General Electric

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Julian Mitchell: Well, thanks, everyone, for coming. It's my pleasure to have next Larry Culp, Chairman and CEO of GE. I'll start off with some questions – Larry, thank you very much for being here – and then we'll throw it open if there's any from the audience.

I think one question, Larry, just investors have been and I think the management of GE has often been very surprised by events or items in the last few years. So, maybe help us understand now how comfortable you are that news flows through the organization well, you hear quickly good things, bad things. How in touch do you feel with what's going on?

Larry Culp: Right. Right. Well, those might be two different questions, Julian. But anyway, good morning, everyone. Thanks for taking time to be with us.

I would say that part of the cultural journey that we're on at GE is very much geared toward making sure that bad news travels fast, if you will. We talk a lot about the values that we're trying to instill across GE. When we do that we talk about candor, we talk about transparency, and we talk about humility. Probably every time we're with the businesses, anytime we're with a small or a large group, Julian, we're talking about that.

When we talk about candor, what we're really trying to encourage folks to do is make sure that they're telling me or they're telling their boss what they think, as opposed to what they think their boss might want to hear. And transparency is all about putting the good and the bad out there, in equal measure.

It's one thing to talk about that, right? You get a lot of heads nodding. But in our operating reviews – and we're with all the businesses quarterly; in some cases, more frequently – we're really trying to walk that talk, to make sure folks understand that we can handle the bad news, that we want to make sure we're putting it all there, not that there's a lack of responsibility. But I think when people see leadership not shooting messengers but, rather, engaging, trying to help, pushing to understand problems, driving to root cause so we really understand why something might have happened so we can fix it in a sustainable way, that begins I think that cultural flywheel spinning. That's not a universal dynamic yet at GE, but I feel in the over 16 months, Julian, I've been on the team full time I can see progress. But clearly, more to do.

In terms of how confident, how in touch, I try not to spend a lot of time in Boston. I'm on the road I think virtually every week, in the businesses, with customers, in the labs, in the factories trying to make sure that my information flow is not just through formal channels, but complemented by those things you pick up along the way.

Julian Mitchell: And that's very helpful on the communication aspect and transparency. How about in terms of the doing on the ground? How much of a Lean- or cash flow-centric culture do you think there is today? Maybe in the past it was more about some adjusted EPS metrics and so forth. You're trying to shift towards regular cash flow. How pervasive is that today versus when you started?

Larry Culp: Right. Well, again, it's only been, what, going on 17 months here. So, it's been a relatively short period of time. But I would say what we've tried to do is move as fast as we can from talking about cash as a priority to actually being able to deliver on cash. You mentioned Lean. Lean is an important part of this. Lean has been part of the GE vocabulary over time. I was pleasantly surprised to see how much Lean talent – true Lean talent, in a Toyota sense – that we have across the GE businesses. But it hasn't been, I think, the primary way we've gone about running the business. We're trying to embed that right now.

So, those transitions, those transformations tend to take a number of years. But if you were to go in to some of the Lean events that we've had, if you were to go into an operating review, or just walk a facility with me, I think you'd see some of the hallmarks of a real Lean transformation taking effect.

And what's important about that is Lean is really the way we're going to deliver better cash at GE. We're going to be better and more disciplined upfront in terms of what we sign up for. We're going to be more effective in product development, in manufacturing, conserving cash along the way, and our execution in the field, be it around a big project. With our service organizations, the same. These tools apply broadly.

So, I think the organization didn't need a new CEO to underscore the importance of more and better cash. Lean is really the way we're going to go about it. But it's again, Julian, I think early innings relative to the work ahead. But I'm encouraged by the progress I've seen so far.

Julian Mitchell: And if you think medium term or long term I think you've talked in the past about getting the firm-wide free cash flow margin maybe towards 9% or 10%, versus that 4% to 5% level in 2018. Maybe explain some of the main levers, segment-wide or in terms of firm-wide aspects around working capital, and why do you think that 9% or 10% rate is the entitlement of today's GE.

Larry Culp: Well, I think when we said that a little over a year ago all we were really saying was that a business like GE with this portfolio yielding 4% to 5% free cash should be able to double that. We didn't put a timetable on that.

