General Electric

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Josh Pokryzwinski

Hi, good morning. I'm Josh Pokryzwinski, Morgan Stanley's Electrical Equipment and Multi-Industry analyst. Thanks for joining us for Day 2 of our Laguna Conference, virtual again this year. Fingers crossed that we're be on the beach in 2022. Joining me today to lead off Day 2 is General Electric. I'm joined with Larry Culp, Chairman and CEO this morning. Before I hand off to Larry who is going to make some opening remarks, I do need to read a quick disclosure statement just noting that for anyone who has questions about our research disclosure, visit the disclosure website at morganstanley.com/researchdisclosure. And that for all other questions, please reach out to your Morgan Stanley sales person. Larry, thanks for joining us as always. I understand you have some opening remarks. I'll let you get to it. But really appreciate you making the time for us today.

Larry Culp:

Josh, thank you. Our pleasure to be here. I'm going to take you up on the promise to be by the beach in Laguna next year. It's been too long. But yeah, let's go through a couple of updates and then happy to get into Q&A. I'm sure that's what investors are keen to hear this morning.

Obviously, we're still in a COVID impacted operating environment, but Josh, despite the challenges that we have encountered, as every other company presenting I'm sure has, I'm really proud of the progress the team has made across a number of fronts here at GE through the course of 2021.

When I joined the company almost 3 years ago, we said job one was the de-leveraging. As you well know, at earnings we updated the timetable for the closing of our Aercap-GECAS merger. We believe that we'll clear the regulatory hurdles and close that transaction this year. That will position us to have reduced our debt load by over $70 billion over the course of the last 3 years. We're excited about that because we really begin to move away from the focus on de-leveraging. Not there today, but I think we've got a path, and that really sets us up to spend more of our time focused on running and growing the business. That said, I think we're excited about the closing, not only from a de-leveraging perspective, but it really will help us. We're going to go to single column reporting, that's exciting because that really is just the beginning of what we think is a more focused, a simpler and certainly a stronger high tech industrial GE.

When we talk about the operational side of things, Josh, as you've heard me perhaps ad nauseum, it's all about Lean. We use Lean to drive sustainable performance improvements in safety, quality, delivery and costs across the business. I could tell you a lot of those stories. I just wish we could share with you what we shared internally just a couple of weeks ago. We had nearly 1,000 GE leaders together for our senior leadership meeting sharing war stories, best practices, lessons learned. And from improving software development to reducing cycle time and service operations, there were just a host of different examples where Lean is having real impact day in and day out to improve our processes with an eye towards serving customers, with plenty of benefits for investors.

We're going to have at our global Lean week in two weeks. All around the world, senior GE leaders including myself, are going to spend a week deeply engaged in Kaizen, driving improvements, but also, I think setting a tone for how we want to run this business. One of the other shifts that we've made in how we run the business is really around being more decentralized, less focused on GE as a whole, more focused on the discrete businesses of which we have 30 all around the world. We're going to kick off in fact tomorrow in Milwaukee with our Healthcare team, our strategic reviews. Which we have every time of the year right now. It's what makes it the favorite time of the year for me. We're going to be with everybody, a lot of in-person meetings thankfully, really making sure we're clear about how we see the future business by business. And as we do that, couple that direction with Lean, we know we're going to drive better operating improvements.

If the de-leveraging and the operational improvements were really jobs one and two, what that progress sets us up for is to frankly spend more time playing offense. First and foremost, organically. Be it improving our commercial execution, putting more money to work smartly in new product development, let alone longer term, relative to technology development, long a GE hallmark. As we get that right, look for us to do more of what we've done recently in Healthcare with the recent bolt-on acquisitions there. That really helps us accelerate the implementation, the strategy and improve our growth and our margin profile for the businesses andGE as a whole.

Obviously, a lot of interest, Josh, and I saw this in your writeup overnight as to the here and now. It is a challenging operating environment. I think in your note you used the expression whack-a-mole. There's a good bit of that going on, particularly with respect to the supply chain dynamics. If I look though at the businesses, at Aviation, I think we've been encouraged by the sequential improvement we've seen though the course of the year. As you know, we watch departures intently in that business. As of this morning, global departures off the 2019 levels, two years ago, down 27%, so we're still dealing with that even though we have been encouraged by the sequential improvement.

We see China down 13%, the U.S. down 10%, Europe down 35%. So different regional dynamics and clearly, as you've seen elsewhere, some softening in departure levels really just since Labor Day as we've gotten into the post vacation period. But we know we've got the largest, youngest expansion platform out there, we're well positioned for the aviation recovery. That we continue to believe is inevitable and we'll be there for our customers and our airframer partners.

