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Brendan Luecke:

Good morning.

Lawrence Culp:

Good morning.

Brendan Luecke:

My name is Brendan Luecke, and I cover U.S. multi-industrials at Bernstein. In light of the upcoming spin at GE, Doug Harned, our aerospace and defense analyst will be co-moderating today's session. We're thrilled to be hosting again, Larry Culp, CEO and chairman of General Electric. Since taking the helm at GE, Larry has driven an ambitious transformation at the firm to create three public pure plays, all the while controlling the controllable in a very tough environment. It's been quite the story. Larry, it's fantastic to have you back at SDC again this year. Thank you so much for joining us.

Lawrence Culp:

Brendan, thank you, Doug. Good to be here. Good morning everyone. Thought what we would do is maybe just give you a quick update on where things are at GE today and then get to Q & A. You'll hear us talk about where we are today as a new era at GE, and I think that's true. That's not hyperbole. We really are here today operating day in, day out as GE Aerospace and GE Vernova. These are two businesses that have a storied past, but I think more importantly, an exciting future ahead of them. Both will go forward off a $30 billion base, so we do not lack for scale, despite the three-way spins.

And as you may have heard us talk before, each has a bold vision for its future. At aerospace, we talk about shaping the future of flight, not for the faint of heart. And at GE Vernova, we talk about how we lead the energy transition, how we'll help electrify and decarbonize the world. Those are ambitious visions that we have for each of the businesses, but fortunately, it's very much in sync with what we do today, day in, day out all around the world. Now, those two businesses like our GE HealthCare business that spun in early January share a common GE heritage. What does that mean? It means a lot of things all the way back to Thomas Edison, and it really is those roots in innovation and technological leadership, which we think have defined this company over time and will continue to be at the core of all we do day in and day out for our customers.

GE has operated around the world for the better part of a century, so we have a global reach. We have a brand. We have a network. We have relationships in each of our businesses that really are fit for purpose when you talk about things like shaping the future of flight, let alone leading the energy transition. And, because of the nature of what we do in these long cycle businesses, those installed bases have grown. We've supported them such that in aerospace, 70% of our revenues today come in services and that number is approximately 50% at GE Vernova. In addition to the attractive economics that you would associate with a large service component, those relationships keep us close to our

customers day in, day out. We know what they're wrestling with, we know how our machines are performing. We take that information and shape the roadmaps for the future.

So, we're excited about where we're headed. As you've seen since we were together at this conference a year ago, we've just continued quarter in, quarter out to drive better performance. We were pleased a month ago with the first quarter results that we shared, the lifting at the bottom end of our range for 2023, a year where we believe again we're going to see strong revenue, profit, and cash flow growth. All the while making sure that we are making good progress and preparations for the spins, which today are still very much on track for some time early next year. It'll be the second step, again, because healthcare went in January quite successfully. And, we know first and foremost that we need to prepare ourselves operationally for the separation. Healthcare was a little easier in that regard.

The operational work that we need to do to separate Vernova and Aerospace is underway. We've kept that to a small group. One of the lessons learned from HealthCare, less than 10% of the people on the GE team today are working exclusively on the spins. The rest of us are trying to run the business as we would want. That running the business involves a good bit of our lean transformation to make sure that we're making every day count, and it's easy to let the day slip away in a long cycle business. But, a lot of what you'll hear us talk about in terms of daily management, structured problem solving, flow and kaizen is really all rooted in making sure that we are as disciplined and as efficient an operator with safety, quality, delivery, and productivity in mind for you, our investors and our customers, as we possibly can be. And, we're far from perfect. But, when I'm out with the teams on a regular basis, I see progress, and it's the cumulative effect of that progress coupled with our technological leadership that I think bodes very well for the future.

Now of course, we couldn't contemplate these spins a few years ago given our leverage levels. And, since we were together at this conference a year ago, we've improved dramatically the de-leveraging of the company. We're now over the hundred billion dollar mark in terms of debt that is by the boards now. So, we can really look forward with an eye toward playing offense again as we prepare for the separation of GE Vernova and GE Aerospace.

