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General Electric Company

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Josh Pokrzywinski: Good morning, everybody. I guess by the size of the crowd no one needs too much introduction here for who's next on stage. I'd like to welcome from General Electric, Larry Culp.

Larry, obviously you've been very busy. Appreciate you taking the time. You've done a pretty, I think, thorough review of the organization at this point. Do you want to just spend a few minutes talking about what you're seeing out there in the organization, the things that you like, the things that you wish you could do better? And we'll take it from there.

Larry Culp: Sure. Sure. Well, thanks for having us. It's always good to be in Laguna. This is a special place, obviously.

It's hard to believe it's just been six weeks since earnings. I don't know about you, but I've never had six weeks fly by in the way the last month and a half have been. It's been particularly busy the last month because we've had a very full schedule. We've kicked off our new strategic planning process. We've had in-depth reviews at both Aviation and earlier this week with our Power businesses.

We had over 100 customers from around the world into Crotonville a couple of weeks ago for our Global Customer Summit, which is a phenomenal event.

We actually were in Crotonville last week with our top 130 leaders for what you might think of as the old Boca meeting. But we had our senior leadership group in for two days, getting into great depth relative to how we want to run the company, going forward.

And we threw a board meeting in for good measure.

So, it's been a busy time at GE, and I think there's a number of signs of progress, things that we're encouraged by as we look forward not only in terms of 2019 but really for the next several years.

I think if I step back for a moment, we're doing what we said we would do in 2019. We said this would be a reset year, that we were going to be hyper-focused on doing two things: one, tending to the balance sheet, making sure that we were strengthening our overall financial position; and making sure that we were in a position to run the businesses better, with an eye toward unlocking the value that clearly exists in this portfolio.

And I think we're making progress. I think from a deleveraging perspective, clearly, we were out this morning with a little bit of – for the last couple of days

with a little bit of news. We have sold the initial tranche of the Baker stake, that will take us below 50%. That's a good trade for us. It brings in $2.7 billion of proceeds, a little bit more possibly with the green shoot. That, coupled with the exit of Wabtec, now that we're out fully, in addition to the prospect of the BioPharma closing here before too long, really sets us up for about $38 billion of sources.

And this morning we began to signal how we tend to put those sources to good use, with a $5 billion debt tender split 50/50 between the U.S. and Europe. That will help us begin to I think show additional progress not only in generating sources but putting them to work.

And we have a number of things to do relative to bringing down that industrial debt load. Right? We've talked about a target of bringing that leverage ratio down below 2.5x. That probably requires, call it, $25 billion of debt reduction off that $54 billion [corrected by GE] that we exited the second quarter with. We feel good about that. And it's going to be a mix with the debt tender that we've announced. Clearly, there's a sizable intercompany loan back to GE Capital that we will be paying down, in addition to looking at the pension and a number of the options that we have to tend to that liability, as well. So, we think we're making good progress there.

Clearly, on the Capital side, again a little bit of news here of late, with the PK Finance sale to Apollo, $3.7 billion there. That puts us over the halfway mark on the $10 billion source program here in 2019 at Capital. And that $10 billion is really in the context of $40 billion of sources that we have to bring that debt-to-equity ratio down on the Capital balance sheet south of 4x.

So, I think we're making progress. Clearly, the BioPharma close will be important in that regard. But we think we have encouraging signs in that regard, as well.

With respect to running the businesses, this is what takes longer, both in terms of how we operate and having that translate into results. When we were together last week with the team in Crotonville, we had a phenomenal session really looking forward. And I know that GE's past is certainly interesting and seems to be a point perhaps even of obsession for some in the media and elsewhere. It is what it is. I think the leadership team and the management team, you should rest assured, is looking forward.

And what we did in Crotonville was really talk about two things. One, how do we really drive a lean transformation in the company. And there are a number of things that we're doing around GE not only in Manufacturing but really around the business to value stream map processes, really look at opportunities not only to eliminate waste but to make sure that we have a keen focus on serving the customer to the utmost.

And that's really coupled with what we're doing, if you will, top-down in terms of making sure that all of our businesses have the best possible road maps for the future. Lots of opportunities; certainly, no shortage of challenges. But when we

marry up through what we call Hoshin Kanri the strategies with the day-to-day execution in our businesses, we think we're going to be in a very strong position.

And you're beginning to see some of that as we work through the course of this year. But that operating transformation, let alone that cultural transformation, is going to take a little while to play out. But again, if you were in the room with us for two days last week, I think you'd be encouraged by the way we are changing the conversation not only in terms of how we want to operate but in terms of the cultural attributes that we want to define the General Electric Company.

