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GE - Q2 2017 General Electric Co Earnings Call

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CORPORATE PARTICIPANTS

Matt Cribbins *General Electric Company - VP, Investor Communications*

Jeff Immelt *General Electric Company - Executive Chairman and Outgoing CEO*

Jeff Bornstein *General Electric Company - Vice Chairman, SVP, and CFO*

John Flannery *General Electric Company - President and CEO, GE Healthcare and Incoming CEO of General Electric Company*

CONFERENCE CALL PARTICIPANTS

Julian Mitchell *Credit Suisse - Analyst*

Andrew Kaplowitz *Citigroup - Analyst*

Jeffrey Sprague *Vertical Research Partners - Analyst*

Deane Dray *RBC Capital Markets - Analyst*

Andrew Obin *BofA Merrill Lynch - Analyst*

Chris Glynn *Oppenheimer & Co. - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the GE second-quarter 2017 earnings conference call. (Operator Instructions) My name is Jason 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, Investor Communications*

Good morning, everyone, and welcome to GE's second-quarter 2017 earnings call. With us today are our Chairman and CEO, Jeff Immelt; our next Chairman and CEO, John Flannery; and GE Vice Chairman and CFO, Jeff Bornstein.

Before we start, I would like to remind you that our earnings release, presentation, and supplemental, and available since earlier today on our 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.

Now I will turn the call over to Jeff Immelt.

Jeff Immelt - *General Electric Company - Executive Chairman and Outgoing CEO*

Thanks, Matt. GE had a solid quarter in a volatile world. Let me give you a few themes that describe the environment. The US is stable at a slow growth rate, global growth is accelerating, but resource markets remain challenging.

Our top-line results are solid. In the second quarter, our organic results were: orders up 5%, revenue up 2%, margins expanded by 10 basis points, and industrial profit grew by 4%. At the half, orders are up 6%, revenues up 4%, margins expanded by 70 basis points, and industrial profit grew by 11%.

At the half, we reduced structural costs by $670 million ahead of plan. We generated $3.5 billion of cash in the quarter, in line with our expectations.

In the quarter, we made progress on our portfolio strategy. July, we closed GE Baker Hughes. This move significantly strengthens our position in the sector. This is a more competitive business and positioned for growth.

We closed LM, a critical vertical integration move for our wind business. LM is already improving growth and margins. We remain on track to close the sale of Water in third quarter and Industrial Solutions by year end. And we see good strategic and operational synergy with Alstom. Overall, we have no change to our 2017 framework. John will update you on his views for 2018 and beyond later in the year.

Our orders have been strong, up 8% year to date and 6% in the quarter. We saw strength in both equipment and service. We grew backlog by $3 billion. We continue to see pricing pressure in Oil & Gas, where we have slow industry with excess capacity.

Let me give you a few order highlights that we consider most noteworthy. Aviation was up 14%; really an amazing performance. At the Paris Air Show, we announced $30 billion of commitments, 10 times our nearest competitor.

Oil & Gas equipment orders grew by 50%. This includes one of the few big project deals in the industry, with Eni in Mozambique. Renewables were up 12% behind some big global deals. We are gaining share in Europe.

We took orders for 9 H turbines in the second quarter, with 33 in backlog. Global orders were up 11% and represented 6% of our total. 9 of 12 regions experienced growth, with China up 26%, India up 36%, and Europe up 35%. Transportation signed an LOI worth $575 million for locomotives in Egypt.

Digital orders were up close to 40%. At the half, Meridium orders were up 86% and ServiceMax orders grew by 101%. Healthcare created a collaboration with Partners for artificial intelligence solution. And in Service, aviation spares grew by 14%, military grew by 28%, and Power received a $3 billion service commitment for power plants in Algeria.

There's no doubt that we're outperforming competition in many markets and gaining share. This in time is building our installed base for the future. With this order rate and backlog, we feel great about the 3% to 5% organic growth for the year.

Organic revenue was up 2% and margins were up 10 basis points in the quarter. Year to date, organic revenues up 4% and margins were up 70 basis points. Service revenue is up 8% year to date.

So here are some key revenue highlights. Global revenue was up 7%, with growth in 9 of 12 regions. Europe grew by 15%, China by 16%, India by 35%, and MENAT by 15%. For the half, we had organic service growth in all segments.

We are gaining share with our products. LEAP has an unprecedented advantage in the market. We believe that GE has greater than 50% share in the gas turbine market and the market for H. In Wind, we are gaining share in Europe for the first time.

Healthcare closed a number of big enterprise deals for both Healthcare Solutions and Life Sciences. Our new cell therapy business grew by 37%, and our mammo business, where we have launched new products, grew by 20%. Digital revenue growth was 17% and we see this accelerating through the year.

Let me give you some perspectives on our margin performance. As I said earlier, our structural cost is $670 million year to date, with strong performance in the business and corporate. We expect to beat our $1 billion goal.

We had $150 million of non-repeat items that impacted our Oil & Gas and Power businesses. Jeff will review these in the segment reviews. We grew equipment in a few areas that are dilutive in the CM rate in the short term, but open up service growth in the long term. These include the H and LEAP products and the power balance plan. This was expected and reflected in our margin goals for the year.

In the second half, we are targeting 120 basis points of improvement to generate 100 basis points for the year. This kind of second-half expansion is typical for GE. We see sustained revenue growth and structural cost-out helping us to achieve this goal. In all, we expect to hit the EBIT target we have discussed in the past.

For cash, CFOA was $3.5 billion in the quarter: $2 billion from capital and $1.5 billion from Industrial CFOA, in line with expectations. Here are some of the main drivers of Industrial CFOA. Net Eng Chem was actually below last year due to increased restructuring cost not covered by gains.

Working capital performance was very good, up $1.5 billion from a year ago and a $700 million improvement in the quarter. We saw improvement in receivables, inventory, and progress, which was partially offset by lower payables. Contract assets were a drag, but better than a year ago.