So, that's the view at a high level, if I go down a notch and just talking about the businesses for a moment. At GE Aerospace, we really are a propulsion and services leader the world over. One quick fun fact, we were underwing for 3 billion commercial passengers last year, and that's not a responsibility that we take lightly. Now, much of that is rooted in what we refer to as our commercial engines and services business, which is about 20 billion of the GE Aerospace revenue, 70%, again, in that instance coming from services. We have an enviable position in the narrow body space with both of the major air framers with our legacy CFM56 engine and now our new platform, the LEAP engine, where we're exclusive on the Boeing 737 MAX, and we have over 50% share with the Airbus 320 family. Lot happening there, particularly around LEAP, an engine that has a 7,000 strong installed base to date. An installed base we think will double between now and 2025 because of the ramp happening at both Boeing and Airbus.

You've heard about the supply chain challenges. We may get into those a little bit later. We're making progress every day such that we think we're going to have a 50% increase in LEAP deliveries this year up to 1,700 units. But, it's a daily battle. But, it's a battle I think that the team is winning all the while making sure that we're continuing to support our narrow body business. Both narrow and wide body traffic is close to 2019 levels now. We're really excited about not marking ourselves to the pre-pandemic period, but I think next year talking about just regular rolled growth, and we've got those opportunities in the wide body space for sure, given our GE90 or GEnx. And coming soon, our GE9X platforms.

So, there's a lot there and the way we break that down within the company is really to think about what we need to do today, what we need to be prepared to do tomorrow, and where we going longer term.

Into the supply chain topic, it really is about making sure that we're supporting the airlines to the fullest extent possible. They want as much lift as they can possibly muster. They're in a demand sweet spot like none of us can remember. And from a service perspective, the growth that you hear us talk about in terms of high teens to 20% after market growth is really rooted in making sure that we're providing the services, the parts, and everything else required to keep those engines running so that those planes are in the air. It's a high class challenge, but it is a challenge given all the post pandemic operating issues that you've heard from I'm sure every company that you invest in or consider.

With respect to tomorrow, we know we have an enviable backlog, particularly in the narrow body space, right? You hear about the major airframers selling slots into the latter part of this decade now. We've got line of sight on a significant ramp. Again, particularly with LEAP. Everything that we're doing to satisfy both the airframers and the airlines that stand behind that backlog is really geared toward making sure that we can reliably and safely step up over the next several years. Again, a daunting operational challenge, but one we wouldn't trade for the world.

All the while recognizing that the engines that we support today and that we're manufacturing for tomorrow are going to be replaced in time by new technology, given the sustainability mandates that every industry is facing. And, that's where you'll hear us talk about our rise efforts. With new technologies around open fan architectures in particular. But also, making sure that from a technology perspective, we're investing in every domain that we should. Be it hybrid electrics, be it sustainable aviation fuels, be it ultimately hydrogen fuel aircraft, so that GE Aerospace continues to lead technologically in the way this business has for decades.

If I shift quickly to GE Vernova. When we talk about GE Vernova, again, we're talking about decarbonizing and electrifying the world. Here, we have tremendous benefits of incumbency because our technology generates a third of the world's electricity today. What does that really mean? It means, again, the world over GE is known. GE is a respected, valued partner and given how daunting in this instance the energy transition can be for our customers, they're looking to us to help them navigate what is clearly an uncertain path going forward.

I think since we were together last at this conference, we've been buoyed by the way the public discussion with respect to the energy transition has evolved, very much in our view on point with the view we've had for some time. And that is, we can't solve for one dimension. We can't simply solve for sustainability even though it is of critical importance. The trilemma is real, right? We need to solve for energy security and energy reliability. And at the same time, we need to be mindful of affordability and solutions that don't consider all three of those dimensions probably aren't solutions.

We were really encouraged with the way things played out in Washington last year. Much has been written about the Inflation Reduction Act. I won't belabor the point, but it gives our customers tremendous certainty with respect to incentives and government supports, particularly as it pertains to wind. And, we already see in our onshore wind business significant visibility in the form of orders, commitments, and other indications of interest that give us a planning horizon in that business, unlike any that we've ever seen. And, that's a market space that's important to our underlying performance and ultimately the spin of GE Vernova. Those government policy moves, in addition to the corporate frameworks, really do give us a backdrop here for GE Vernova that we think is pitch perfect for this business to spin sometime early next year. We think about GE Vernova as our GE power and our GE renewables businesses that will come together under the Vernova roof. At GE Power, we really are talking about our gas turbine business here, not unlike its aerospace cousin, a strong aftermarket play here, 70% of revenues in the aftermarket. This was the business when I joined the company back in the fall of 2018, a number of people suggested, "Larry, you can give it away." Remarkable turnaround on the part of this team, a $2 billion free cash flow generator this year. This may not be the highest growth

business in the GE Vernova portfolio, but it is solid bedrock, strong cash generation, important role to play, will give us, I think, opportunities to reinvest and strengthen those customer relationships at the same time.