And we know we do all of that on the back of over 125 years of history. And by and large, that history is history we're proud of. Right? There's no – there's very little when you look back that didn't contribute to this tremendous brand reputation we have around the world, a backlog now that's in excess of $375 billion, excluding Baker-Hughes. And our installed base, which really is the focus of that backlog, allows us to be in day-to-day contact with customers, helping them solve the problems that they're facing. In turn, that drives over half of our revenue and certainly a greater proportion of our profit and cash.

So, there's a lot of moving pieces. I think the reset year thus far here in early September is playing out fundamentally in line with what we had anticipated. But we know we have a lot more to do, both with respect to the balance sheet and the way we run the business, to make sure that GE is not only a good investment for you but for the company that we all want it to be.

Josh Pokrzywinski: So, that's a helpful intro. And I think, Larry, a few things that you touched on there. Clearly, GE's destiny is going to be determined by internal actions maybe more than the market at this point in terms of where you're focused. That said, I think a lot of companies on this stage have talked about maybe a little bit more pronounced macro agita over the last several months. Does that factor into the planning process, at all? Or is there enough wood to chop internally to say those things are still kind of a distraction or outside of the cyclicality of some of the longer-cycle elements, particularly in Aviation?

Larry Culp: Right. Right. Well, I think we like the way our business is structured going in to whatever may be in the offing here. Again, given over half the revenue comes in the aftermarket, tending to our customers in and around that installed base, that's real ballast to take forward.

I don't think we really have much by way of a meaningful update since we updated our second half – our full-year outlook back on the 31st of July. China is a watch point for us operationally, particularly in Healthcare.

But the bigger issues that we're keeping an eye on really are not operational in the context of the economy, be it the return to service of the 737 Max; clearly, the impact on rates – the rate impact, I should say, both on our pension liabilities and the insurance book. And as you may know, we're going through the GAAP test, the LRT test, to update our insurance assumptions here in the third quarter, as well.

So, operationally, I think we feel pretty good. Certainly, from a strategic perspective, Josh, one of the things that I think the team has heard loud and clear from me is that as we look forward we want to be optimistic, we want to be positive, but we want to be grounded. In just the last two days with the Gas Power team in Atlanta, a good example where they've gotten off to a good start. It appears that we may see a market somewhat north of that 25- to 30-gigawatt volume that we talked about coming into this year and perhaps a little bit of tailwind going into the next couple of years. The team said, it's possible but we're not going to run this business with that assumption in mind. We know we got caught being a little unduly optimistic in years past. We were slow maybe to tend to the cost structure, hoping we'd see a little bit of volume covering that. We're not going to run the business that way.

So, where we can push hard, given the tailwinds we have in Aviation and Healthcare, we will do that. There's a lot of wood to chop, to use your phrase, around the portfolio, but particularly in Power, in Renewables, and even in Corporate, where we're trying to make sure we've got a smaller footprint, a better cost structure, and, frankly, just a better day-to-day rhythm in the way we execute around the business.

Josh Pokrzywinski: I guess within Power, something that's become a lot more topical lately is this global push on LNG and kind of harmonizing gas prices globally to line up with the U.S. low rates. How do you see that supporting the business? That more optimistic view that's coming from Gas Power, is that informed by LNG at all? Or is that just the market looking a little bit better?

Larry Culp: Well, I think that is certainly a dynamic and it's a positive contributor, as is the way countries around the world are trying to meet their energy demands, in addition to deal with the energy mix, the energy transition that we all know well.

So, I think when we step back – right? – we know we're not going to keep pace with Renewables. Fortunately, we've got a good position on the wind side, particularly, and onshore. But that doesn't mean there isn't an important role for Gas. Gas' role is going to evolve. And again, what was really I think impressive about what Scott Strazik and the team took us through the last couple of days is country by country, region by region, looking at not only underlying demand but the way the turbines, the way the machines will be used and what that means for our new product road maps, but also the way we tailor our service offering on a go-forward basis.

So, it will be more nuanced, more segmented, Josh, but certainly you've got a number of positive dynamics here into the foreseeable future which we think set us up to have the room to tend to the other operating issues in that business.

Josh Pokrzywinski: I guess one of the cross-currents within that, or at least one of the questions that a lot of folks have, is China plays an important role on the LNG regasification side or the destination point for a lot of what comes from the U.S. The market dynamics there seem to be evolving very quickly around Gas Power. What role do you think GE plays in that? Or from a market share perspective – I know you don't play for share; you play for profit – how do you see that evolving if China

ends up being one of the bigger draws on gigawatt capacity over the next several years?