Clearly, we went into last year concerned that we didn't have control over some of the variables that ultimately proved controllable and manageable. In turn, we delivered the $2.3 billion of free cash that we did.

We know that as we come into 2020 we have the opportunity – once we even adjust for the dispositions; principally, the BioPharma business and, obviously, Baker Hughes – that we should be able to deliver $2 billion to $4 billion of free cash, which really on a pro forma basis is coming off of a base adjusted in '19 of just over $1 billion. So, it's a significant step up, but still a good bit away from where we should be longer term.

I think we're going to see some pressure here in the first half, particularly here in the first quarter. As many of you know we are a back-half cash business. You're smiling broadly. We'll change that over time, Julian, but it's going to be I think difficult, particularly in light of the 737 MAX dynamics with Boeing, to do that. Corona, certainly a bit of a wildcard for us, like everybody.

So, I think we're going to see here in the first quarter free cash probably in the range of a negative $2 billion. Right? So, we'll be about $800 million off, largely due to MAX, but as we work our way through the year a lot of these Lean efforts should continue to bear fruit. And you mentioned working capital. Working capital is part of that. Just being smarter on CapEx, as well.

But we're also I think going to be in a position where we not only work through the Alstom legacy liabilities over the next several years, bring down our restructuring spend, but again also make sure that we're just that much smarter in and around the projects we sign up for and our execution. We do big projects a long way from home. Every day matters. And that daily management mindset that we're trying to bring to our facilities applies to our job sites, as well. And the more that we do of that we should get better margins. When we sign up for new opportunities we should deliver on those margins, if not do better, rather than have some of them get away from us.

That, coupled with some of the quality challenges that we've had – again, due to some of the legacy issues – really are the sorts of things I hope we're going to wring out of our day-to-day reality here and there through the Lean transformation, such that each one of those elements of our cash performance should be better. And that's before we talk about getting back – well, continuing the good growth that we've seen in Aviation and Healthcare, particularly, over time.

If we can do that with Power and Renewables pulling their weight, I feel more confident today than I did a year or so ago with respect to that potential for us to be a high-single-digit cash generator.

Julian Mitchell: Got it. And you mentioned just now the Aviation headwind to free cash early in the year. The target for the year as a whole needs about $2 billion of free cash step-up, like for like, with that $1 billion base. A lot of that it seems has to come from the Power division. Maybe just talk us through what's changing in Power to get that cash flow uplift this year.

Larry Culp: Right. Right.

Julian Mitchell: And I think last year it came in a bit better than you thought. Maybe talk about what were the drivers behind that.

Larry Culp: Sure. I would say that we were very pleased with the Power performance on a relative basis, but any time a segment prints a free cash number with brackets around it there's a limit to how much we're going to celebrate that.

But just to make sure we're all on the same page, Julian, you talk about an incremental $2 billion, you're really talking about getting to the midpoint of the $2 billion to $4 billion range off that, call it, $1 billion base once we adjust for the BioPharma sale, which we continue to believe will close here in the first quarter, in addition to the Baker Hughes dividend, about $350 million we enjoyed last year we won't see this year.

Power is not the only part of that story, but let's start there. We think Power will do better than the negative $1.5 billion we saw in '19, but it will still be negative but I think on very much the right track. It really is the cumulative effect of much of what we talked about earlier, both in Gas Power and in the Power portfolio.

We certainly have seen a slightly-better-than-anticipated order book in Gas Power. That helps from a cash perspective. I think we've gotten much better control of our projects. So, there's a lot less leakage in that regard and, in some cases, just flat out better margin performance. I think we're slowly turning the performance of our service business. Haven't seen as much of that in terms of the top line. Orders were flat last year, for example, but the mix underneath the hood there, particularly on the transactional side, encouraging. And we really have put the emphasis on margins and cash, as opposed to share. I think you're seeing some of that play out. Certainly, being more conservative on CapEx helps, as well.

And in the Power portfolio, three different businesses but, in many respects, a similar story. Our Steam business is clearly the big business there. They, too, better project execution, a runoff on some of the inheritance taxes, and just better day-to-day execution in the factories and on the project sites. That sets us up, I think, for a better year this year and before too long, hopefully, getting past the breakeven point, to where we're making a contribution in that segment to the GE whole.