The second-half CFOA profile will be a lot like last year. We expect higher earnings. We expect to reduce working capital by about $4 billion in the second half. Last year this was actually more; it was about $5 billion. Contract assets will grow at about the same level, and we will benefit from timing of other items.

We ended the quarter with $14 billion of cash on the balance sheet, in line with expectations. And we should be within the $12 billion to $14 billion goal for Industrial CFOA.

Now over to Jeff.

Jeff Bornstein - *General Electric Company - Vice Chairman, SVP, and CFO*

Thanks, Jeff. Starting with consolidated results, revenues were $29.6 billion, down 12% in the quarter. Industrial revenues of $27.1 billion were also down 12%. As you can see on the right side of the page, the Industrial segments were down 2% on a reported basis, but up 2% organically, driven principally by the Appliances disposition.

Industrial operating plus Verticals EPS was $0.28, down 45% versus the prior year, driven by a substantial Appliance gain in the second quarter of last year. We had $0.06 of restructuring with no gains in the quarter versus $0.11 of net gains after restructuring last year.

Operating EPS was $0.19 in the quarter, down from $0.39 in the second quarter of 2016. This incorporates other continuing GE Capital activity, including excess debt and headquarter runoff costs that I will cover on the GE Capital page.

Continuing EPS of $0.15 includes the impact of nonoperating pension. The net EPS of $0.13 includes discontinued operation. The total disc ops impact was a charge of $152 million in the quarter, driven by GE Capital exit plan items.

GE tax rate was 13% in the quarter. We still expect the ongoing operations of the business to have a mid-teens tax rate for the year. However, the Water disposition will be a low tax transaction and will bring the overall tax rate for our Industrial to around 10% for the third quarter and about that for the total year. The GE Capital tax rate was favorable, reflecting a tax benefit on a pre-tax [contingent loss].

We had a better cash quarter. CFOA was $3.5 billion, including a $2 billion dividend from GE Capital. Industrial CFOA was $1.5 billion in the quarter. It was up $3.1 billion from the first quarter and up substantially from the second quarter of last year. At the half, Industrial CFOA is a $200 million usage.

We expect substantial improvement in cash in the second half, driven by higher earnings, continued working capital improvement on higher shipments, partly offset by contract assets. For the year, we are trending to the bottom end of the $12 billion to $14 billion range on CFOA, driven by pressure, principally in Power and Oil & Gas.

John and I are reviewing our capital allocation plan for the year. Dividend remains our priority. We are relooking the $11 billion to $13 billion range of cash used for buyback based on the timing of dispositions. Year to date, we bought back $3.6 billion of shares.

On the right side of the segment results, as I mentioned, the Industrial segment revenues were down 2% on a reported basis and up 2% organically. Through the half, the Industrial segment revenues were up 4% organically. Industrial segment op profit was down 4% reported and down 1% organically. And the Industrial op profit, which includes corporate offering costs, was down 1% reported and up 4% organically.

The difference between Industrial op profit and Industrial plus Vertical EPS year over year is driven by the effects of restructuring, the Appliance gain, and the associated tax impacts of Appliance.

Through the half, Industrial op profit of $6.8 billion is up 4% reported and up 11% organically. On an EPS basis, we've earned $0.48 of EPS, which is $0.62 excluding the first-half naked restructuring. Given our outlook on Oil & Gas and Power, we are trending to the bottom end of the range of $1.60 to $1.70 EPS for the year.

Next on Industrial and other items for the quarter, as I said, we had $0.06 of charges related to Industrial restructuring and other items that were taken at corporate. Charges were a little more than $700 million on a pre-tax basis. This was slightly less than we expected, driven by lower cost to execute projects and short-term timing delays on projects that will likely execute here in the third quarter.

Corporate, Power, Renewables, Healthcare, and Oil & Gas had the largest investments in the quarter. Restructuring charges totaled about $500 million, and BD charges were approximately $200 million, mostly related to Baker Hughes, the LM Wind acquisition, the Water disposition, as well as the Industrial Solutions disposition and the Digital transactions. There were no gains in the quarter.

For the year, we expect about $0.25 of restructuring to be offset by $0.25 of gains from the Water and Industrial Solutions dispositions. We are targeting a third-quarter close for the Water transaction and a fourth-quarter close for Industrial Solutions.

The Industrial Solutions transaction may push to early 2018, but our plan is to do $0.25 of restructuring this year. We will update you on deal timing as we get close.

Next I will cover the segments, starting with Power. Power recorded orders of $7.7 billion, down 1% in the quarter. Excluding the large Halcyon steam order in the second quarter of last year, orders actually grew 11%.

Equipment orders were down 1%, but up 33% ex the Halcyon order.

Gas Power Systems was up 26% on higher H turbine orders of 9 versus 5 last year and 6 HA units booked in Mexico, our first in the country. The H backlog totaled 33 units. HRSG orders grew 100% to 10 versus 5 a year ago. Offsetting GPS was Steam Power, down 42%, with no repeat of that Halcyon order, which totaled about $800 million. Equipment backlog grew 27% year over year.

Service orders were down 1%, primarily driven by lower AGPs in the quarter of 20 versus 24 last year and the larger mix of light AGPs versus full scope and by lower outages, which were down 9%. This was partially offset by growth in installations and other upgrades. Service backlog grew 7% year over year.

Power revenues were up 5% to $7 billion. Equipment revenues were up 12%, driven primarily by Gas Power Systems, up 17% on higher scope balance of plant and higher HRSG shipments of 10 versus 4 last year. This was partially offset by lower gas turbine shipment of 21 versus 26.

Service revenues grew 1% on Distributed Power Services up 10%, offset by flat Power service. Power service was flat on lower outages and fewer and lighter scope AGPs, 21 versus 28, offset by higher other upgrades, which were up 42%.

