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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the General Electric Second Quarter 2020 Earnings Conference Call. (Operator Instructions) My name is Brandon, and I'll be your conference coordinator today. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to turn the program over to your host for today's conference, Steve Winoker, Vice President of Investor Relations. Please proceed.

Steven Eric Winoker ***General Electric Company - VP of Investor Communications***

Thanks, Brandon. Good morning, and welcome to GE's Second Quarter 2020 Earnings Call. I'm joined by our Chairman and CEO, Larry Culp; and CFO, Carolina Dybeck Happe.

Before we start, I'd like to remind you that the press release and presentation are available on our website. Note that some of the statements we're making are forward-looking and are based on our best view of the world and our businesses as we see them today. As described in our SEC filings and on our website, those elements can change as the world changes.

With that, I'll hand the call over to Larry.

H. Lawrence Culp ***General Electric Company - Chairman & CEO***

Steve, thanks. Good morning, everyone. We hope you and your families are healthy and safe. We, like many others, had a challenging second quarter that the GE team met head-on, executing well operationally, while we took actions to further derisk our company. I want to thank all of my GE colleagues who are working tirelessly to serve our customers, our communities and our company.

Now as we expected, our financial performance declined across the board in the quarter. The sharp -- the deceleration caused by COVID-19 that we experienced in March continued through May. But we've started to see some early signs of improvement in June and July. Nonetheless, we remain cautious going into the second half given the uncertainty associated with the pandemic.

Now taking our second quarter results by business. At Aviation and GECAS, many of the drivers we saw in March, airlines conserving cash, not flying the planes they have, limiting maintenance spend and deferring orders are still relevant today. We're aggressively managing these businesses with cost and cash actions and partnering closely with our customers on a daily basis. I'll provide more color on this shortly.

In Healthcare, we continue to have elevated demand for COVID-19-related products. However, procedure deferrals are still affecting other products, including those in our high-margin Pharmaceutical Diagnostics business. Despite these volume and mix pressures, our team held margins flat in the quarter.

In Power and Renewables, outages pushed from the first to the second half, and field mobility constraints impacted projects. To offset those pressures, we continue to improve the cost structures of these businesses. Carolina will discuss these segment results in detail later.

With this backdrop, we saw revenue down 20% organically due to lower volume across all businesses. Recall that some of our shorter-cycle, higher-margin businesses, like services in Aviation and Gas Power as well as Healthcare are more heavily impacted by COVID-19. Combined, their revenue was down 3x that of the rest of GE Industrial. Despite this, our backlog remains a great strength at $381 billion, with about 80% in services. While services are hurting in the near term, they have a multiyear time horizon and keep us very close to our customers. Industrial margin was negative and decremental margins were 44%.

Our adjusted EPS was $(0.15), down significantly year-over-year. This was largely driven by lower volume at our shorter-cycle, higher-margin businesses and impairment charges related to COVID-19 at Aviation and GECAS.

And Industrial free cash flow came in above the guide we provided in May at a $(2.1) billion, better, but obviously still negative. This was largely driven by working capital improvement, primarily led by better-than-expected collections across the company. While this reflects improved operational execution, we have plenty more work to be the lean company we want to be.

So clearly, this was a tough quarter, and the COVID-19 dynamics continue to evolve with global cases rising. We acknowledge that the full duration, magnitude and pace of this pandemic across our end markets, operations and supply chains is still unknown. The macroeconomic environment could deteriorate further before it recovers. That said, based on what we see today and the actions we've taken, sequential improvement in earnings and cash in the second half of 2020 is achievable, and we expect to return to positive Industrial free cash flow in 2021.

Moving to Slide 3. We're focused on what we can control in the near term while positioning the business for the long term. Importantly, the near term still starts with our COVID-19 response. Our top priorities remain the safety of our employees and our communities, serving our customers in these critical moments and preserving our strengths.

Here's how we're operating today in 3 core steps: first, embracing reality. The current environment is what it is. So we're further optimizing our cost structure. And as mentioned before, we're targeting more than $2 billion of cost actions and $3 billion of cash actions this year.

Second, redefining winning. For example, we've shifted our focus from margin expansion to decremental margin improvement. Our businesses have also adjusted their priorities for 2020. Let me share a recent case. It spans Healthcare and Aviation and illustrates the point well. Our team stood up patient care monitor production at our Power and Avionics manufacturing facility in Cheltenham. They used lean to deliver 300 units per week with quality and efficiency, achieving the necessary 13-minute average production time. This certainly wasn't on Healthcare or Aviation's priority list at the beginning of the year, but it's a priority today and a job well done.

Third, we're executing our plan. We haven't lost sight of accelerating our transformation. For example, in Gas Power, the team is leveraging lean problem-solving in the new production introduction process for the third generation of the HA turbine, the 7HA.03. This allows us to drive efficiencies and solve potential problems earlier than ever, focusing on both the present and the future.