Larry Culp: Well, there's no question China is going to play an increasingly important role in the global market, both in terms of domestic use of gas in power gen but also the way the local players participate not only in that market but globally.

I was there – I think we may have talked about this – I was there in July meeting with our partner, Harbin Electric, meeting with a number of the senior officials in Beijing. And my takeaway I think was consistent with what you've heard from our team here for a bit. We're fortunate to be on the ground with an active partner – right? – rather than on the outside looking in. This is going to evolve – I'm not sure we'd say quickly – but we're engaged in making sure that we're bringing the capability that we want to bring to China there in a profitable way. Right? We don't want to play to play; we want to make sure that we're creating value not only for our customers there but for our shareholders here.

And so, this will play out over time. But I think we feel like we have a plan for China. Obviously, with the trade dynamics in play, things are a little more challenging day to day than they were a couple of years ago. But that said, I think we are in a strong competitive, a strong strategic position in China, and that will continue to be the case as we play this forward.

Josh Pokrzywinski: And now, I guess just thinking about getting the cost base right in Power, some early upside on restructuring. Can you walk us through how you were able to get better yield out of that savings and how that is manifesting itself in Power?

Larry Culp: Sure. Sure. Well, I think it's important on a couple of points there, Josh. When we talk about restructuring, remember we're really talking about, call it, $3.5 billion of spend over these three years – last year, next year, in addition to '19 – where we typically are going to see a 12- to 24-month payback. So, those are good programs.

We are going to spend less this year than we thought – that was part of the upward revision in our free cash guidance back in late July – really, in part, because a little bit has pushed, particularly in Europe as those consultations go on; in part, because we were able to do some things more efficiently in terms of the execution; and there's a little bit of conservatism in that roll-up, as well.

We continue to push the businesses hard to make sure that if there is anything we want to do under the restructuring guise that we do that. Now, remember, that's particularly focused again in Power, Renewables, and Corporate. And if you look there, I think we've got basically a 20% headcount reduction over the last 18 months in that population.

But when we talk about margins and cash, we need to do a better job making sure that folks understand that it's not just about restructuring. Right? Because I think part of the criticism I've heard of the company, at least historically, has been, "You restructure a lot. We see very little of it in terms of those returns." I think that's fair, but there's a lot under the hood in a business like GE that goes into making sure we're driving the margin expansion. Right?

We need to be smart in terms of the business that we pursue, pricing, terms, and the like. We need to be better, particularly with respect to projects, in the way we execute. And that's part of what you see this year, particularly from a cash perspective, weighing down both Power and Renewables. And we just need to be better day to day in our factories, in our supply chains. Right? More variable cost productivity, less waste, less scrap, things of that nature on the floor.

So, when you pull it all together, restructuring-plus-plus, we think we're in a position to get the Power and the Renewables margins well up from where they are, to have those margins convert comfortably into cash. We'll always be restructuring, but I hope it's less of a focus, less of a topic of conversation for investors and for ourselves, going forward, and it becomes more normal course.

Josh Pokrzywinski: And I would imagine within that there's kind of a range of outcomes that the current restructuring supports. Clearly, you're running all-out to bring cost out of the business. If the market were to shift lower – and I'll make up a number – 20 gigawatts or pick your number that's lower.

Larry Culp: In Gas Power.

Josh Pokrzywinski: Yes. Is there another wave of actions that you guys have sitting on the shelf and you've said, "Here's what we could do next."? Or does that require kind of a bit more of a recasting of the business?

Larry Culp: I would say there's very little on the shelf. If we can see it right now, Josh, we're getting after it. Right? But in my experience – and I saw Vicente Reynal, from Gardner Denver; I think Vicente and I have both seen this – your first leg of cost reduction gives you visibility for your next leg. Right? It's a continuous process.

So, I think Scott and the team have been through a lot here in Gas Power in the first year. Russell Stokes running similar plays in the Power Portfolio. I can see toward the end of the year the team having visibility, if you will, on the next wave. And again, it's a mindset. The moment you give up, by definition, you're going to be done. But if you don't, there's always something.

Josh Pokrzywinski: So, just shifting elsewhere in the portfolio – a better topic to talk about, at least a more fun topic to talk about – Aviation. It seems like for most of our folks that participate in that space it's been a spectacular year for commercial aero aftermarket. GE has had a good year, but I think there's probably some timing differences with the way engines are treated in that life cycle versus others. Could we see the kind of strength that others are seeing on the back of the Max grounding show up in 2020? How should we think about the timing of your kind of outsize aftermarket period?