If I move quickly, Josh, to Healthcare, it really is largely a supply chain story right now. Demand has continued to be I would say strong if not robust. Encouraged by that really

the world over. However, it has been a bit of a whack-a-mole game in making sure we've got what we need to fulfill demand at the levels that we'd like to. We've talked about semiconductors, we've talked about resins, logistics. You've heard that from others. We're no exception. So we're really engaging that challenge on a daily basis. Despite those issues, we're making sure that we can continue to protect our investments because this is a growth story, be it in Digital, be it in some of the commercial execution improvements, and we still feel confident that we're going to see 100 basis points of margin expansion in Healthcare this year.

In Renewables, couldn't be more pleased with the tone the world over. Obviously, this has been a year full of climate driven news events. Certainly, the Biden administration has picked up the mantle with full force. We've been encouraged by what we have heard, the discussions we've had with respect to offshore wind, real movement in that regard. And you know the grid is front and center relative to the infrastructure bill and some of those opportunities.

A lot more to come in the run up to COP26. I think what we're watching carefully right now is what happens with the PTC incentives relative to onshore wind investments here in the U.S. That's an important business for us, probably some of the best business that we have in our Renewables segment. And there's just a lot of uncertainty right now. Policy makers understand the swings put a lot of pressure on the supply chain and having a domestic supply chain in that regard is really important. So we're working through that as we go through the second half here, as we said at earnings, simply because those incentives drive orders and those down payments on those orders are an important part of the business model here.

But a lot going on. We need to continue to restructure and improve our customer position in Renewables broadly. That work continues and this is the area where we're probably seeing some of the most head-on inflation to come. Probably more of a 2022 story, particularly given the role steel plays in our Onshore and Offshore Wind businesses.

Power, really quite steady. We know the third quarter is often a softer quarter volume-wise, just given the assets that are online in the northern hemisphere. So our outage count comes down, that will impact margins sequentially following what was a very I think admirable first half performance by the Power team. A lot more I think to come in that regard given the operating improvements, the momentum they have there. As you saw, Scott Strazik has picked up responsibility for all of our Power businesses now. He’s going to accelerate the restructuring in our Steam business I think in a way that will help us all and certainly add to the high single digit plus ambition we have in the segment. So steady, good progress in Power.

Capital. Josh, recall a year ago we gave you a quick update on the loss recognition test in Insurance. We tend to do that full update at earnings. We'll do that again next month in earnest, but happy to just share with you briefly here that no charges anticipated. In fact, we think our margins on the reserves are going to be a little bit better than they were a year ago. So cost curves hanging in there, no real news, and that's probably good news relative to that part of the GE story. And then just putting a bow on it, we strengthened our free cash guidance for the year, $3.5 billion to $5 billion of free cash at earnings. Continue to believe that holds despite some of the wash items that we've talked about, be it COVID on the demand side, let alone supply chain and inflationary pressures, let alone the PTC dynamics here in the U.S.

The other thing, Josh, I think that I saw in your note that resonated with me from yesterday is, we really will step back here as we get into our strategic reviews and make sure to be laser focused on our longer-term strategic mission of building a world that works. And that takes different form in the businesses, but it very much is part and parcel of what we're doing to shape the future of late. John Slattery, our Aviation CEO, and our friends at Safran announced earlier this summer our CFM RISE program which is really a next generation technology development to shape the future flights' drive emissions improvements. That's what GE Aviation has done for decades. We're going to continue to do that as those challenges become more important in and outside of the industry. If you look at precision health, we touch a billion patients a year. That's a remarkable number. The investments that we're making, not only on the commercial side, but from a technical perspective, digital, AI, and the like, we think will enable us to be better positioned in critical workflows to help drive better outcomes, both for patients and for payors alike.

When we talk about the energy transition, we have a lot to help solve these issues. Be it our Onshoren and Offshore Wind businesses, Grid, not to mention Gas Power. But it's not all about one dimension of the energy transition. The trilemma as we see every week, is not easily solved. We need to tackle sustainability. That's clear. But without affordability and reliability, we really don't have a solution that works for everybody. That's what we're deeply engaged in discussing, not only with policymakers, but frankly with customers as well. We like the capabilities that we bring to that conversation, a lot to do, time is short, we're on it.

