Healthcare Digital to Veritas Capital was completed on July 10th.

Next on Oil & Gas, Baker Hughes GE released its financial results this morning at 6:45 and Lorenzo and his team will hold their earnings call with investors today at 9:30. Since we hit the one-year anniversary of the merger of Oil & Gas with Baker Hughes in July, this will be the last quarter that I provide a comparison of the combined business based on financials as if the merger had taken place on 1-1 of 2017.

For reference I'll give you the total organic orders and revenue comparisons as well. These represent the results of our legacy Oil & Gas business. Orders were $6 billion, up 95% reported and up 2% organic. On a combined business basis orders were up 9%.

The Oil & Gas market continues to grow as crude oil prices have remained relatively stable. Our short cycle businesses are already benefiting from this, which is driving the growth this quarter, particularly in the upstream oil field services business, which was up 13% year-over-year.

Our outlook for long cycle is becoming more constructive and we saw good growth in Oilfield equipment orders, which were up 30% on a large award from Chevron for the Gorgon Stage II project. This was offset partially by Turbomachinery and Process Solutions down 4% and Digital Solutions down 6%. Revenues were $5.6 billion, up 85% reported and down 12% organic. On a combined business basis, revenues were up 2%.

Short cycle Oilfield Services and Digital Solutions revenues were up 14% and 7% respectively, while the longer cycle Oilfield Equipment and Turbomachinery and Process Solutions were down 9% and 13% respectively. Operating profit was $222 million, up 86% reported and down about 27% organic driven by declines in our longer cycle Oilfield Equipment and Turbomachinery businesses partially offset by synergies.

During the quarter cash distributions from BHGE totaled $439 million, including the share repurchases and the quarterly dividend of $125 million. Lorenzo and Brian will provide more details on their call today. We are pleased with the team's execution on strategic goals of growing share and improving cash and margins. The integration is going well with $189 million of synergies in the quarter and is on track for $700 million for the year.

Next on Transportation. North American carload volume was up 5% in the quarter, primarily driven by Intermodal carloads up 7% and commodity carloads up 4%. Parked locomotives continue to improve, ending the quarter down about 31% from last year. Orders of $1.1 billion were up 42% with equipment orders of $486 million up 110%.

We received orders for 115 locomotives principally from North American customers versus 26 in the second quarter of 2017. Additionally, we continue to see strong growth in mining wheels with unit orders up 115%.

Services orders of $620 million were up 13% driven by double-digit growth in both locomotives and mining. Backlog was up $300 million versus prior year to $18.3 billion with equipment up 30% and services down 7%. Revenues of $942 million were down 13% with equipment down 40% on lower loco volume.

We shipped seven North American locomotives this quarter versus 37 in the second quarter of 2017. International unit shipments were 47 in the quarter versus 83 in the second quarter of 2017. This was partially offset by mining which was up 109%. Services revenue was up 12% driven by locomotive and mining parts growth.

Operating profit of $155 million was down 15% due to lower locomotive volume partly offset by services growth. We announced in May that our Transportation business will be merging with Wabtec. The deal is progressing and we expect it to close in early 2019.

Moving over to Lighting, revenues for this segment were down 9% with Current up 6% and the legacy Lighting business down 26%. Revenues for the segment were up 6% organically. Operating profit was $24 million, up from $17 million last year.

In the second quarter we closed on the majority of our sale of our Europe, Middle East, Africa, Turkey and global automotive Lighting business. These businesses represented approximately 15% of Current and Lighting's annual revenues. We expect to sign a deal to sign the remainder of Current and Lighting by the end of 2018.

Finally I will cover GE Capital. Continuing operations generated a loss of $207 million in the quarter, down 20%. We had a $38 million charge associated with the upfront costs of calling approximately $700 million of excess debt which will be accretive by the end of 2019. Compared to last year the business recorded lower gains and higher impairments primarily related to EFS, which was mostly offset by higher base earnings and lower cost.

As mentioned previously, for the year we are targeting to be about breakeven on continuing net income. We expect to have higher income in the second half driven by lower excess debt costs, incremental tax benefits in the fourth quarter and additional asset sale gains. The timing of asset sales could impact the exact outcome.

GE Capital ended the quarter with $136 billion of assets, including $16 billion of liquidity. We paid down $7 billion of long-term debt during the quarter and reduced our commercial paper program by $1 billion, which is in line with our overall capital allocation framework.