Operating profit in the quarter was down 10% on higher equipment versus services, including higher balance of plant volume at low margin, fewer AGPs, and lower variable cost productivity, which was partly offset by structural base costs down 7%. Lower VCP in the quarter was impacted by about $70 million of liquidated damages for delivery delays and fuel mod costs of about $20 million that we don't expect to repeat going forward.

The business is finding opportunities for growth. We took 9 H turbine orders in the quarter. We also booked the largest services deal in the history of the business: the $3 billion Algeria deal with Sonelgaz that included 68 AGPs. This showed up in backlog, not orders, in the quarter.

However, we are planning for a down market this year. We expect the power market to see demand for about 40 gigawatts of power this year, down about 10%, consistent with what we said in March. We also are planning for a down market in 2018.

We expect to ship 100 to 105 gas turbines in the year; no change in that outlook. We believe that we have a technology advantage relative to competitors and we are gaining share. Having said that, the market is very competitive and overcapacity in new product introductions will continue.

For Services, we expect 2017 outages to be down about 4%, driven by F-class major outages, which we think will be down about 9% as a result of lower utilization, lower capacity payments, particularly in North America, and extended intervals between outages. This is softer than we expected coming into the year.

We are targeting total upgrades to grow and AGPs to total between 155 and 165 for the year. However, we've got a risk of 20 to 30, driven by timing of large second-half AGP deals that are yet to be agreed to.

For the first half, the business is up 10% on revenues and higher by 7% on operating profit, with margin rates down 50 basis points. Power has taken out around $143 million of structural base costs to date and we are continuing to work additional actions on costs for the year.

Next is Renewables. Orders in the quarter were $2.1 billion, up 2% reported and down 2% organic. Onshore Wind orders of $1.7 billion were down 5%, driven by lower repower orders and services. Onshore Equipment orders were higher by 4% on strong international Wind. The number of units ordered was 567 versus 637 last year, down 11%, but the megawatts grew 12% on larger machines.

Hydro orders of $250 million were up 38%, and LM at $80 million of orders in the quarter. Revenues were $2.5 billion, up 17%, up 13% organic. Onshore revenues grew 12% and Hydro grew 79%. Onshore was driven by the repowering product that we introduced last year. Wind turbines shipped totaled 757 versus 856 last year, down 12%, but the megawatts shipped grew 8%.

Operating profit of $160 million was up 25%, driven by repower volume, net of product costs and foreign exchange, partly offset by price. Margin rates improved 40 basis points.

The wind market continues to be very competitive. Product cost-out is absolutely imperative and the team has made progress on the 2-megawatt platform and need to execute the same on the 3-megawatt turbine as we begin to deliver that machine. LM will be critical to drive cost and differentiation going forward. This business is on track with double-digit growth and improved margin rates for the total year.

Next on Aviation, the market continues to be robust. Global passenger RPKs grew 7.9% year to date through May, with strong growth on both domestic and international routes. Air freight volumes have been very strong as well, growing up over 11% May year to date. And load factors globally are above 80%.

Orders in the quarter totaled $7.3 billion, up 14%. Equipment orders grew 11% and Services grew 15%. Within Equipment orders, commercial engine orders grew 35% to $1.9 billion on higher LEAP, GE90, and GE9X order. These orders did not include any of the Paris Air Show announcements we made.

Military equipment orders of $292 million were down 48%, driven by no repeat of an order last year for 212 T700 helicopter engines. Service orders grew 15%, as I mentioned, with commercial services higher by 16% on strong spares growth of 14% to $21.6 million a day and strong Military Services growth of 14%. Backlog finished the quarter up 2% to $159 billion.

Revenues in the quarter were flat at $6.5 billion. Equipment revenue was down 16%, driven by commercial down 15% and military down 39%. Commercial engine shipments were lower by 10% on fewer legacy engines, partly offset by higher LEAP volume. The business shipped 93 LEAP engines in the quarter.

Service revenues grew 13% on higher commercial spares, up 14%, and good military performance, including on military spares. Operating profit of $1.5 billion was up 11%, primarily driven by higher service volume and base cost productivity, which more than offset the negative LEAP margin. Margins were 210 basis points higher in the quarter.

At the Paris Air Show, we announced $31 billion in orders and commitments, including new engine commitments totaling $21 billion and services of $10 billion. None of these announcements were booked in orders in the second quarter.

In Additive, we announced the development of the world's largest laser-powered machine targeted to the Aerospace segment. We also announced a partnership with Stryker to provide machines, material, and services for their global supply chain operations.

The LEAP engine continues to perform to spec, with 62 aircraft flying today. The business is on track to ship 450 to 500 LEAP engines this year. The business has executed well in the first half. As LEAP shipments accelerate in the second half, we expect the margins to be pressured and still expect total year margin rate to be roughly flat with 2016.

Next on Oil & Gas, we closed the combination of our legacy Oil & Gas business with legacy Baker Hughes on July 3. The new company is listed on the New York Stock Exchange under the symbol BHGE. In September, Lorenzo and his team will give you an update on the outlook for the new company and their progress on integration and synergy. Today we will discuss only the results of GE's legacy Oil & Gas business and not the results of legacy Baker Hughes' business.

The oil and gas environment remains challenging. Our legacy business sees some improvement in activity, but we have not seen meaningful increases in customer capital commitment. Oil prices remain volatile, and as a result, our customers remain cautious.

As we have said previously, we expect shorter cycle activity to increase in the second half of the year. So far, these improvements are trending below expectations.

Orders in the quarter of $3.2 billion grew 12% versus last year and grew 14% organically. The equipment book-to-bill ratio was 1 to 1 for the first time in the better part of 2 years. Equipment orders totaled $1.4 billion, up 50%.

Every business segment grew. Subsea was higher by 177% on orders in Brazil and the Eni Mozambique Coral project. Turbomachinery was up 14%, also driven by the Eni Coral scope. And service orders grew 57% on strength in the Middle East.