Larry Culp: Well, I guess some people are having a good year in aviation. We look back and we think we've had a good century. This is the year that we're celebrating our 100th year at GE Aviation. From a service perspective, if you look at the first half we're up 5%. So, good, but not high singles, low doubles, as some are.

I think what we are dealing with in light of what's happening not only in terms of the Max dynamic but also some supply chain tightness is, frankly, two things. One, we are not bringing in certain engines in for repair or for overhaul. That's just a function of not having everything we would want to in terms of our own components and the like to service those engines quickly. So, I look at that as a supply chain challenge which we'll work through.

And in addition, clearly, with capacity constrained given the grounding, if a plane can be in the air rather than in a shop, there's a push in that direction, as well. So, we think that will play itself out as we get the Max back up in the air. I know Dennis was here and spoke to that yesterday. So, that will even out.

And when you look at the competitive position that we enjoy – right? – particularly, in the narrow-body space, passenger-miles over time, we think that service business at GE Aviation is as fine a franchise as we have in all of GE.

Josh Pokrzywinski: And I guess when I think about the longer-term momentum in Aviation, for as good as performance has been you still do have the margin headwinds from LEAP, the margin headwinds from Passport, 9X coming on next year and not that upside from aftermarket, at least in the near term. In the next couple of years – call it 2021, or thereafter – a lot of those issues start to drop off. And in the absence of a big new program, should we start to expect margins in Aviation to really expand outward? You do have a lot of support from military. You'll still have a good shop visit momentum pipeline. LEAP starts coming in. It seems like you can add up the positives pretty quickly and it's increasingly hard to find any offsets.

Larry Culp: Right. Well, I think that's right. And we don't want to be over-focused on any one quarter, frankly, let alone any one year. If you look at that installed base and that position that we enjoy today – nearly 70,000 engines around the world – that's a function of investing in technology, winning those new platforms, and then setting up customer relationships that can span decades. Right?

So, we are at a point where we're going to see that pressure, both from the ramp at LEAP – 9X, as well – about all the things that you talked about, in addition to just better day-in, day-out execution.

What I was referring to earlier was not a Renewables-Power phenomenon; we see a lot of opportunity for lean at Aviation, as well. So, I think David Joyce, the CEO of Aviation, talked at the Paris Air Show about being in the 20% operating range. I think as we look forward – again, we hear the call of margin expansion. We'll balance that out with investment. But that will certainly – that goal will certainly be our bias.

Josh Pokrzywinski: And I guess just moving over to the cash side, you touched on a few of those elements earlier, particularly on pension and long-term care where the testing is going on right now. I guess, first, on pension, snapping the line where we are on interest rates today, the PBO looks like about a $10 billion headwind. I know asset returns have been generally good this year, but it's hard to get a perfect window into where all the investments are. How has the underfunded status

changed as a function of all that? And I guess we'll start there and then we'll follow up with that.

Larry Culp: Right. Well, your math is pretty good, Josh. No surprise. And with the drop in rates, I think the last time I looked at this if you took a 110-basis-point drop, the PBO is up roughly $10 billion. Our returns there have been good this year. So, there's an offset; call it $3 billion. So, we're in the $7 billion range. We'll obviously tidy that all up at earnings as we put the quarter to bed. But that's clearly something that we wish we weren't dealing with, but we will.

Josh Pokrzywinski: I think because of voluntary contributions you're in good shape this year and next.

Larry Culp: Yes.

Josh Pokrzywinski: Could there be more voluntary contributions that come in 2020? Or are you satisfied with what you've already committed to?

Larry Culp: Well, there's no doubt the $6 billion that we put in last year covers us in '19 and '20 from an ERISA perspective. As I mentioned earlier, with the sources that we have we're going to manage the mix. Right? The debt tender that we announced today, the intercompany, and we're going to look at other options in and around the pension. So, we haven't really ruled anything off the table at this point. We want to be thoughtful. We want to make sure we're looking at the right returns and the right balance for GE and for our shareholders. But again, I think we're in a position of strength to deal with this issue given the abundance of sources that we have and/or are in the course of receiving.

Josh Pokrzywinski: Now, I guess as it pertains to the long-term care side, you're in the middle of the GAAP testing now. And as tempting as it may be to say this is the cash component – I understand there are kind of two different elements – what could people infer? What should they infer, if anything, based on the GAAP results?