At renewables, we really are working in three different areas, onshore, offshore,

... Offshore wind and grid. I mentioned the Inflation Reduction Act earlier. There's a lot to this self-help story at onshore wind. The Inflation Reduction Act really does give us that demand backstop that customers and we were looking for, but there's a good bit of self-help here. I mentioned SQDC earlier. From a safety and quality perspective, we've evolved our product roadmap such that we're not trying to bring a new turbine to market seemingly every six to nine months. Customers have really embraced our workhorse strategy.

We can come down the learning curve from a quality, from a cost perspective as a result that bodes well. In addition, we've just gotten into our fixed cost structure rather dramatically our headcount and that business is down 20% from where it was just last summer. So there's a lot that gives us the optimism that you've heard us perhaps express elsewhere. A tough first half in Onshore Wind in 2023, but markedly better performance in the second half of this year with an eye toward profitability in '24. We know Offshore is in its infancy as we work through our initial backlog of our Haliade-X offshore wind turbine. All the while positioning ourselves, I think, well, with everything required in the grid, this again was a business a lot of people suggested we give away, we shrunk it with our selectivity strategy to go after the business where we could play, win and do so profitably. I think we're on path here to not only have a profitable business, but now especially in Europe, you may have seen a couple of big HVDC orders from Tenet, one of the major grid operators in Central Europe, really looking to make sure that all the renewables being brought online are able to be successfully integrated into the grid. A lot going on, a lot still to do, but I think we're excited about where we're going to be tomorrow, let alone early next year when we've got two industry leading investment grade GE companies out there. So with that, we'll go to Q&A.

Doug:

Excellent. Thank you so much, Larry. It's been quite a journey. I'd love to take a quick look back to kick things off. First question for you in Covid is fading in the rear view mirror. We'd all love to forget it, but we're still living through some of the after effects economically. What are your two or three biggest lessons having led the firm through this crisis?

Lawrence Culp:

Brendan, I'm not sure it's something that we learned and knew, but one of the things I learned as a CEO early on in the dot-com crisis, and then in the great financial crisis, you've got to embrace that reality, particularly as a CEO, because it's not

Something the organization will beat you to. The organization needs to be led and going in and just embracing that reality, getting the team wrapped around the idea that this could really be rough, may well be rough, controlling what you can control and just keep moving forward while offering employees, customers a ray of hope with respect to what's possible. Helping them believe that we'll get through this. We all remember some rather dark days back in March and April of that year. I think the GE team had not necessarily been without tests in the recent past. It's a resilient group. It's a resilient group as I've ever seen. Our lean work really helped us focus on problems rather than finger pointing, and we just kept moving forward next time around, I hope we don't see a pandemic again, but when we're in crisis, we're in a period of pitch uncertainty. I really think that simple idea of just embracing that reality and moving forward, controlling what you can is just the best way through.

Doug:

Well, it's got to be good coming out of the crucible.

Lawrence Culp:

We'll take it. We'll take it.

Doug:

Yeah. I just, I'm going to tie this into Aerospace a little bit, but I remember four years ago you had just come to GE. We were here, and I had a CEO ask me to ask you, another CEO asked me this, why the hell did you take this job? So here we are four years later. Now you're looking at a slightly different job with aerospace.

Lawrence Culp:

Yeah.

Doug:

How do you think about that in terms of the way you manage aerospace going forward relative to what it was under the broader GE umbrella?