We had terminations in the quarter totaling $542 million, driven predominantly by one project scheduled to deliver beyond 2018. Service orders were $1.8 billion, down 6% on softer markets, driven by Turbomachinery down 13%, Surface down 11%, Subsea down 6%, partially offset by strong performance by Digital Solutions, which grew 6%.

Total backlog ended the quarter at $20 billion, down 12% versus last year. Revenues of $3.1 billion were down 3% versus last year. Equipment revenue was down 8%, driven by Subsea down 31%, which more than offset growth in Surface up 12% and Turbomachinery up 3%. Service revenues were flat year over year.

Operating profit of $155 million in the quarter was down 52%. Performance was driven by unfavorable price and negative variable cost productivity that more than offset sourcing and structural cost-out.

On variable cost productivity, I put the impacts in two categories. First, we had two big one-time items: rework on a nonrecurring issue related to a single contract totaling about $30 million and a write-down of obsolete inventory for about $25 million.

Second, lower volume impacted both overhead absorption and supply chain benefits. We also had $25 million of integration costs in the quarter. As the market recovery has been slower and more volatile than we planned, the performance of the business in the second quarter was below expectation. Customers are delaying purchasing for both larger projects and shorter cycle OpEx activity.

Given the slower market activity, we expect the numbers in the second half from legacy GE Oil & Gas to be lower than previously anticipated, but improved from the first half. The business is very focused on the synergy pipeline with the integration in order to offset as much of the market pressure as possible.

Beginning with third-quarter results, BHGE will release its own financial statement and hold a separate earnings call. We will consolidate Baker Hughes GE into our financial statements, less the 37.5% minority interest.

Next on Healthcare, orders of $5 billion grew 3%, 4% organically. On an organic basis, the US was up 1%, Europe was up 2%, and the emerging markets were 11%, driven by China up 11%, ASEAN up 25%, Latin America grew 5%. The Middle East actually declined 6% organically in the quarter.

On a product basis, Healthcare Systems orders grew 3% and 4% organically, driven by ultrasound up 8% and imaging products higher by 4%. Mammography and CT were particularly strong on the new product launches.

Life Care Solutions was flat, driven by the impact of healthcare reform uncertainty in the US market. Our Life Sciences business grew orders 5% organically, with core imaging up 8% and bioprocess up 5%.

Revenues in the quarter of $4.7 billion grew 5% organically. Healthcare Systems grew revenues 5% organically and Life Sciences grew 8% organically. Operating profit was up 6% in the quarter to $826 million, driven by volume and productivity, partially offset by price and programs for product cost reduction.

Margins improved 30 basis points in the quarter. We expect the second-half performance to be similar to the first half, with low- to mid-single-digit revenue growth with stronger operating profit growth. The business is executing well and we'll continue to simplify structure to drive lower product cost.

On Transportation, North American carload volume continues to improve off a low base. Carload volume grew 7.3% in the quarter, driven by Intermodal higher by 5.6% and commodity carloads up 9%. Commodity carload growth was driven by export coal up 18% and agriculture up 10%, partially offset by petroleum down 4%.

Despite improving trends since mid-2016, overcapacity remains, with parked locos around 4,000 and very little investment appetite from US customers.

Orders in the quarter of $830 million were higher by 22% on easy comparison. Equipment orders of $231 million doubled on international demand for 26 locos. Service orders of $600 million grew 7% on good growth in loco parts and mining.

Revenues of $1.1 billion were down 14%, with equipment down 27% and services flat. We shipped 120 locos in the quarter versus 222 a year ago, with international shipments up 34%, partly offsetting North America, which was down 77%. Operating profit in the quarter was down 26% on lower volume, partly offset by cost action.

The North American locomotive market will continue to be challenging in 2017 and 2018. We expect 2017 loco shipments to be lower by about 50%, with operating profit down double digits as we have guided.

The business is focused on growing internationally. The business recently announced a $575 million win in Egypt for 100 locos plus services. We expect this to book as an order in the third quarter. Executing on resizing the business to market has been ongoing and we'll continue to evaluate additional actions as needed.

Next on Energy Connections & Lighting, orders for the segment totaled $3 billion, with Energy Connection orders of $2.6 billion and Current orders of $380 million. The Energy Connections orders were down 12% reported and down 7% organic, driven by grid down 8% on no repeatable large Egypt order and power conversion down 14%, offset by 1% growth in Industrial Solutions.

Revenues ex-Appliances were reported down 2%, but up 2% organic. Energy Connection revenues were higher by 4% organic on strength in Grid and Industrial Solutions, partly offset by Power Conversion. Lighting revenues were down 9%, with Current down 2% and legacy down 17% as a result of the market exits and restructuring we have been doing over the past year.

Operating profit in the quarter was $80 million, up over 400% ex-Appliance. Energy Connection nearly doubled profits to $68 million on Grid and Industrial Solutions performance and productivity, partly offset by Power Conversion on weak volume. Lighting earned $13 million versus a loss last year.

As announced, Energy Connections will be consolidated with Power in the third quarter, which we believe will create significant opportunity for future structural cost-out. We will provide recast data once we finalize it for the third quarter.

Finally, I will cover GE Capital. The Verticals earned $544 million in the quarter, up 20% from the prior year, driven primarily by higher base earnings. GECAS, Energy Finance, and Industrial Finance all had strong quarters and they delivered a solid first half of the year. They executed ahead of the plan on their 2017 assets.

In the second quarter, the Verticals funded $1.9 billion of unbooked volume and enabled approximately $3.9 billion of industrial orders. Overall, portfolio quality remains stable. Other continuing operations generated a $716 million loss in the quarter, driven by $343 million of excess interest expense, $182 million of preferred dividend, $146 million of restructuring costs related to portfolio transformation, and $45 million of headquarters runoff expense.