As we announced in January, we modified on July 1 the internal GE Capital preferred stock to be mandatorily convertible into common equity in January 2021. Remember, this was a back-to-back arrangement with GE, so the modification does not change the terms of the external GE preferred stock. In January 2021 the GE preferred stock becomes callable and we'll make a decision about the as part of our overall capital structure at that time.

Our strategy with respect to GE Capital remains clear. We intend to materially shrink the balance sheet of GE Capital. We are making progress in our target reduction of $25 billion in energy and industrial finance assets by the end of 2019. We sold approximately $2 billion of assets in the second quarter and expect to exit more than $10 billion of assets in the second half. With that, I'll turn it back over to John.

John Flannery - *General Electric Company - Chairman & CEO*

Thanks, Jamie. In summary, we see continued strength in Aviation, Healthcare and Corporate cost in the second half. This will offset pressure in Power, and Renewables, Transportation and Oil & Gas should be about as expected. Cost out was $1.1 billion in the first half, on track to be better than $2 billion target. We are aggressively reviewing all cost out opportunities for the second half.

We are targeting GE Capital earnings to be breakeven for the total year due to portfolio actions. We expect the second half to be better than the first half.

GE is on a multi-year transformational journey and the path forward is clear. Overall we feel good about our execution. We see strength across the majority of the portfolio. We remain focused on implementing the broad macro strategic changes we outlined in June while making sure our micro execution in each business continues to improve across the Company. And with that, Matt, I'll turn it back over to you.

Matt Cribbins - *General Electric Company - VP of IR*

Thanks, John. With that let's open up the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Scott Davis, Melius Research.

Scott Davis - *Melius Research - Analyst*

Good morning, guys and gals. The Power business, it continues to get a bit worse it seems and the news flow just continues to get worse. And I guess the question is the original restructuring plan, when you look at it now is it enough and can you get enough? With the agreements that you have with the French government, is it even possible to take out enough capacity to get close to matching up supply and demand on that?

John Flannery - *General Electric Company - Chairman & CEO*

So Scott, let me just start out saying it's clearly our top priority is managing through and fixing our issues in the Power business. So we are working that intensely, a total sense of urgency. The market is challenging but we need to work through that.

It's going to be a multiyear fix I think with some volatility. This is not something that's going to move straight line quarter to quarter. But let me take it in three pieces really. One is just the market; 2 was how we are fixing it and then just as we look into 2019 and beyond.

I will start with markets. So we are looking basically 50% down the last two years. We are planning for this to stay at those levels, so we're not looking for any rebound there. On the installed base side, the industry is not going away.

I think if you look at every forecast, recent forecast, Bloomberg and others, the amount of electricity generated by gas turbines will increase. So we think there's something substantial to build around longer-term here and our strategy is to restructure the business and maximize the value.

We've got five basic things, Scott, in the plan here in terms of addressing this. One is right sizing the footprint in the base cost. I think the team made good progress on that. We are about $550 million, $560 million of cost out in the first half. We will be ahead of the target on $1 billion out.

Then maximizing the value of the installed base. Again, we've gone through that with you before but we continue to make progress, I think, in improving our visibility, improving our commercial execution, sales incentives, pricing controls. So I think the team -- we've got execution and quality and in liquidated damages and in cycle time, selling non-core assets, IS sold, DP announced, low-voltage motors and changes in management.

So we see a very clear plan of what we need to do there. The market continues to be a challenge, and so what we announced today, Scott, was this -- we see pressure on orders. We're going to continue to have to take additional cost out. We're going to continue to have to restructure the footprint. We can do that, we will do that, but it's going to take some time.

So I don't see any change to our core strategy with the business, our core approach to what we see in the market. But I agree with your point that it's going to take more ongoing actions here and that's what the team is focused on.

And I think as we look beyond -- 2019 and beyond, we're already working with an assumption of a very challenging market. So we had 107 gas turbines last year, we are about half of that this year. We are not expecting any improvement on that. We have the commercial teams intensely focusing on getting our fair share but make sure we are disciplined on the terms of that. And we just continue to grind down the footprint in the base cost.

So, I think the picture the industry is not going away, the short term cycle is severe and we've got to manage through that. But there's an asset worth maintaining and preserving and expanding the value here.

Scott Davis - *Melius Research - Analyst*

Makes sense. Just quickly, you guys haven't really given us a number yet on what you think the run rate corporate expense is once all that Healthcare spend and Transportation -- once this all occurs. Do you have a sense of how much it takes in pure dollars and cents to run a company like GE from a corporate perspective?