Lawrence Culp:

Yeah. Well, I'm so glad that I took this job four and a half years ago, Doug, not anticipating all that came, but it has been an absolute joy every step of the way. It's interesting, I've been dual hatting for almost a year now, and when I went in late last June to run Aerospace, there were hosted reasons why. I think it was the first week it dawned on me, it's been a long time since I ran a business. I don't want to scare anybody, but you go back to the late nineties, I had group responsibilities at Danaher. I was CEO there for what? Better part of 14 years. And I've said publicly, I'll say it again this morning, as CEO of a multi-line business where you have CEO's reporting to you is a different job than it is when you're running a monoline business and you've got a number of functional VPs coming at you. I won't tell you which is the better job, but I'm sure there may be some other CEOs that I know here who will speak to that.

I have to go back into that operating company mode, not looking to try to micromanage everything. Aerospace, as you well know, big complex business. I've got to make sure we've got a great team, we're clear on strategy. We've got our daily, weekly, monthly, quarterly cadences laid in. It wasn't as if I haven't been doing that for the last 20 some years, but I have really more than anything, been helping CEOs and leadership teams do that, so a level down, it's a bit more hands on, but it's a blast because you get to know the people better. You get to know customers intimately. It's just different than when you were managing a portfolio, managing a group of CEOs.

Doug:

It's interesting to think about the difference between the two because one of the goals that you all have said is to have 20% margins for Aerospace in 2025. That seems like one of those sort of top down leadership goals but when you think about it, how do you think about the path to get there given the different pieces of GE Aerospace cost inflation pricing, this is the complex problems to solve.

Lawrence Culp:

Yep. Yeah. Well you'll hear us talk about lean and you'll hear us talk about decentralization. Both of those are key levers here. Rest assured, Doug, when we talk about, as we did in March on Investor Day, that 20% margin target for Aerospace in 25, more importantly, 2 billion of our profit growth between now and then significant growth rate. That's not something that Larry Culp GE CEO dropped in on the Aerospace team or that I came up on my own as the Aerospace CEO. We put the team in the room and just looked it straight in the eye, what are we willing to commit to. To investors who are going to come visit us for a day, as many of you may have in March. What sort of aspirations should we be willing to take public as we think about telling our own story to investors as GE Aerospace in the not too distant future?

We saw that we're going to have tremendous volume, that the lean and the decentralization efforts are going to really help reduce cost, our price cost equation, given the way we price, particularly in the aftermarket with inflation protection like our escalators and the help us in that regard. The real offset will be the mixed pressure that we see, particularly from leap, and I think increasingly later in the decade from the nine x new engines early in their life cycle aren't nearly as lucrative, both from an OE perspective and in the aftermarket as their predecessors are. It's a good bit of everything but what we've done to operationalize that, Doug, is to make sure we know what we need to do from a narrow body perspective, what we need to do from a wide body perspective, what the defense and systems teams need to do as well. All the while making sure our engineering, our supply chain, our finance teams are locked in as tightly as possible.

Doug:

Now, I mean, to get there, you mentioned that in your opening remarks, including the supply chain has been a huge issue. But in the last year both Airbus and Boeing pointed to you, they pointed to Pratt and Whitney as a constraint on their output in engine availability.

Lawrence Culp:

It seems to have stabilized somewhat, and we hear other things being the bottlenecks now.

Doug:

When you look forward, how do you see the balance of having to deliver the OE engines demanded by Airbus and Boeing.

Spare engines needed by some of your customers and spare parts, which absolutely are critical. How do you play that balance?

Lawrence Culp:

Well, I get it really gets back, Doug, in the most fundamental of ways to just good core lean principles applied on a daily basis. It wasn't that long ago where we were really focused on a quarter, and you can still see, I think some of that lack of linearity in our operations, but there's no way we're going to drive the ramp that we're driving here, be it on the OE side, be it in the aftermarket without making good use of every single day, whether it's the first or the last day of the quarter. That's a different mindset, but that's not just something we can talk about from the CEO's bully pulpit. What does that mean to operationalize that? We get excessively granular, literally plant by plant to make sure we're clear on how much we need to do every day. We use our kaizens to make sure we're driving better productivity, that we're making use of scarce labor, be it in shrinking the turnaround time, as we did just last week in one of our core repair facilities. We take the same effort to our supply base and often to our supplier, supplier, just to make sure that as much as we can, we've got a reliable ramp from here but it's hard.