Other Continuing was $335 million better than last year, driven by lower excess interest and lower headquarter cost. Discontinued operations generated $152 million loss from trailing cost and exit-plan-related items. Overall, GE Capital reported a net loss of $324 million, 72% better than last year.

GE Capital paid $2 billion in cash dividends during the quarter, bringing the year-to-date total to $4 billion. And ended the quarter with $160 billion of assets, including $37 billion of liquidity, down $7 billion from the first quarter.

Looking ahead, during the second half of the year, we expect lower asset sales. And as a reminder, we will conduct our annual impairment review of GECAS in the third quarter.

In the fourth quarter, we will perform our annual cash flow test of our runoff Insurance business. We recently have had adverse claims experience in a portion of our long-term care portfolio and we will assess the adequacy of our premium reserves. We will update you in the fourth quarter.

Lastly, in Other Continuing operations for the second half of the year, we continue to expect incremental tax benefits associated with recovering a portion of the exit plan tax cost we incurred.

With that, I will turn it over to John.

John Flannery - *General Electric Company - President and CEO, GE Healthcare and Incoming CEO of General Electric Company*

Thanks, Jeff. I just wanted to give you a quick update on our transition process. As you know, my official start date is August 1. And we had indicated earlier that I would be doing a full review of the Company and be back to investors in the fall with my views.

We are on track with this process. I am in the middle of a series of deep dives into each of the businesses. We're looking at everything you would expect. What is the market outlook? Where can we grow? Where can we improve margins? How is the cash conversion? What returns are we getting on investment? For example, next week we will be visiting our Power and Aviation businesses.

We are also taking a hard look at our corporate spending, going through a zero-based budget exercise on all of our functions and making sure 100% of our GE Store outlays are accretive to the overall results of the Company.

In addition to the business reviews, I want to repeat the process I used in Healthcare to really get out and listen to what people are thinking, good and bad, about the Company. I always start with customers and employees, but it's also important to get the view of our government partners and especially our investors.

I was out with Matt Cribbins last week and we saw about 100 different analysts and portfolio managers. And we will be doing more of that over the next couple of months. There is a lot of positive feedback from these listening sessions, but also plenty of suggestions on ways we can improve.

This is all leading to a report-out in November. Our main focus then will be translating the business assessments into our thoughts on cost-out and capital allocation choices as well as reframing our look at 2018 and beyond. I am really excited to get started officially on August 1 and look forward to our ongoing dialogue.

So Jeff, back to you to wrap.

Jeff Immelt - *General Electric Company - Executive Chairman and Outgoing CEO*

Thanks, John. Overall, we have no change to the framework, but there are puts and takes in each area. We see the key elements of earnings to be on track, 3% to 5% organic growth, and 100 basis points of margin enhancement.

We have pressure in Power and Oil & Gas, but we will outperform on structural cost-out. We have set a target of $17.2 billion for Industrial EBIT and we expect to hit it, even with those headwinds. Jeff discussed the impact the additional pressure from the resource sector could have on the EPS range earlier.

We expect to hit $16 billion to $20 billion of free cash flow plus dispositions. We still expect to have solid Industrial CFOA between the $12 billion to $14 billion. Again, somewhat dependent on the resource sector.

Our dispositions are taking longer than expected, but we hope to close both in the year. I expect John to take a fresh look at capital allocation, but GE will always have a strong commitment to the dividend.

Let's take a bigger picture view of the Company. We have created a very strong position in Power, Healthcare, Transport, and Resources -- big industrial segments. We don't like the current oil and gas cycle, but our business is significantly improved and will prosper as the cycle recovers.

We are gaining share in most of our markets, with $327 billion of backlog. We have a leadership position in the Industrial Internet and Additive Manufacturing, two growth areas and drivers of Industrial productivity.

In a volatile global economy, our Industrial EBIT plus the earnings from our GE Capital verticals should be about $19 billion. And again, generate between $16 billion and $20 billion in free cash flow plus disposition. So a pretty good performance in a volatile environment.

I know John Flannery can improve on this. John is off to a great start and I look forward to working with him.

Matt, now over to you for some questions.

Matt Cribbins - *General Electric Company - VP, Investor Communications*

Thank you. With that, let's open up the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Julian Mitchell, Credit Suisse.

Julian Mitchell - *Credit Suisse - Analyst*

My question would really be on the CFOA for the year, coming in at the lower end of the $12 billion to $14 billion guidance. It sounds like that's mostly Power and Oil & Gas. So I wondered if you could give us some transparency around what is the cash conversion or free cash flow margin like in those two businesses in 2017.

And when you think about their cash flow performance this year, how much do you think it's weighed down by short-term one-time factors? In other words, how quickly do you think it can spring back to an acceptable level of cash flow in those two businesses?

Jeff Bornstein - *General Electric Company - Vice Chairman, SVP, and CFO*

So we expect the Power business to deliver a positive CFOA in the year for sure. As well as Oil & Gas, and we actually expect Oil & Gas to have a -- relative to the environment they are operating in and how we see their second half, a reasonably good performance around CFOA for the year for Oil & Gas.

So the Power business is going to be something like a 50% to 60% conversion in the year. Other businesses will be higher. Healthcare will be closer to 100%, Aviation will be quite good, but I would guess that Power is going to be somewhere between 50% and 60% conversion for the year.

Jeff Immelt - *General Electric Company - Executive Chairman and Outgoing CEO*

I would also add, Julian, we are doing $2 billion of cash related to restructuring. A lot of that is in the Power sector. None of us expect that to repeat in 2018, so that's a natural tailwind, let's say, in terms of CFOA in 2018.

Jeff Bornstein - *General Electric Company - Vice Chairman, SVP, and CFO*

So why don't I walk from the first half to the second half a little bit in terms of how we are thinking about it. There is no doubt we have a big second half to deliver on cash and that's similar to where we were last year.