Julian Mitchell: And in Renewables, I think you mentioned on the last call you may have a step back on free cash this year versus last...

Larry Culp: Right.

Julian Mitchell: ...a wider free cash outflow. Maybe explain how much of that is cycle-driven, how much is internal cleanup, how temporary that cash step back may or may not be.

Larry Culp: Sure. Sure. And Renewables really is the business that will make less of a contribution in '20 than they did '19. We think despite the challenges related to the MAX, we think Aviation could be flat to up from a cash perspective. If we adjust for the BioPharma transaction within Healthcare, we think Healthcare is poised to do better in that regard. And I think Corporate will be less of a drag in 2020, as well.

But specifically, to Renewables, I think it's important just to step back for a moment. What is Renewables? It's really three businesses, in many respects, or at least three different dynamics that we're managing through. The first is our onshore wind business. As many of you know, a business that has enjoyed tremendous growth the last couple of years. We'll see another strong growth year here in 2020. We're #1 in it from a share perspective in the U.S. A good business that has not been optimized, despite that growth. Certainly, some quality challenges there, some execution issues outside of the U.S. So, many of the same dynamics that I referred to earlier.

The second business is our offshore wind business. Related to onshore, but a different category. We really have, in many respects, an R&D program underway here. We've built the next several years of backlog on the back of customer responses to our Haliade-X product, which we will certify next year. The prototype at Rotterdam has been performing very well. So, we're excited about that. But that's, as you would imagine, a sizable cash drag, given that it's fundamentally an R&D bet at this point.

And then we have in the third category our two Alstom turnarounds: our Grid and our Hydro businesses. And I kind of circle the two of them because those really are fundamental turnarounds where we have work underway.

So, as we think about 2020 we know the onshore wind business will be challenged, just given the dynamics with the PTC cycle here in the U.S. We are going to continue to invest in our onshore effort. And we have work to do, quite frankly, at Grid and Hydro. And that is work that a fundamentally new team that we've put in place is embarked upon here in 2020. But the nature of some of those issues, Julian, are going to simply take a while for us to work through.

I'm hopeful a year from now we can talk about the progress that we've made in Renewables, particularly in those turnarounds. But when you put all that together that's why you have the negative numbers. That's why it's going to be a little more challenging this year but, nonetheless, why we have conviction that we can run that segment toward much better performance than we've put up here of late.

Julian Mitchell: Thank you. And then just on the portfolio, soon after becoming Chief Executive you made some quick decisions around shrinking the Baker Hughes stake and also exiting BioPharma. Assuming both of those play out or are largely concluded in 2020, do you then take another look at the portfolio? You have some bits and pieces.

Larry Culp: Right.

Julian Mitchell: I think investors always ask about Grid, Hydro, Power portfolio.

Larry Culp: Right.

Julian Mitchell: Maybe explain how much time you're willing to give yourself and those businesses to improve their earnings or cash path.

Larry Culp: Right. Well, we might appear much more patient on stage than we are behind closed doors. I think our teams know full well what we need to do here in 2020 and the trajectory that we want to be on going into '21.

It's not just me, Julian, but really the entire board I think is ever mindful that the way we optimize value at GE, first and foremost, is continuing to work through the deleveraging and improve the underlying performance of the business. We're going to have many more strategic options as to how we maximize value over time – right? – if we don't have the debt situation taxing us as it has here the last couple of years.

I think we're excited about the progress that we made on the Industrial balance sheet in 2019. Brought down $7 billion of debt. With the BioPharma transaction in sight we think we're positioned to bring that to net debt-EBITDA ratio from 4.2x to 2.5x, or below, just as we had targeted. So, we're on our way in that regard. Some people will say, "You're going to be underlevered soon." Well, first things first. Let's get the BioPharma transaction closed.

Brought down $7 billion of debt on the capital side. We're well within that 4x debt-to-equity ratio that we had talked about. Very encouraged about what we've done in terms of the asset reduction there. I think we exceeded our $25 billion two-year target by $2 billion there.