This is an industry, I think what you've seen over the last year, right, is a recognition. This isn't one company or another. It's not one commodity or another. It's an industry-wide post pandemic phenomena. It really requires that level of discipline, that level of intensity operationally that we're trying to bring. I think when you look at the improvement that we're driving with our commercial engine output, particularly in leap in this environment, you don't bring anything up 50% year over year without some underlying process improvements. That's just 2023. As you know Doug, we've got backlog for as long as the eye can see. We'll be ramping for a while. We can debate at what rate, but it's still a ramp. Our shops, our suppliers, their suppliers need to be at their best and that's what we're trying to deliver. That's what we're trying to achieve on a regular basis.

Doug:

Do you have a sense, I mean, castings have certainly been an issue over time, and if you look at the situation today, where do you see the issues still in the supply chain, and can you give us a sense how far out it will take to be back to normal?

Lawrence Culp:

Yeah, well I'm not quite sure what normal

Doug:

Lawrence Culp:

Well.

Lawrence Culp:

What was it going to look like?

Doug:

The sort of like 2019.

Lawrence Culp:

It wasn't as interesting perhaps in 2019, but I think we were all huffing and puffing trying to keep pace with a pretty good clip, and that was before we had the structural impact of the pandemic.

Everything that we see would suggest this is going to be a daily battle for the foreseeable future. So, when you hear some of our customers talk about this not normalizing this year, perhaps toward the latter part of next year, we're working hard to make it happen sooner. But if it were the latter part of 2024 that would not surprise me.

Again, you mentioned castings, I wish it was one commodity. We wish it was one vendor. We could all go in not as GE Aerospace but as an industry and go solve that. But if you look at our screens and we look at this on a weekly basis by product family, we go to the part level, the part, the supplier, the facility. It's everywhere. It's everywhere. And it's not just heavy capital fixed investment that is lacking in many instances, it's labor. Sometimes it's just arms and legs. Sometimes it's frankly experience that left perhaps in early retirement programs, pre-pandemic that didn't necessarily come back.

And when you replace a 58-year-old with a 28-year-old, you have a different capability on the floor in that instance. It's not bad, but in the near term it's disruptive. And that's just, as gritty and as wonky as that is, Doug, I think that's what we're all working our way through.

Doug:

Well, you mentioned on the margin, on the question of the 20% margins, a very important part of that is clearly the aftermarket business.

Lawrence Culp:

Yes.

Doug:

Given the high amount of profitability. There's been a real issue across the industry in terms of inductions for shop visits. The 58-year-old being replaced by the 28-year-old has affected the time it takes to get a shop visit done.

Lawrence Culp:

Yes.

Doug:

So if you could free up labor constraints, parts constraints, I would expect you could drive that aftermarket revenue up higher. That would clearly be ...

Lawrence Culp:

Very much.

Doug:

... much better for margin mean. How do you think about that in terms of over the next year, what's the path to get that MRO work up even higher than it's growing now?

Lawrence Culp:

Well, we are really working with the suppliers to ramp their production, production that tends to feed both our new engine lines and our aftermarket repair shops, so what we were talking about a moment ago applies. And at the same time when we talk about these lean improvements, these kaizens to drive out the waste in our processes, and I'm here to admit there is waste in our processes, we can really bring down that turnaround time, that in the door, out the door time.

We had some strong results just last week and one of our major repair facilities where over the last year you can see we've reduced the turnaround time anywhere between 20% and 50%. Now, that's in the ideal state, that's when we have all the parts. So we've got to work the supply base, again, oftentimes helping them with their own suppliers. We're going into the smallest of machine shops to run similar activities all the while making sure that our processes don't have any waste, or at least have as little waste and as little friction as possible. Again, I wish there was a silver bullet here. We haven't found it yet.

Doug:

Well, one of the challenges with new engines is durability. It's a normal problem with a new engine if LLPs come in a little sooner, those sorts of things. So the LEAP has not had, at least in our view, has not had quite the time on wing that all your customers would like yet.

Lawrence Culp:

Sure.

Doug:

Now, some of the things, and this maybe is too detailed, but like HPT shroud, fuel nozzle, some of these things, it appears you really have very well addressed. But can you give us a sense for where you are today in terms of time on wing in a kind of neutral environment, in a harsh environment? And where you expect to be able to take that with the LEAP?