Relative to the first half, there's really three big drivers. One, we have got higher earnings in line with our volume, our cost-out profile, and gains versus restructuring. In the first half, we had a $0.14 headwind. In the second half with the gains will offset that $0.14 headwind and have a $0.14 offset in earnings.

We will have significantly better working capital performance, although I think we feel pretty good about the second quarter. We generated $700 million of CFOA in the second quarter from working capital. And that was almost $1.5 billion better than where we were in the second quarter of last year.

And I think importantly within that, there was a couple hundred million of inventory improvement, which I don't think we have ever realized on in the second quarter of any year in recent history.

As we look to the second half, the working capital will get better, largely driven by inventory, a bit by payables. And we will have some receivables improvement, and that's consistent where we were last year.

So working capital last year we improved in the second half better than $5 billion. We are not anticipating $5 billion; we are looking more at just under $4 billion of improvement this year. So we think we have executed before; we can execute again in a similar way.

Lastly, on contract assets, we still expect contract assets to be a cash usage in the second half, but not nearly the rate that we saw in the first half. And we expect it to look very similar to the change in contract assets in the second half of last year, which was about $1.4 billion, $1.5 billion.

So if you look at second-half cash flow versus 2016, we delivered $11 billion of CFOA in the second half of last year. We need to do about $1 billion more this year, which is primarily a function of earning.

And we expect working capital to be about $3.9 billion better in the second half. So the total improvement for the year of about $3.3 billion, and that's less than the $5.1 billion of working capital improvement we had in the second half of last year. As I said, contract assets will be a little bit of a drag in the second half, but in line with where we were in the second half of last year.

And I'd say lastly, other operating -- all the other elements of cash flow will be better in the second half than the first half and will be better substantially versus 2016. So that is kind of how we think about going from first half to second half.

Jeff Immelt - *General Electric Company - Executive Chairman and Outgoing CEO*

I'd also say, Jeff, in 2016, we ran the place with a couple, $3 billion less working capital. We are going to do the same thing in 2017. But I think the team -- there's a lot of juice in this left. And I think we have every expectation that we are going to be able to continue to reduce the amount of working capital that is needed to run GE in the future.

Operator

Andrew Kaplowitz, Citi.

Andrew Kaplowitz - *Citigroup - Analyst*

Good morning, guys. Jeff Immelt, good luck as you move on.

Jeff Immelt - *General Electric Company - Executive Chairman and Outgoing CEO*

Thanks, Andy.

Andrew Kaplowitz - *Citigroup - Analyst*

Sure. So could you give us a little more color on what you are seeing in Power? You mentioned trending toward the bottom of your EPS range for the Company, I think despite a lower tax rate.

And then Power specifically, is Services overall just a tougher market than you thought? You had talked about the [voyage] you were seeing in Services. But how much of the Power weakness would you say is execution-related? And how much low-hanging fruit does Russell have to improve delivery timing and overall execution of the business?

Jeff Bornstein - *General Electric Company - Vice Chairman, SVP, and CFO*

So I guess I will start. Others can weigh in. I would say -- generally, I think the units market on the equipment side is more or less what we thought it would be. We said we saw a 40-gigawatt market, down 10%.

In that context, we said we thought we'd take orders for 85 to 95 units in the year. We still think that holds. We've got about 39 units through the first half. We said we thought we would ship 100 to 105. We think that is still a reasonable expectation.

And we talked about the gas turbine business, the units business, turning around profitability from the launch last year to this year. And we still expect that holds true.

I think on the Service front, I think it definitely is softer than we thought. When you look at outage volumes, we thought outages were going to be down mid-single digits. Right now, it looks like, particularly in the gas space and on the bigger F-class outages, we are running about 9% down year over year. That is partly driven by utilization; it is partly lower capacity payments. It's partly extending intervals between outages.

But that feels softer. So the transactional business, which is 50%-plus of the business, that feels softer than where we came into the year.

But I will put it a little bit in perspective. I think, having said that, through the first half, revenues in the business were up 10%, operating profit was up 7%. There was definitely some execution there. I talked about $90-million-plus of LDs and a fuel mod that we had to do.

We don't expect those to continue. The $70 million of LDSs were really around 3 launch H unit, where we took a little bit of risk on schedule and commissioning, not having been through the process. And it took us a bit longer to get there. We feel like we are absolutely on track on the balance of the H commitment. So we don't expect the LDs to continue.

Then when you think about total year, we still think about the Power business being up mid-single digits on revenue and up roughly high- to low-double digits on earnings. I just think that in the backdrop of everything we've got in front of us here that it does feel softer.

The business still thinks they are going to do 155 to 165 AGPs in the year. But I think the mix of light AGPs versus full scope AGPs is a higher -- the mix to light is heavier than we probably anticipated coming into the year.

And then I talked about in that estimate on AGPs, we have some risk. We got some really big deals in the second half that could put 20 or 30 of those units at risk. I'm not telling you the business doesn't think they are going to deliver them. I'm just highlighting for you there could be a risk there.

So definitely Services softer than maybe we came into the year with. I think the units business is more or less as expected. And its gas outages on the Service side, lower steam and boiler work on the outage side in Services.

But overall, if we can get to a year that's up mid-single digits on revenue and high-single digits to low-double digits on op profit, everything else being equal, not too bad.

Jeff Immelt - *General Electric Company - Executive Chairman and Outgoing CEO*

And I would add to that, Andrew. As you put the Energy Connections business together with the Power business, you are going to look at a funnel of maybe another $1 billion of structural costs you can take out of the combined business rolling into 2018.

So I think add to Jeff, there is probably close to $100 million that shouldn't repeat that we should have done better in the quarter. I think the profile for the year is still going to look attractive for the segment. I think the team has a nice cost -- or is developing a good cost plan going into 2018 that I think should create a buffer against the market.