Jamie Miller - *General Electric Company - SVP & CFO*

Yes, Scott, from a corporate perspective, so for this year we are looking at between $1.2 billion and $1.3 billion of corporate. Back on June 26 we announced, both externally and internally, a number of changes to our corporate structure.

First was really decentralizing a lot of what is done at corporate today and both moving folks to the businesses as well as a number of headcount reductions. I'd say the second thing is we had historically run a lot of things centrally here at corporate as well. And that's all getting pushed out to the businesses, things like global growth, things like ventures, things like IT and other shared services.

So, as you look at that, part of that as well was to announce at least $500 million in incremental cost out over the next two years and those are actioned. We are in the process of really laying out the execution for that right now and that really starts now and into the second half.

John Flannery - *General Electric Company - Chairman & CEO*

I would just add, Scott, on that just as a matter of philosophy, I'm deeply committed to the philosophy that the corporate center should be significantly smaller and really focused only on governance, on talent, on capital allocation strategy. So, a radical resizing of what it's been in the past.

Operator

Andy Kaplowitz, Citigroup,

Andy Kaplowitz - *Citigroup - Analyst*

Good morning, guys. John or Jamie, can you give us more of an update on GE Capital in the sense that you mentioned some smaller impairments in EFS? Can you give us more color on those?

You said you still expected GE Capital to be breakeven for the year with a decent ramp up in the second half. Has visibility decreased at all in that target given your results in 2Q, or do you still see a nice ramp in second-half gains to get you there? And I assume no new update in WMC at this point?

Jamie Miller - *General Electric Company - SVP & CFO*

Yes. So, on GE Capital we are targeting roughly breakeven. That really hasn't changed from our earlier conversations. That could vary based on the timing of asset sales. We do expect fourth-quarter tax planning benefits like we've had in the past and asset sale gains.

I think one important thing to note in the first half versus the second half is as we've begun the process of asset sales and we are doing pricing discovery, we often have to take marks or impairments on specific assets where they may be a loss on sale, but those gains we have to defer until the actual sale happens. So that gain portion of it really flushes through in the second half.

We will also see lower access interest costs. You saw we had a number of debt maturities in the first half. So, still in targeting roughly breakeven for GE Capital, but, again, timing of some of that could vary and that is a rough guide. On WMC, I would say at this point really no change to what we talked about before.

Operator

Jeff Sprague, Vertical Research.

Jeff Sprague - *Vertical Research - Analyst*

Thank you, good morning, everyone. Just two quick ones for me, first on restructuring in 2018. I was wondering how much of the $2.7 billion you would label as actual cost out restructuring relative to write offs, the GE Healthcare charge and the like.

And then the second question, I was just wondering on, looking at the Aviation margin sequentially -- pretty significant drop in sequential spares growth and a little bit of a lift in LEAP volumes but not materially. So just trying to get a better handle on how Aviation looks for the year. Jamie, I think you said up 15% in OP. Is that correct and what's the revenue trajectory associated with that? Thank you.

Jamie Miller - *General Electric Company - SVP & CFO*

Yes, so let me start with the restructuring and I'm going to talk about restructuring including Baker Hughes GE. So restructuring for the year at this point we expect to be about $3.2 billion, that includes about $500 million of Baker Hughes GE. When you really break that down, of that $3.2 billion we see roughly $2.6 billion being related to headcount reductions, site closures, other facility exits, things like that.

We do have a heavier run rate of what I will call BD and transaction-related costs this year. Just as you know, we've announced our $20 billion of dispositions. We are working through the other portfolio changes. So we do see things like carve out audits, transaction fees and other things rolling through there as well. So that's that piece of it.

Just shifting to Aviation for a minute, let me start with -- for the full year we expect Aviation to have positive margin uplift and that's consistent with the 15-plus op margin discussion we've had before. But just looking at second quarter in particular, you saw a couple of things here.

So first, sequentially we had 64 more LEAP engines in second quarter versus first quarter. But if you look at second quarter year-over-year that ramp was really 3 to 4X. So that was really a significant pull and really impacted margins in the second quarter.

When you start to look at the second half, LEAP continues to come down the cost curve. So while volume continues to ramp up we're seeing a nice benefit continuing in terms of the cost piece of it. On the services side we are seeing some higher turnaround times in our shops just given the volume ramp, which is resulting in higher shop costs. We saw some of that in the second quarter. The team is taking very specific action on that and we expect some of that services pressure to continue in the second half but not at the same level.