Lawrence Culp:

Well, there's a lot there, Doug. You're exactly right to draw that distinction between the LEAP, the performance of a LEAP engine, apples to apples, with a CFM56, right? We've got a model in the CFM56 that is really at the end of its maturity curve, the LEAP still very much in its early stages. And customers like what they have today with the CFM56, and they want anything that comes online either to replace or augment the 56 fleet to be at that level.

And that's not where we are today with the LEAP engine. That said, I think that when you look point to point in the lifecycle with where we are today with LEAP versus where the CFM56 was at a similar point in its lifecycle, we're much further ahead. We're much further ahead from a durability, from a utilization perspective, and that's what we would've expected. That's all part of managing a long cycle business. But again, customers don't care about that, particularly in a moment like this. They want what they enjoy today with the CFM56.

Our fleet leaders are at approximately 10,000 cycles. We've got a roadmap. You mentioned a couple of improvements around the shroud, for example, that we're going to lay in systematically over the next several years to drive those performance improvements. Again, particularly with an eye toward durability. So we get the LEAP on par with the 56 if not better. But that's a multi-year effort, one that we understand, one that we're making progress towards. But again, we just can't make that happen overnight as much as we would all like it to be.

Doug:

Your competitor on the A320 has had some challenges with theirs, at least that we've seen to be a little more challenging than with the LEAP. Do you see the potential over the long term to gain share because you're able to address these problems more quickly?

Lawrence Culp:

Well, I won't speak to competition, Doug. I think that the sheer fact that we're sole source underwing on the MAX, that we have in excess of 50% share when customers can choose on the Neo suggests that we've got an enviable market position today. Again, given the backlog, both with new units and in the aftermarket, plenty of work to do to sustain that. And that's really where we're focused. If customers who haven't had GE underwing want to come and have a conversation perhaps that they haven't in the past, we would welcome that.

Doug:

I want to just go slightly differently, and then I'm going to hand it back to you, Brendan. So 15 years ago, GE acquired Smiths. It looked like you were building a systems business there. How do you see that now? Is that an area that you expect to grow? Would you think of more acquisitions in that space? What's the future of the system side?

Lawrence Culp:

Well, it's interesting, Doug. When we talk about systems, one of the things that we've done very much with our decentralization thrust is to say, "Let's not talk so much about systems anymore. Let's recognize we've got four discreet P&Ls in that group. Let's do less horizontally. Let's do more vertically." And that's where we are today. So, our power and avionics businesses are now looked after by Amy Gowder, who has a number of our defense assets. Ricardo Procacci looks after Unison and Dowdy, and they're really focused on running those businesses bottoms up.

And I think that's really been one of the key tenets of the overall GE transformation the last several years. What we want to do is make sure they're performing well operationally, they're growing organically, and if there are ways to augment that inorganically we'll certainly take a hard look at that. But first things first.

But we're excited because we know that they have important roles to play as we talk about the future of flight, we talk about new technologies like hybrid electrics, let alone a good bit of what we want to do over time in the defense arena now.

Brendan Luecke:

Excellent. We've got about 15 minutes left. Why don't we pivot to Vernova. As you mentioned in your opening marks, Larry, electrical power is a world of incumbency.

Lawrence Culp:

Yes.

Brendan Luecke:

And in my mind investors are clearly ready to reward credible decarbonization stories. Vernova definitely feels like one as the incumbent. What elements of the decarbonization side of Vernova do you think perhaps are underappreciated?

Lawrence Culp:

Well, I think it's a tough question, Brendan, because of the way I think the stock has performed since last fall, as this all came into view. I think there's been a better appreciation for what Vernova is, let alone what Vernova can be.

If I had to put my finger on one aspect of the story that may be underappreciated, I'll go back to what I said at the outset. If we're going to have any impact, we're going to have to solve for the trilemma. And I don't know how we could be better positioned to be part of that, not only given the array of products that we have, right? From gas turbines all the way to small modular reactors. But the entirety of what that history means for our customers. We're not necessarily a default option for them, but we are in the conversation as to how they navigate, how they solve for reliability, how they solve for affordability, let alone sustainability.

And as we think about trying to not only lead the energy transition, but to have that be a strong equity story, I think you really have to start with those fundamentals. And fortunately we do.