And then if I step back all the way for investors, it's about value creation. And I think with GE, it's important to remember that over half our business comes from services. So day in, day out, we are with customers, in their operations, identifying and solving problems they have t today and perhaps helping them see issues and opportunities tomorrow. That just gives us I think an enviable position relative to all 3 of these major strategic opportunities that we have. We're clearly on a path given what we've done the last couple of years to deliver high single digit free cash flow margins, if not by 2023, shortly thereafter.

And our Board was together again last week, Josh, and we have a heck of a board, a Board very keen as we get past the de-leveraging to make sure we're reinvesting at every turn, both organically and inorganically into the business. We're going to have more options going forward to think about other ways to create value, be it with more competitive dividend, be it with respect to buyback, and that all ultimately drives more strategic optionality for us at GE. So COVID, still with us, no difference at GE, but a lot of progress on those things that we can control. We like the environment over the medium term. That's what we're up to.

Josh Pokryzwinski

That's a great opening, Larry, I appreciate that. It sort of touches on I guess my first question about the biggest areas of focus today. If I think about the past 3 years at GE under your leadership, you turned the corner on some of the major self-help initiatives, the balance sheet repair you talked about with Aercap. And more broadly, de-levering. I think COVID impact on Aviation, you've probably seen the worst of it. Not that there's still not heavy lifting to go, as well as some of the legacy items, the turnkey projects, the factoring, etc.

So the big strategic imperatives that you're thinking about over the next kind of 12 to 18 months, I mean Aviation upcycle, Offshore ramp seem like the big ones. Without having to go in that 3 to 5-year window, is that sort of a fair summary of how you see kind of the

big in the business priorities? Because you mentioned you're sort of pushing down the strategic imperatives rather than being at the GE level.

Larry Culp: Yeah. And we're not really pushing those down, Josh, to be clear. It really is part of an iterative conversation we have with the businesses all the time. We'll do that a little bit more formally here during our strategic reviews in the coming weeks. But I would say if I go by business, certainly, the Aviation recovery is number one, right? That's our biggest, best business in so many ways. You saw that in the 2019 profile from a profit, from a cash perspective. COVID really hit that business hard. The recovery, which we still think from a narrowbody perspective is a 2023 dynamic, widebodies in 2024, is what we simply can't sit back and wait for. We've got to make as much of our own luck as we can, the team is very committed to doing that. Just simple things like improving the turnaround time on our shop visits, creates a little bit more room for us to handle the demand that is there. Working more thoughtfully with our supply base, another way in which we're going to take more advantage of the demand that is there, as that demand builds. So I think that's a clear number one. But I'm not sure I'd put Offshore necessarily as number two. There are lots of other opportunities within Aviation that we are keen to make sure are top of the list. We've talked a good bit about the Military business for example. We've got backlog in that business that we need to clear. There's a host of underlying process improvements that we're putting in place there. There are a number of things that we can do here while we're still dealing with these demand pressures to drive better performance in Aviation.

Healthcare is not a business that I would take for granted. Clearly, we've been, I think, a good top and bottom-line grower in this business, but there's so much more to do in Healthcare. And as providers look to the post COVID environment, we're seeing both public and private investment being ratcheted up and in areas where we can be I think a contributor and a beneficiary.

And there's just a whole host of things, Josh, besides Offshore, that I would say we are doing and will do relative to the energy transition. At a baseline level, clearly there's a lot of cost that needs to come out of Renewables, making sure that we're doing all that we can, particularly around our Digital Grid assets. Both within Grid and within our Digital business at Corporate, I think vital. Making sure that we're positioned, not only in the U.S. but globally with a strong position inOonshore wind, will be an important part of the ongoing Renewables story. And as I mentioned a moment ago, really pleased with the progress the team in Gas has made broadening and accelerating that type of improvement. Admittedly gradual in Power, while continuing to articulate the role that gas can and should play in the energy transition is at the top of the list.

I guess I could go on, but in the spirit of managing from the bottoms-up, those are some of the priorities business by business and we're working hard with all the businesses to make sure we realize the full potential each of them have.

Josh Pokryzwinski: Got it, that's helpful. On the kind of near-term outlook or environment for Aviation, obviously with Delta variant we've seen a bit of a pause in travel a little bit. Some of it is seasonal, but a few of the airlines domestically have given some updates there. Obviously green time plays something of a role even relative to that and maybe all those airlines are just using this bit of a pause in the action to catch up on maintenance. But how do you see this evolution of green time playing out both as the environment improves and with this near-term blip that you're seeing with Delta variant?