Larry Culp: Right. Well, the GAAP results again will be something that – we're in the midst of this review. Had a lengthy review with the Audit Committee earlier in the week as we work our way through the LRT this quarter. Rates put pressure on the GAAP test, no question. And there again, if you use 110 basis points as your marker there, we're probably talking somewhere south of $1.5 billion in rate-driven adjustments coming in the LRT. The rest of the assumptions are ones that we're working through.

We're not yet ready to talk to the STAT test. That will come in the first quarter. But I think it's important to remember that they are two different tests. And there's a much more conservative set of assumptions, including rates, that go into the STAT test. So, it's not a one-to-one translation as we go from the LRT this quarter to the STAT test in the first quarter.

Josh Pokrzywinski: Now, is the STAT test something that you can do on an off-cycle basis, kind of for your own benefit of having an idea of where you might be? Or does that really need to wait until the first quarter?

Larry Culp: I think we can begin to extrapolate once we get through the LRT. Right? It's complicated. Right? It's the law of actuarial science in play here.

What we don't want to do, frankly, is get out of cycle with these tests. There's a reason that we go through rigorously all that we do in both areas on an annual basis. And that's a calendar that we want to make sure we lock down, processes that are robust. And whether it be the new team that's in place, certainly the review that the insurance book, the attention the insurance book gets from my senior team and myself, in addition to the Audit Committee – right? – we want to make sure we continue to do that as well as we possibly can so that we limit the surprises.

Josh Pokrzywinski: I guess, by the same token, there's been a lot of public comment on where you stand there. Some of the analysis we would disagree with from some independent folks who I think are a little inflammatory. Is there a desire to maybe curtail that or kind of nip that in the bud by saying, "Here's what we've looked at. And we're not going to make this an annual thing, but we're going to give you a little bit more of a peek under the hood."

Larry Culp: Well, I hope we've given you a little bit more of a peek under the hood. I'm not quite sure what you're referring to. But it was just four weeks ago, this morning, that suggestions were made that we obviously have a real issue with. And you've heard from us both in terms of written form and from Leslie Seidman on CNBC, chair of our Audit Committee.

I think what we've tried to do, Josh, is recognize that this is an issue that we wish we were not dealing with, simply put. We want to make sure that we demystify it as much as we humanly can. So, you've seen enhanced disclosures in our Qs, in our K. Steve Winoker, who's here, our new – relatively new – head of IR, spearheaded with Tom Timko, our new controller, the insurance teach-in that we had earlier in the year. We want to let you know as much as we can.

And I think that, coupled again with a new management regime at every level in Insurance, at GE, and at the board, we're going to be as thoughtful and as careful about those obligations and those liabilities as we possibly can. And to the extent that we can do more with the passage of time, say, in the wake of the LRT here in the third quarter, we're going to do that.

Josh Pokrzywinski: Got it. That's helpful. We can certainly see from our perspective that there's been increased transparency, and I think that helps all parties. One element on that transparency front, as well, has been on cash flow. You guys have given a lot more color over the last several quarters. I guess, thinking about the out-year bridges where there's still a lot of noise in the system and it's hard to parse through, certainly people have varying opinions on what that looks like. When you think about the cash flow headwinds this year, how much of that is tied to kind of fixable practices in working capital or restructuring or other temporary issues like supply chain finance or long-term AR factoring where the passage of time and the implementation of processes make those better? Versus saying, these are endemic to the businesses and they're harder to get at. Deliberately, not an easy question.

Larry Culp: Well, that's good. I'm just going to wait for the 47 seconds we have left to expire, then.

It's an interesting frame. It's an interesting frame, Josh, because I don't – I can't think of anything that we're working our way through right now that is outside of our control. Right? Proudly spending the money we are in restructuring. We want to generate a return, bring that down over time.

The inheritance taxes that we have in terms of obligations and liabilities with some of these legacy projects, both at Alstom and elsewhere in Power and Renewables, we have a pretty good line of sight as to how that tails over the next couple of years. But we so far this year have seen little by way of additional news and noise. So, that's a good thing.

So, those are the sorts of things that we can I think manage – manage aggressively with greater discipline – so that we have less leakage. And the strong cash flow that we have at Aviation, the strong cash flow that we have at Healthcare, coupled with improvements, even a little bit would go a long way in those other businesses to get us to a place that we want to be, and we want to be there badly.

Josh Pokrzywinski: Understood. Larry, appreciate your time. Always a pleasure.

Larry Culp: Thanks, Josh.