Brendan Luecke:

Makes sense. And then longer term, I think revenue selectivity makes all the sense in the world. We see it in Grid, we see it in Gas Power, we see it in wind. But is there a risk that you position yourself to be subscale? How do you get comfortable with the idea that you're only playing in part of the market rather than going after the whole thing?

Lawrence Culp:

Let me just back up for a moment. When Brendan references our selectivity program, one of the real keys to the Gas Power turnaround back in '18, '19, it's something we have been doing the last couple of years in renewables, is to simply forego the view that we have to capture every order or that market share is the end all and be all objective for the business. What we found was that with the best of intentions, we just chased business that we weren't well positioned to necessarily fulfill. You get the order, hey, great, but there's some other things you have to do to have that be good business.

And over the first couple of years in gas power, we weren't trying to be all things to all people. We weren't trying to go after every opportunity. We were much more selective. And what we found is that we had a higher win rate. More importantly, we just had better execution in terms of cost, in terms of cash, and the customers were better served. And that's really what we're doing.

Your question's a good one. With respect to core economics, we just haven't seen anything as we've played this out in Gas, in Wind, and in Grid now, to suggest that we're going to be so selective that we're going to be subscale. I think we're mindful of those scale economics, but take Onshore Wind, for example, we're number one in the US. The US market is going to be on a tear here for the next decade. That volume coupled with our workhorse product strategy, I think will allow us to lead and as we forego some opportunities in other parts of the world where the volumes are smaller, you end up with more bespoke products. We actually will have better scale economics. Sometimes the benefits of scale and synergies can be a bit of a mirage, and I think that's a truth we have reckoned with. So we're mindful of the potential to be subscale, but that's low on my worry list, Brendan.

Brendan Luecke:

Good to hear it. Onshore Wind, you mentioned. So a perfect storm over the last couple years here, but with price costs rolling, with the IR in place and orders coming in, it feels like this business is really going to start to find its footing in the next year or two. As we look to the profitability targets for FY24, what are the big pieces you feel need to fall into place to make it happen?

Lawrence Culp:

Well, I think we're very much on our way. Again, as you start, from an SQDC perspective, that workhorse product strategy where we have fewer variations will allow us to drive higher quality, thus lower field performance issues, which we've talked about our warranty expense problem quite publicly. It really starts there.

We get the knock on effect to your earlier question with these workhorse products of just the benefits of real scale in the factory, in sourcing and the like. You then look at just the pricing dynamics in the face of the inflation reduction act, right? I think the market understands that really in a point of scarcity, in contrast to where we were not that long ago. That's helpful to the margin story. And then we talk about

the underlying restructuring that we've done to lower our footprint costs dramatically. 20% headcount reductions alone since last August.

You put all that together. We weren't proud of the first quarter. I'll say again, we're going to have an ugly print here in the second, very much in line with expectations, but we think we really then demonstrate in the second half sequential improvement, all of those things falling into place such that we can talk about losing the parenthesis.

Brendan Luecke:

Excellent.

Lawrence Culp:

In 2024.

Brendan Luecke:

And as we look at those orders coming in and off the IRA, when I think of the Onshore Wind business in particular, the aftermarket services piece feels like a very comfortable revenue flywheel, it's the recurring cushion on top of your capital goods orders. How should we be thinking about that side of the business? If you don't offer any color on attached rates or what you're doing strategically on that front, it'd be very honest.

Lawrence Culp:

Yeah, it's similar but different than the service businesses we talk about in aerospace and gas power. Our services in offshore, about 25% of the revenue stream. Again, we've got to be careful, particularly from a service as opposed to a parts perspective, because we can end up servicing small volumes because we don't have installed based density in various parts of the world and those economics can be challenging in the US market.

Another structural distinction, we've got a number of customers who are basically self-service providers. They look after their own fleets. So it's different fundamentally because of the technology, but that doesn't mean it isn't an opportunity. And part of, I think what we've tried to do in the spirit of selectivity over the last year is to be really clear as to what aspects in the aftermarket are attractive. Where can we really add value to a customer and get paid for doing so? And that has enabled us to lower our cost footprint in a number of instances. While I think positioning ourselves to keep services moving in lockstep with turbine installations as we go through this decade. But again, it's not as strong a service opportunity as we might see in some of the other businesses, but it certainly is I think, an important part of the growth story for Vernova going forward.