Larry Culp: Yes. Josh, I would say that we have worked closely with all of our carrier customers over the last 18 months or so as they have ratcheted down their schedules and moved heaven and earth to conserve cash. You mentioned green time, there are a host of other tactics that were used in order to do that. We were doing similar things in our own business. So hopefully, we played a role.

I think what we saw during the course of this year thus far is whether it's green time or some of the other variables, and there are many, that impact how the airlines are using the fleets and in turn, what happens in our service business, that those delays can only be maintained for so long. So I think we've been encouraged by the induction levels of late, surprises on the margin have been more shall I say pleasant than not. But we clearly have more time to go here before we clear some of these COVID induced noise factors in the business. That said, I think we're encouraged by what we see booked already for the rest of this year, primarily sequential improvement. We'll see how high, but we'll take that slow, steady improvement from here as opposed to waiting for some sort of spike that may come, but we're really not planning for that.

Josh Pokryzwinski: Have you seen any notable disruption? Aviation stands out, but I guess you could maybe point to Healthcare as well with Delta variant where there's been either site access issues or changes in customer behavior as we've seen cases kind of rise in certain parts of the country. Again, we're not in the same place we were a year ago, so maybe reactions are different, but have customers altered course seeing that in either of those businesses?

Larry Culp: Josh, I would say we talked a bit about the Aviation dynamics, right, and I'll leave it to the airline CEOs to talk about their forward scheduling, how they're thinking about that vis-à-vis Delta. I would say we really haven't seen major changes in customer behavior elsewhere. The one that does come to mind is simply it's clear that Healthcare investments, again, both on the public side and on the private side, have been designed with the future in mind. So even though providers are working through some of these near-term pressures given Delta, they're continuing to invest maybe in contrast to the last year or so in the future. Because so many of them see opportunities. Some at least in the public space perhaps recognize they've been undercapitalized. But other than that, I don't think we can really point to anything, at least as of today, that contemplates a major customer behavioral change.

Josh Pokryzwinski Got it, that's helpful. You made some comments around supply chain and obviously you guys aren't alone in that environment as you mentioned. We saw yesterday as well. It seemed like the time aspect of that was maybe the more critical component rather than the costs. How would you weigh those two pieces of this environment relative to GE's experience? Is it really more on procurement and timing? Or is it really the cost to procure these things?

Larry Culp: Well, they tend to be intertwined, Josh. I think what we've tried to do is stay true to our SQDC, our safety, quality, delivery, cost mantra. We've got put the emphasis on delivery ahead of cost. But that has become tougher because of some of the more acute shortages. But we're really trying to work both, and we know that that is most pressing in our shorter cycle business, i.e., Healthcare, and will be a bit of a lag factor for us in some of the longer cycle businesses. Again, Renewables come to mind.

So that's really the way I think about it. And what we're trying to do operationally is make sure that it isn't strictly a cost, cost, cost conversation with our supply base. Because we've got, again, all of those dimensions to manage through, but at the same

time, make sure that we are exercising or perhaps strengthening our muscles on the sell side so that we are pursuing those price opportunities that we have at the same time. You've got to work it all to make sure when you get to the other side that you've offset as much inflationary pressure which is increasingly suggesting it's structural in nature, as you can.

Josh Pokryzwinski: Got it. And then if I just think about how that compares itself out in the numbers, the cash flow seasonality I think over the last couple of years has been particularly 4Q heavy, more like in the $500 billion to $700 billion range in third Q with big step-up. Anything about this year, whether it's the cost environment or some of these pushouts or anything else going on that would make that unusually acute one way or another with all the strangeness that 2021 has brought?

Larry Culp: Josh, I don't think so. I think we're encouraged to have been in a position where we can take the cash outlook upback in late July. You'll recall that we had a first half that was better than a year ago. Still a bit too backloaded for my taste. I think that as we have unwound the factoring dynamics, we have uncovered a whole host of let's just say insidious ways in which our reliance on factoring helped move the organization toward a quarter-end sprint and a year-end sprint. So Lean is all about linearity. Be it in production, be it in collections, everywhere in the business, I think as we move past factoring, we're going to have less of that thrust, that will drive more process improvements across the business. But it'll take a while for that to really bring down that fourth quarter, that back half dynamic that you referenced. We are watching what happens around Renewables demand, Onshore Wind in the U.S, in particular. There's probably a little bit of an offset given some of the delays in the 787 program that had been discussed from an AD&A perspective in Aviation. But all in all, we think we're going to have a good cash year. We want it to be less backloaded than it is, we're working on that.