Remember, we've got a very strong spares rate we are seeing right now and we expect that to continue. But bottom line is, when you put all that together, we expect full-year margins to go up. But second quarter definitely had some shifting, especially with that year-over-year comparison in LEAP.

John Flannery - *General Electric Company - Chairman & CEO*

And I'd just add just as a macro comment on the Aviation business overall, this continues to be an extremely strong asset. I think if you look at market conditions, they are extremely good in commercial, extremely good in freight frankly picking up, good in military.

We have a very strong team. The team is working through the LEAP launch well. David went through that at the Farnborough show this week in terms of our delivery schedules and being on track with our delivery schedules. They are on track coming down the cost curve as well on a per unit cost.

So, we've got I think a good market, a very strong franchise. We continue to clearly outperform on the orders and with customers and a very strong team running that business with a great execution track record. So when I step back and look at our portfolio of businesses, this one remains a premium business with a very good and visible long-term outlook.

Operator

Andrew Obin, Bank of America Merrill Lynch.

Andrew Obin - *BofA Merrill Lynch - Analyst*

Good morning. Just -- I guess I have two questions, one related to Farnborough and another one related to Power, both in services. There was a quote on Bloomberg from one of your colleagues I think, one of your aftermarket folks, about some sort of MRO sharing arrangement with Boeing.

It was fairly vague, but I'm just trying to understand is that the direction you are going. And second, if you could just provide more color as to when you guys think transactional business is going to bottom in terms of revenues. Thank you.

John Flannery - *General Electric Company - Chairman & CEO*

I'm not familiar with the comment, Andrew, on the Boeing MRO strategy, so that sounds off point to us. But we'll follow-up with you on that one. On the transactional services business, I assume you are referring to the Power side of things. And I would just say it's a longer cycle process, so you're dealing essentially with coverage of our installed base and coverage of outages.

So, our first step obviously has been trying to drive visibility into our installed base. That's up to about 90% right now from quite low levels. We've got about 80% of those sites with commercial processes and commercial bids being worked on.

So this is something that's going to unfold over the next several quarters. But I think the tactical steps up front around visibility, commercial intensity, sales incentives -- the building blocks, if you will, of something that can unfold over the next several quarters. The team feels good about what they are doing there.

So, it'll take some time but it's an opportunity for us. Margin rates were up I think about 400 basis points on the CM line in transactional, so we've got some work we can do on pricing and product quality and things. But it will take several quarters I think for this to unfold.

Jamie Miller - *General Electric Company - SVP & CFO*

And Andrew, I would just add on the transactional piece of it, we did see lower core volume in the quarter with fewer outages. But the other piece, just to take into consideration, is that upgrades were down close to 50% year-over-year as well.

Operator

Steve Tusa, JPMorgan.

Steve Tusa - *JPMorgan - Analyst*

Good morning. I just want to thank Matt for all the help over the years. He was extremely diligent with us, so I really appreciate his help. So thanks, Matt. So just two questions. The first one on Aviation just to kind of clarify, and I think you've made a lot of comments on the call about third quarter/fourth quarter.

Given that seasonality has probably changed a little bit with the new accounting it's a little bit unclear how we're supposed to kind of think about Aviation seasonally. Would you expect it in the third quarter to be down, flat or up relative to the second quarter from a profit perspective in Aviation?

Jamie Miller - *General Electric Company - SVP & CFO*

Up, yes, we see the second half with the volume story, we see strong services continue, we see third quarter being up versus second quarter sequentially.

Steve Tusa - *JPMorgan - Analyst*

Third quarter being up versus second quarter? Okay, great. And then on the restructuring side, so $2.6 billion is -- how much of that is actual headcount?

Jamie Miller - *General Electric Company - SVP & CFO*

I don't have that split with me. We will have to follow-up with you after that. But of that $2.6 billion, Steve, all of that relates to investments that we make against headcount reduction, site and facility closure and other cost out actions.

Operator

Nicole DeBlase, Deutsche Bank.

Nicole DeBlase - *Deutsche Bank - Analyst*

Good morning, guys. So I guess two questions for you. The first is just a high level question, if you could just comment a little bit on the work you've done around potential impact from all of the tariff activity that's been thrown around over the past few months and if there's risk to your guidance associated with that.