Jeff Bornstein - *General Electric Company - Vice Chairman, SVP, and CFO*

There is both an opportunity and a necessity to restructure the cost structure of this business, given the market that we are operating in. And I expect that the business on their structural cost commitments is going to overperform in 2017. And as Jeff just talked about, we are building a plan around something close to $1 billion of structural cost-out as you move through 2018.

Operator

Jeffrey Sprague, Vertical Research Partners.

Jeffrey Sprague - *Vertical Research Partners - Analyst*

Thank you, good morning. Jeff Immelt, good luck and thanks for all your thoughts and insights over the year. Much appreciated.

Jeff Immelt - *General Electric Company - Executive Chairman and Outgoing CEO*

Jeff, you and I have done this a long time. I'm going to miss you and I look forward to having a beer with you as a citizen someday -- as a civilian.

Jeffrey Sprague - *Vertical Research Partners - Analyst*

I would like to do that. Definitely. Just on cash flow, I guess maybe perhaps for Jeff Bornstein. The first half obviously came in short of what you thought. You thought you would kind of equal last year at roughly $400 million.

I wonder if you could also decompose what the source of that may be roughly $600 million shortfall was.

And just your comment on share repo. Are you linking the conclusion or execution of these divestitures to your share repurchase plan? Or what variable is really driving the reevaluation of the repo? Thank you.

Jeff Bornstein - *General Electric Company - Vice Chairman, SVP, and CFO*

So I think what I said on the call -- maybe I misspoke on the call. What I meant to say on the call was we expected that CFOA in the second quarter would be substantially better sequentially from the first and substantially better than the second quarter of last year. I didn't mean to say that we would be flat year over year.

I think generally speaking, that $1.5 billion, $1 billion of CFOA, we felt pretty good about that. Would we have to like it to been a bit higher? Sure. But I thought the inventory performance was pretty good. The receivables performance was pretty good. Payables were a use in the quarter maybe a little higher than we expected, but that's partly driven by the cost-out that's happening in the inventory improvement.

So I think that at $1.5 billion, that was reasonable performance and it puts us pretty close to where we were at the half. You are right; we are down $600 million year to date year over year. But that was included in the context of how I walked you from how we think about going from the first half to the second half of the total year and what that means for working capital and other cash flow improvement we expect to see.

On repurchase, I think our share buyback has always been predicated on dividends from GE Capital and the disposition. So no change in there. I think that there's a risk that Industrial Solutions won't happen in the year. It's hard for me to exactly handicap, but I think there is at least an equal probability that it will happen in the first quarter of 2018 as it will happen in the fourth quarter of this year. As I mentioned earlier, we feel pretty good about the fact that Water will get to a closing here in the third quarter.

So having said all of that, I think as part of John's relook about what we are doing, I think John wants to go back and rethink about how we think about capital allocation in the Company. And embedded in that, obviously, is how we think about share buyback.

And so we are being open and objective. And John wants to take a look at it and really work through with the team what the right way forward is and what the right alternatives are.

Jeff Immelt - *General Electric Company - Executive Chairman and Outgoing CEO*

Can I add something? Again, I hate to be a broken record. But Jeff, there's $2 billion of cash associated with restructuring in 2017. That's probably $500 million or $600 million more than 2016. And that should mainly not repeat going into 2018. So that's in these numbers.

And I would just echo what Jeffrey said about capital allocation, what John should do. The only other context I would give you, though, is that everybody here prioritizes the dividend at a very high level. And I just don't want anybody to ever be confused about that in the context of GE -- what we do, how we do it, and whoever our CEO is, how we think about that as a context.

I was here the day we cut the dividend. It was the worst day of my tenure as CEO. And the dividend is really, I think, incredibly important for our investors and for the team.

Jeff Bornstein - *General Electric Company - Vice Chairman, SVP, and CFO*

Just one point of clarification on the restructuring cash. So we will probably spend slightly more than $2 billion in cash on restructuring in 2017. Everything else being equal, I am trying to avoid giving you 2018 guidance here before John's gone through the framework. But we would expect to spend substantially less than that in 2018, but it won't be zero. There will be projects we do in the third and fourth quarter that will have cash that spills over.

Operator

Deane Dray, RBC Capital Markets.

Deane Dray - *RBC Capital Markets - Analyst*

Thank you. Good morning, everyone. For Jeff, congrats and best wishes on your last earnings call. And we are expecting to hear good reports about improvements in your golf game.

Jeff Immelt - *General Electric Company - Executive Chairman and Outgoing CEO*

Thanks.

Deane Dray - *RBC Capital Markets - Analyst*

A question for John. So given the management transition and now the mid-November timing for the reset and the new vision for the Company, how can you minimize the effects of GE being in somewhat of a state of limbo until then, for want of a better word?

John Flannery - *General Electric Company - President and CEO, GE Healthcare and Incoming CEO of General Electric Company*

Listen, we are going through a process that we have laid out for you guys. It's a substantial process in a large company that takes a commensurate amount of time. I would say Jeff and Jeff have laid out a framework for the year already, so there should be no change in thinking around that.

Then we are spending a lot of time internally with the team. So I would say there is no risk of limbo inside the team. I actually start August 1, but there is a lot of interaction already.

So I am not worried about internal paralysis, if you will. And you have our outlook for the year. So I look forward to the November -- a robust discussion in November about the Company and not worried that we are going to be dead in the water in the meantime.

Jeff Immelt - *General Electric Company - Executive Chairman and Outgoing CEO*

And I think the teams are still executing against their AIP plans, their LTIP plans. There is a ton of operational focus inside the Company that investors can count on while John is going through his kind of an over-the-top review.

Jeff Bornstein - *General Electric Company - Vice Chairman, SVP, and CFO*

I would just -- if you don't mind, John. I would just add it's an enormous company; it is complex. We want to reground, rebaseline everything we do in this Company, how we do it. The value of the GE Store, how it creates value in our franchise. That's a big, big body of work.