Josh Pokryzwinski: Got it. Understood. We talked about a few kinds of portfolio-wide endeavors. Seems like some of the particular pain points of a few years ago have been kind of alleviated here. The balance sheet is repaired. Some of these inheritance items have come down. Even to your point, maybe some of the concerns, more secularly in power of a few years ago have abated as part of gas being in discussion in energy transition. With that as a backdrop, what becomes kind of the long-term justification for all of this particular collection of businesses at GE?

Larry Culp: Well, Josh, I don't think I've ever kind of seen my role as justifying really anything. I think what we're hyper focused on here is performance. And performance business by business with an eye toward performance as the whole. I think we're making a lot of progress in that regard. There's still plenty more to do. And I think as we drive that performance business by business, coupled with the de-leveraging, we're going to have lots of opportunities to invest, both organically and inorganically. And hand in hand with that, we're going to have I think a great deal of strategic optionality. So as we go forward, again, I think that this Board is going to be hyper focused as well on making sure that we evaluate any and all options to create shareholder value. We want to do that in a thoughtful, rational, considered way. We can do that more so today than we could 3 years ago given the balance sheet progress, given the underlying operating improvements, and there will be more where that came from. So that's really the best answer I can give you today relative to what we're doing day in and day out at GE to serve customers, and along the way, create value for investors.

Josh Pokryzwinski: I think that makes a ton of sense. Just on Renewables, given that there was a lot of near-term dynamics both with the PTC side and self-help side of that portfolio, Offshore ramping. How do we think about the margin potential there over the next several years? And I guess more specifically, on some of the parts where the tail has wagged the dog on things like Grid, at the societal level, we're talking a lot about grid modernization and reinvestment and areas where you have these big weigh-in mark issues in places like Texas and California. Why isn't there kind of a bigger tailwind for that part of the business even as all of this stuff starts to come together over the next few years?

Larry Culp: Josh, I think that there will be a tailwind, to use your term, in Grid not unlike what we have seen in wind, pardon the pun, both Onshore and Offshore. But it's still early. I think policymakers recognize that there is a limit to how much of the generation mix we can resort here for Renewables without modernizing the grid both in terms of hardware and frankly software.

But I wouldn't want you or anyone else on the call to think we're waiting around, right, for that tailwind. We know operationally there's a lot more we can do to improve our current performance in Onshore wind, and the team is committed to that. Offshore to date has been very much a startup type bet long-term given deployments are still several years away in any meaningful volume. But that said, given the generation mix that governments around the world aspire to see, we think we have a wonderful opportunity in Offshore ramp.

Grid I think is going to see demand, probably not in every product category there. But we know particularly in the digital assets, again, some of which are in the segment, some of which are in corporate today, are going to be major beneficiaries and we're seeing good growth there in our Digital software businesses.

That said, there too we've got real operational improvements if not turnarounds underway. And while I think we're going to make progress and we're going to see positive margins, not negative margins in renewals as a segment, there's a lot of work to do. And that's work that I think we've made a great deal of progress on this year. If you look at the margin improvements, I think we're up over 500 basis points here recently. But no one is satisfied, rest assured, Josh, and no one is going to wait for some of these policy tailwinds to deliver us.

Josh Pokryzwinski: Excellent. I see we're close on time, but I want to ask one last question here because you had highlighted that you guys have made some great progress on the Long-Term Care portfolio over the last couple of years and have shown some positive margin even on those charges. When does that become kind of a tipping point to think about that business's future a bit more strategically rather than kind of stemming the bleeding call it 2 or 3 years ago?

Larry Culp: Right. Well, understandably, folks were anxious given the news flow a few years ago. I think what we're pleased with is the way the cost curves have held in the face of real experience and the way the team has managed that runoff book, both in terms of just the underlying obligations to those that are insured, in addition to managing the investment portfolio. Strategically, Josh, I don't think we're of a different mindset today than we've been for some time. If and when there's an opportunity to perhaps partner with someone else for part or all of that, we would be open minded to that conversation. Are we any closer today than we were a week ago or a year ago? I think that's hard to tell. A lot of factors go into that. But to the extent they would pass the time, this appears to be what it

is, something that we have our arms around, I think that has to increase the probability that something is going to happen. When? Time will tell.

Josh Pokryzwinski: Excellent. Larry, appreciate the time as always. Thanks for joining us this morning, and again, hope to see you on the beach next year.

Larry Culp: Let's do it, Josh. Thank you.

Josh Pokryzwinski: Thanks, Larry. Be well.