And then the second thing is just thinking about the Power ramp in the second half of the year. How much of that improvement is underwritten by restructuring actions that have already been taken? I'm just trying to get a sense of the risk if we see further deterioration on the top line.

John Flannery - *General Electric Company - Chairman & CEO*

Okay, Nicole, let me take the China tariff situation and then Jamie can follow up on the Power thing. I think just on the -- let me give you some context really on our business in China first and then how we see this unfolding.

So, we import about $29 billion of goods globally into the US, about 10% of that comes from China. And our business in China, we do about $7 billion, a little over $7 billion of revenue in China and the majority of that is in our Aviation and Healthcare business.

If you go and look at the actual tariffs, the $50 billion that are announced and implemented and $200 billion announced but not implemented yet, I'd say we look at it sort of a gross and a net basis. So, it could be $300 million to $400 million at a gross level before any mitigating factors are taken there and there's some significant mitigating factors.

The first is what's called duty drawbacks. And these are basically credits for any components and things that we would import from China and ultimately re-export as part of a gas turbine or an MRI machine or an aircraft engine. And that's a significant amount of what we import. So we think that could mitigate half or more of what the tariff picture is there. And then obviously over time we also can adjust our supply chains in response to some of these issues if that's what made sense.

So I'd say we don't see a major impact yet financially, certainly not on our 2018 guidance. But that said, we are a Company that's built for fair and open trade. That is obviously a subject of debate and discussion, I think that's what you're seeing right now. We are supportive of fair and open trade. We have a massively global business in every sense, both with the customers, supply chains, everything.

And our view right now is we hope and we expect that ultimately these matters reach a sensible negotiated conclusion. And we think that's really in the best interest of all parties involved. So we are watching this carefully, but I think the financial parameters of this we've got a good handle on. And then, Jamie, you want to comment on the Power question?

Jamie Miller - *General Electric Company - SVP & CFO*

Sure. So, just looking at Power first half/second half, I think when you start to look at the second half, one thing to keep in mind is that the fourth quarter of 2017 we had $600 million of one-time items with some inventory write-offs and some other things last year. So you have to think about that in the comparison first.

In the second half we do see lower gas turbine units year-over-year. Services, as John mentioned, we do expect to start to see that pickup here in the second half as the results of Scott's efforts really start to take hold.

Cost out you asked about. We've seen -- we have a $1 billion cost out program in Power this year. For the first half we've seen about $560 million, $565 million of cost out already. We expect to see at least that same amount in the second half, but fourth quarter is our biggest quarter.

We've got the volume being lower, the services ramp coming through, the cost out coming through. And one other thing just to remember on volume is that of our gas turbine volume, about 90% of that is already in backlog. And then just when we look at the aero units for the second half, we have a very strong pipeline there, but that can be a bit lumpy too.

Operator

Julian Mitchell, Barclays.

Julian Mitchell - *Barclays Capital - Analyst*

So, just a couple of quick questions. One is on the second half free cash flow of about $7.5 billion. Within that portion how much is really coming from working capital versus the $2 billion, $2.5 billion outflow in the first half? And I guess how much of that is Power?

And then secondly, you talk a lot about the structural cost out. You had about $1 billion out or more in the first half firm-wide, but your industrial EBIT still only flattish year on year. So, I guess trying to get a sense of the urgency around the magnitude of stepping up the cost plan, because maybe not that much of it is dropping through to the bottom line.

Jamie Miller - *General Electric Company - SVP & CFO*

Good morning, Julian. Let me walk you through the second half on free cash flow and then maybe I'll touch a little bit on the cost out element and John may comment as well. So, for the second half on free cash flow, we do see higher earnings across all of the businesses as we've got a very strong volume second half, as you see.

With respect to working capital, we see about $3 billion of inventory liquidation coming through in the second half really with the shipment profiles we are seeing across Aviation, Power and Renewables. We continue to expect progress drag at Power, but we also expect that to be largely offset by Renewables second half collections as we really start to see that PTC cycle in 2018, 2019 and 2020 ramp.

On contract assets, we had usage in the first half of about $900 million. We expect usage to be higher in the second half, but lower than the $3 billion usage we had previously planned. So that's a little bit there.

Just talking about the structural cost piece of it. So, $1.1 billion out year to date, we still expect the $2 billion plus for the year. When you look at the $1.1 billion and where we're seeing shifting in the industrial margins, we are seeing lower volume impacting our margins primarily at Power, that was about $600 million.