So, we're getting close to where we want to be on the balance sheet. And again, as we talked about both in Power and Renewables, I think we know what we need to do. Encouraged by the progress in 2019. More to come. We'll continue to shrink Corporate, smartly, and look to set up Aviation and Healthcare to continue to do the good work that they're doing.

So, with the passage of a little bit of time I think we have the balance sheet that gives us flexibility and optionalitiy and we should have the businesses in a place where if other structures, other arrangements make sense you'll see us do that. But no business has a holiday here from improved performance. And trust me, those teams feel that responsibility and understand what we're looking for from them during the course of this year.

Julian Mitchell: Maybe switching to GE Capital, I certainly get much fewer questions on it today than a year ago, but it's still $100 billion-plus of...

Larry Culp: Sure.

Julian Mitchell: ...assets, still will need some cash from Industrial this year, maybe next year.

Larry Culp: Right.

Julian Mitchell: So, maybe frame how much cash you think Capital will need and how you think about the pace of that $100 billion coming down in the long run.

Larry Culp: Right. Right. Well, two related questions there. Right? You look at the balance sheet today, actual liquidity, we're talking about $102 billion of assets. Because of the way we have reduced the size of that balance sheet, we really have a GE Capital today that – the way I think about it – is kind of barbelled, right? Eighty percent of the assets are either in GECAS or in our legacy Insurance book. So, the pieces in between are not unimportant, particularly our energy finance business which supports some of the work we do in Renewables and in Power. But we have two businesses, obviously, different ends of the spectrum: GECAS, a wonderful aircraft leasing business; and our legacy Insurance business.

I think GECAS is a business that is certainly a good, strong business. It helps us just in general, certainly has ties to GE Aviation. How that plays out over time, again I think we have optionality once we are deleveraged and the businesses are performing well.

Insurance is certainly something none of us would have signed up for. I give the team a lot of credit in terms of the way the new leadership has gone in and just, if you will, applied some of the Lean principles to running that run-off book, so much so that we're getting a little bit of price support, we're doing a little bit better on claims management, certainly managing the investment portfolio there better.

And we have just completed the statutory, the cash flow test. Right? We separated the timing of the two tests from a year ago. We moved the GAAP test into the fall, as you know, Julian. The cash flow test came in a little better than we had anticipated. So, that's really going to be about a $100 million true-up here in the first quarter of 2020, and you would compare that somewhat apples-to-apples to the $1 billion that we took on the GAAP test at the end of last year.

So, I think that's evidence again of the progress the team is making with respect to the business. That doesn't mean that we don't have a parent support obligation there in line with Insurance. We're talked about that being far less in 2020 than the $4 billion-plus that we put in last year, and I think that will certainly play out, given the CFT results. And I think, going forward, what if anything will be required will really be a function of the earnings potential, asset sales, and just the underlying performance within GE Capital.

Julian Mitchell: Got it. And when you were talking earlier about the Industrial cash dynamic through the year and the sort of low base to start out, is that –? The big headwind is really around the Aviation business...

Larry Culp: Very much so.

Julian Mitchell: ...the timing. That's the biggest piece of that.

Larry Culp: Very much so.

Julian Mitchell: Okay.

Larry Culp: I think when we were together just a couple of weeks ago talking about the year, I think we felt very good and continue to feel good about a 2020 at GE, low-single-digit growth; operating margin expansion, call it, zero to 75; with the $2 billion to $4 billion of free cash.

We know we are back-loaded, but principally because of the MAX dynamics this year the first quarter, as I mentioned earlier, we're going to be particularly challenged. We'll see a little bit of earnings pressure from that, as well. So, we might be below last year as a result.

But given what we know at this point, I think we'll be on our way in the back half with respect to the return to service, given everything that we've heard from Boeing and elsewhere, and that will be good for us. It will just be an operating challenge here in the first half, given that we will have a temporary slowdown. But we don't want to take out too much of our cost structure, given the snap back that we know is inevitable here in the back half and in the years to come. I know you've heard that from others in the supply chain, our suppliers and others who are supporting Boeing during this challenging time.