As well as understanding portfolio and John getting deep on developing his own views about what we are going to invest against, what we are not going to invest against, etc. So I understand the point completely, Deane. I just think that's a meaningful body of work.

And I think when John gets up in front of investors and shares his views, we want that to be as absolutely as well informed as possible. So I just think it takes that amount of time, but I understand your point. Between now and then, there will be a lot of people speculating on how John might come out on some of it.

Operator

Andrew Obin, Bank of America Merrill Lynch.

Andrew Obin - *BofA Merrill Lynch - Analyst*

Yes, good morning. Jeff, thanks for all the work over the years. Look forward to work with your successor. Thank you very much. Just a question on Power, the outlook for 2018, just talking about lower and thinking about Siemens' commentary. Is it cyclical or is something structural going on in terms of outlook for Power?

Jeff Immelt - *General Electric Company - Executive Chairman and Outgoing CEO*

I think, Andrew, if you look at a macro study like IEA or [EP's] study of the industry and things like that, these would show slow but steady increases in the evolution around natural gas really for the next 20 years in terms of additions to capacity and things like that.

And you can triangulate that against whatever your assumptions might be on accelerating penetration of solar, reduction of nuclear. There's a whole series of things over the next 5 or 10 or 20 years.

But I think what is clear is with the ongoing outlook for the cost of natural gas, gas turbines and gas power generation are going to be one of the staples of the future of the industry. Now, does that mean 50 gigawatts instead of 40 gigawatts in the short term? I don't think any of us are that smart.

You got places like Saudi Arabia that used to be the biggest gas turbine market that have been slower over the last couple years. They are going to need capacity. What does China do vis-a-vis their environmental issue? There is probably five markets that matter that would make it more on the upside, but I actually think there is a fit for the gas market going forward.

That being said, I don't think there's any benefit to Jeff or John or to Russell now to be overly bullish about the near-term dynamics around the industry. But at the same time, I think somewhere in the 40-ish area is pretty much where I would think about the industry going forward.

Then outages, as Jeff went through, this is going to be a function of renewable mix. It's going to be a function of hot summer, cold winters, price of coal, price of gas, a bunch of other things. But I think there's reasons to believe that that number stabilizes as time goes on.

Jeff Bornstein - *General Electric Company - Vice Chairman, SVP, and CFO*

Andrew, I think that when we get up in November, we will share our view of where we think the Power business is going for 2018 and some degree beyond that. We think the Power market this year for gas turbines is going to be 40 gigawatts. That's down roughly 10%. It might be down again next year.

I think so far, the businesses competitively have been in a good place. We have seen a little bit of price, but we are definitely outperforming competition on both price, orders, and share. And when John is deep in the business and developed a view with Russell on where this is going, we will share that in November.

Jeff Immelt - *General Electric Company - Executive Chairman and Outgoing CEO*

I think you are sitting, though, Jeff, in a year where equipment [V] is going to be -- the Power equipment V is going to be 10% or something. It's going to be high, let's put it that way. So that doesn't spell disaster, I don't think.

Operator

Chris Glynn, Oppenheimer.

Chris Glynn - *Oppenheimer & Co. - Analyst*

Thanks. Good morning and congratulations, Jeff and John. I just had a question on the contract accounting long-term service agreements. Wondering if there is an update on the accounting change impact next year? And also if there's any view to somehow monetizing the LTSAs in a way that's different from the past?

Jeff Bornstein - *General Electric Company - Vice Chairman, SVP, and CFO*

So a couple things. One is I don't have an update for you today on the 606 accounting change. We are working it rigorously. When we have an update as to the impact to 2016/2017 and a relook at what we think the impact might be in 2018, we will share that with you.

Right now, we are going through first-quarter actuals and auditing those and making sure we have got the processes in place to deal with all the changes. So I don't have any change in guidance for you on that and I don't have an update, other than we are going through the mechanics in the process. It's pretty complicated stuff, particularly around LTSAs.

On a monetization -- listen, I'm -- particularly where there's an interest in putting upgrades or other investment into a contract, if there are capital market solutions to help customers do that and we're pricing for that as opposed to us essentially pricing it, I'm wide open on that. Those structures are not simple, but we continue to explore what those might be.

We have done a little bit of it. We have done some of it for sure. But mostly focused around how we think about upgrades. And the variable component, where it is utilization-based, it's very difficult to think about doing something around that. But if you have got fixed payments embedded, like for an upgrade, that is something that we can think about doing.

The last thing I would tell you, just because -- in the quarter, nobody asked, but our CMRs or LTSA gains in the quarter were $500 million. They were $600 million in the second quarter of last year, so they are down $100 million year over year.

Matt Cribbins - *General Electric Company - VP, Investor Communications*

Thank you. Just a reminder that the replay of today's call will be available this afternoon on our investor website. And Jeff, to wrap up your last call.

Jeff Immelt - *General Electric Company - Executive Chairman and Outgoing CEO*

Great, Matt. So the first time I did this, all we did was fax a press release and that's been replaced 64 subsequent times by this incredible work. So it shows you I've been doing this a long time or how much times have changed.

I would like to publicly thank the GE Finance team, led by Jeff. You guys have no idea how much work goes into this. Matt, thanks for your great effort. But John, especially you, it's been great to work with you for so many years.

And I just want all of our investors to appreciate the incredible work that goes into this. We have always tried to be respectful, transparent, and honest in this process.

I am looking across the table at Jeff Bornstein. He has got a six-inch binder. He knows every fact and everything to do with the Company. And I feel great about John Flannery and what he is going to do with the Company going forward.

So again, I'm sure I will see many of the investors over time. But I want to use this as an opportunity to do a shout-out for the GE team and what great work they do.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference. Thank you for participating and you may now disconnect. Good day.