Brendan Luecke:

Okay, great. And then continuing that services theme. I mean, I really look at the long-term service agreements and the gas power side of the businesses.

Lawrence Culp:

Yeah.

Brendan Luecke:

It's just foundational for Vernova. Again, maybe not a huge growth story, but certainly a good profit story. Why do customers choose long-term service agreements here versus transactional, and how's that trending over time, particularly on those renewal rates? You gave us some color back in March.

Lawrence Culp:

Well, it's interesting. You can see a bit of the customer psyche at work here, right? It's a big ticket commitment for a utility. They want to make sure that they have the manufacturer looking after it for as much as that life cycles make sense. And that's what we do at Gas Power in particular. So they like the idea of the certainty of having the vendor look after the machine. Part of that's a cost dynamic, certainty, control for them. But at the same time, they know that we're going to help optimize that machine over the course of that machine life. So that works for them. It works for us.

We typically see, let's call it 70% of those long term agreements end up being renewed. When they aren't renewed, it means that, again, in part because of the life cycle, the customer's going to seek a different arrangement, but that arrangement more often than not is going to have us providing the parts that will be used to support the machine to the end of its useful life. So we'll be manufacturing the parts, we'll be providing the ancillary services in the first part of that life cycle. Then we really go to a part supply arrangement, typically, if that contract isn't extended. In either instance, we're trying to serve the customer and we can do so profitably and well.

Brendan Luecke:

Excellent. And then one more quick one on Vernova, and we'll shift back to the big stuff. So in the past you've guided to about 80, 90% free cash flow conversion of this business. You upped it to 90 to 110 recently, but conversion's still choppy. I mean, it's clearly good this on the Power side this year. What gives you confidence in that higher target?

Lawrence Culp:

Well, I think when we updated that back in March, it was a bit of function of getting ahead of the equity story that we want to tell at the spins, but no reason to wait. But we were also past Scott's first year mark with the Renewables business. Scott Strazik, the CEO of GE Vernova, an outstanding executive, led that turnaround in power now has the entire portfolio. We wanted to give Scott an opportunity to get his arms around all of that before we were raising our public commitments.

We've talked about the turnaround very much a self-help story and Onshore Wind. I think the IRA will help ring out some of the noise in our cash flows primarily around progress. I think the timing should be less interesting, less newsworthy, and that's a good thing. And then again, backed to services. The Gas Power, really the entirety of that business with 50% of revenues in services should be a good consistent cash generator. And that's, you put all that together that's why we were able to take the conversion outlook up.

Brendan Luecke:

Excellent.

Lawrence Culp:

After March.

Brendan Luecke:

And then one on the spins real briefly, lessons from the HealthCare spin. How are you applying those as we look at the last round here?

Lawrence Culp:

Well, I think what we heard from a lot of people prior to embarking on the spins was, put a small team together, keep them focused on the spin, make sure everyone else was running the business. We thought that sounded like good advice. It was excellent advice. I think that's what we did with healthcare, which is why I think you saw healthcare launch well, from an operational perspective, there were no loose ends, no hanging chads, and they've been able to go forward in a focused way.

I think we've also appreciated the fact that as HealthCare went, they got the audience that they needed. An audience they weren't necessarily getting as part of an industrial company. And I think we've seen even before the second spin, heightened focus on the pieces, Vernova and aerospace, which is what we wanted. It's what we wished for. So it's also good to see that coming through.

Brendan Luecke:

Excellent. Well, it's good to see it all fall into place. Larry, if there's two or three messages you'd like to leave investors with today, what gets you the most excited looking forward? Where should we leave it all?

Lawrence Culp:

Well, I think it's just that, we're looking forward, and if you haven't been around the name in a while, I would just encourage you to look where we are today, look where we're going. These are two businesses where you want to operate at scale with problems worth solving, right? The future of flight and the energy transition. And I think we're ready to go.

Brendan Luecke:

Outstanding.

Lawrence Culp:

Thank you.

Brendan Luecke:

Thank you so much.

Lawrence Culp:

Thank you.

Brendan Luecke:

Always a pleasure. Thank you.

Lawrence Culp:

You bet, you bet.