We are seeing mix also affect the margins element, primarily LEAP there, and some FX. So it is being offset in terms of what you see right now in your operating margins, but, again, expect a strong second half as well on both cost control and cost out.

John Flannery - *General Electric Company - Chairman & CEO*

And, Julian, I'd just say on the cost side of things a couple of things here. One is the cost out initiative will never end. If we have headwinds in other parts of the business, as Jamie mentioned, that are eating that up, we just have to do more. So, we are looking constantly and aggressively at everything on the cost side of things. So, I think the sense of urgency and our knowledge of the need to execute on that is front and center.

I continue to see additional opportunities I think in Corporate. We have also gone through with our teams this whole notion of decentralizing Corporate, pushing down, if you will, or eliminating activity at the corporate level. I expect that to also happen at the Tier 1 level in the Power business, in the Healthcare business, etc. So, I think there's more to go there. But this is a self-help execution story for us and cost is a huge part of that.

Operator

Steven Winoker, UBS.

Steven Winoker - *UBS - Analyst*

Good morning, all. I've got just two quick ones. Just the first one is I know you guys gave us adjusted EPS guidance of $1.00 to $1.07. But I think most companies that we cover tend to give us a GAAP number as well, especially considering all the moving parts around restructuring and everything else.

Is there a way you could give us a sense of what that implies from your perspective on GAAP? And then the second question is around just pricing in the order book, particularly around wind and on the equipment side in Power. Thanks.

Jamie Miller - *General Electric Company - SVP & CFO*

So, let me start with the pricing discussion for a minute. Pricing from a Power perspective, as you see, the market is very soft right now. We are expecting a flattish market for the next couple of years in Power, and there's a lot of overcapacity in the market. So as you would expect, we are seeing continued price pressure on equipment in many markets.

I would say on the services side we're seeing pricing being relatively stable in transactional services. You saw that come through in the first half with orders and revenue on transactional services up 5%.

When you start to look at Renewables, a couple of dynamics here. First, we are still feeling the effects from the European auction environment. So, pricing does continue to be challenging, but we are seeing it moderate and we saw that this quarter. As we move into what should be a very strong volume couple of years, we expect that to help the pricing element as well.

John Flannery - *General Electric Company - Chairman & CEO*

I would just add on with respect to the adjusted earnings topic in general, that's something I've asked Jamie and now Todd, as he's coming in here, to look at. I understand your point and I would say expect an update on that later this year.

Matt Cribbins - *General Electric Company - VP of IR*

Great, thank you. Just as a reminder, John, before you wrap -- a replay of today's call will be available this afternoon on our Investor website.

John Flannery - *General Electric Company - Chairman & CEO*

Great. Thanks a lot, Matt. And I, as Steve noted earlier, do want to thank you really for just a tremendous job in this role. You have led us through a lot of change and movement in the Company and have always been responsive and service oriented to our investors and analysts. So, thank you for an incredible effort and performance there and we welcome Todd Ernst as well. So Todd, the baton is passed to you. We have every expectation you will build on Matt's great work.

So, I'd just finish really by saying this is really the one-year anniversary, if you will, for me. And as I reflect back, really much progress has been made at the Company. If I look back I see -- obviously we spent a lot of time working on a very clear strategic direction, positioning the portfolio so that the businesses can thrive, delevering the Company, decentralizing the management approach.

So strong progress on the strategic direction of the business. Good ongoing progress in our tactical execution items, with $20 billion of dispositions, cost out, the team continues to just execute on the day-to-day things we need to advance things. And a lot of change, change at the top of the Company in terms of -- whether that's the leadership team, changes in our Board, changes in the culture of the Company.

So, a lot has happened in 12 months. As we stand today I'd just say we look forward and say the path is clear. This is really a pivot point for us that this is an execution story going forward. We know what we need to do, we know where we want to go, we know what our strengths are and they're significant, and we know what our issues are and some of those are significant. So we are focused on execution going forward.

And I'd say the team is clear where we are headed. They know what they need to do, they know where they can contribute. They are excited about the path we are on. In different pieces of the Company, they have different roles to play, but there's a confidence in the future and I'm personally certain we are on the right path.

So, as we said, it's a multi-year journey, but I'm highly confident in the direction we are on and it's up to our team to execute and I'm confident in our ability to do that. So, that's it and, Matt, thanks again for great performance.

Operator

Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.