Julian Mitchell: Maybe the last one from me, and then we'll see if there's any in the audience. You've talked in the recent past about "evaluating additional actions at delevering GE Industrial." It's a sort of mysterious phrase. So, I wondered if you could flesh it out or help us understand what's alluded to or in the scope of that.

Larry Culp: Well, if I explained it, it wouldn't be mysterious anymore. I think all we're suggesting is as we look at the debt complex, as we look at the pension, there may be some economic moves worth making. Right? We have no intentions of trying to operate in an underleveraged way, but there are some things that might make some sense for the shareholder, frankly, on an economic basis that we would consider. That's all.

Julian Mitchell: I don't know if there are any audience questions. Maybe while people mull it over, one from me would be around cash restructuring. It came in quite some way below last year where you had thought.

Larry Culp: Right.

Julian Mitchell: How much of that is pushed into this year? How much is just a more efficacious restructuring effort so we just got a lot done at a lower cost than that; done, there's no catch-up or step-up that needs to happen?

Larry Culp: Well, it's mainly the former than the latter, Julian. We certainly spent less than we had anticipated. And admittedly, we probably set ourselves up with a wide berth coming into 2019, making sure that we had the room to do whatever might come forward. There were instances where we took cost out, spending a fraction of what we anticipated. Some of that was a function of attrition. Some of that was just good execution.

So, we took the costs out of the organization that we wanted to, by and large. There was a bit of a push into this year with respect to the timing of some of the European actions that we're taking, principally in Power.

So, I think when you look at restructuring 2019 you really need to put it in the context of the $2.5 billion that we've spent the last couple of years, investments which we think basically have a 12- to 24-month payback. They're very much in line with what I have seen and done elsewhere. Feel good about that.

But I would just say on the topic of restructuring, Julian, my impressions over the last nearly year and a half are that that is sometimes overweighted relative to the road ahead at GE. There are – what I mean by that, there are lots of ways in which we're going to expand margins and drive better cash: again, upfront better discipline around price, terms, scope with respect to what we sign up for; better execution in our factories and our supply chains and at our project sites. And certainly, there are opportunities to drive better price, better cost performance in our service businesses, particularly in Aviation and in Power. Clearly, our services businesses are smaller on a relative basis in Renewables and Healthcare. So, they won't count as much.

But when you put all that together, in addition to what we're doing to move the center of gravity, taking a good bit of Corporate, putting it in the businesses, and just shrinking the overhead levels, there are lots of different pieces to the puzzle that I think we're going to put together, again, to drive better margin performance and better cash performance over time at GE.

Julian Mitchell: Good. Well, I think we're out of time, essentially. So, we'll switch now to the Audience Response Survey questions, please. The first one is, "Do you currently own GE stock? Overweight, market weight, or underweight?"

Larry Culp: That's not for me? Okay.

Julian Mitchell: Hopefully, they're doing it. (inaudible) familiar with this, from Danaher days.

Larry Culp: Well, I remember this vaguely, but my wife makes me watch "The Voice." This is what – I feel like that poor singer on the stage now.

Julian Mitchell: So, still 80%, "no." So, a lot of room to go.

Next question, please. "What's your general bias, aside from the ownership aspect?"

So, extremely balanced; surprisingly, I think.

Number 3. "What do you think the through-cycle EPS growth will be for GE against its main multi-industry peer group?"

So, still about half say less than the peer group.

Number 4: "What should GE do with excess cash?" It may not be a question for this year, perhaps, but I suppose...

Larry Culp: Soon.

Julian Mitchell: ...soon, yes. Medium term, this will be a more helpful question.

So, as you'd expect, sort of three-quarters – I guess it's being answered as a Year One question, not medium term.

And then Number 5, "What multiple should GE trade at in terms of 2020 EPS?"

Okay. So, mid-teens multiple, for the most part.

And the last question, "What's the biggest headwind or reason why sentiment is still pretty negative?"

Fifty percent, roughly, say execution or strategy.

Larry Culp: That's good news, because that's within our control.

Julian Mitchell: Right. Self-help, exactly.

Thank you very much, Larry, for coming.

Larry Culp: Thanks, Julian.