This quarter, we also announced some important changes to our team, complementing our strong existing bench of GE talent. First is the retirement of GE Vice Chairman and Aviation President and CEO, David Joyce. Over David's remarkable career, his leadership established GE Aviation as the world's foremost aircraft engine franchise. I personally thank him for his 40 years of service to our company. It was not easy to find a worthy successor to David, but I'm very excited to welcome John Slattery, a proven leader with extensive global commercial aviation experience to our team.

Pat Byrne, who recently celebrated 1 year with GE as our Digital CEO was recently named Vice President of Lean Transformation. Additionally, 2 GE veterans were appointed to key leadership roles. Nancy Anderson was named Chief Information Officer; and Mike Barber was appointed Chief Diversity Officer, as we take steps to drive further inclusion and diversity. To support that effort, we've also named diversity officers across all of our businesses, in addition to Mike, to drive that accountability. Together, these leaders, both those new and those well-known to GE, will play critical roles in GE's operational and cultural transformation.

In terms of de-risking the balance sheet, we prioritize maintaining liquidity in this environment, exiting the quarter with $41 billion of cash. We also proactively extended near term maturities, and we continue to reduce debt. Since the beginning of last year, we've reduced debt by $22 billion.

Concurrent with today's earnings, we're launching a program to fully monetize our Baker Hughes position over approximately the next 3 years. Executing this program in a patient and disciplined manner allows us to divest a substantial noncore asset, redeploy capital, enhance our financial flexibility and strengthen our balance sheet. We also continue to focus our portfolio recently completing the sale of GE Lighting.

Now I'll give you a deeper dive on GE Aviation and GECAS, given the severity of COVID-19's impact on commercial aviation. On the left slide -- on the left side of Slide 4, you'll see departures, which drives our services business, much more so than RPKs. We track departures by region and by platform daily. And what we're seeing in July suggest continued improvement globally. GE and CFM traffic has rebounded off of a low of down 76% in April from the January baseline to down 43% in July.

While we're seeing some improvement in aggregate, it varies by region as countries reopen. China has gone from being down over 70% to now being down 9%, which is obviously encouraging. In contrast, Europe is down 45% and has been rebounding since the beginning of July. The Americas are also down 45% and were getting better until very recently. This recovery will continue to be correlated with departure trends across global fleets and per aircraft, which ultimately impact the pace of shop visit growth.

If we look at GE Aviation and the trends we're seeing through July, commercial units are down 50% year-on-year. And services shop visits are down 55%, and CSA billings are down 60%. Services are critical to the recovery of GE Aviation as we generate a lot of cash here especially within narrowbodies, which were more than 40% of our revenue. On the other hand, our Military business remains strong, with unit growth up 10% year-over-year.

Our teams are not standing still, carrying half of the $2 billion in cost reductions and 2/3 of the $3 billion cash actions for all of GE. This has improved decremental margins slightly with further progress expected in the second half.

Shifting to GECAS. Similar to our peers, we continue to see elevated deferral requests from about 80% of our customers. To date, we've granted approximately 60% of short term deferrals based on a thorough review process. Importantly, we're starting to see customers pay on these deferral plans. At quarter end, we had 17 aircraft on the ground. We have a daily operational dashboard that allows us to closely monitor developments, ensuring that customer by customer, we have line of sight on where we may have repossession or restructuring exposure. We're also actively managing our skyline to better align with customer demand and the airframers' production schedules.

Our GECAS portfolio was also more diverse today than prior downturns. While approximately 60% of our fleet exposure is in narrowbody aircraft, our widebody aircraft make up less than 30%, and the remaining balance is in regional jets and cargo.

The widebody asset class has been hit hard during the pandemic, but we're being strategic around future placements, and programs like cargo conversion help extend the life of these aircraft. For example, we recently delivered a prototype to Israel Aerospace as part of a partnership to convert 15 of their 777 passenger jets to cargo.

We're planning for a steep market decline this year and likely a slow multiyear recovery. Long term though, the Aviation market has solid fundamentals, and we're committed to protecting the future of this business and our leadership position within the industry.

And with that, I'll pass it to Carolina.

Carolina Dybeck Happe ***General Electric Company - Senior VP & CFO***

Thanks, Larry. Time flies, and I'm heading into month 6 with GE. These are difficult times, but everyone is very focused on working as hard as humanly possible to make progress every day. Everything I've seen so far reinforces my conviction that we, as a team, can make GE stronger. I am an industrialist at heart. We operate in important spaces with a great team and leading technology. And we have many opportunities to improve... operations, capital discipline, digitization, using lean to enhance processes and deliver better results.

Now this was a very challenging quarter, which is evident in our financial results. The simple reality is that the broader macroenvironment impacted all our businesses. Aviation and GECAS were hardest hit, in line with what we expected in April.

Orders were down 35% organically. All segments down double digits other than Healthcare, which was basically flat, on the back of a $600 million of demand for certain COVID-19 products. Backlog was up year-over-year, but down 5% sequentially. Our backlog provides us with visibility as it spans over 15 years and normally covers more than 80% of annual revenue. Industrial revenue was also down but to a lesser extent than orders, down 20% organically. This was largely driven by Aviation, commercial engines and services, both down more than 50%, in addition to some shorter-cycle businesses such as PDx, down 28%.

Elsewhere, our equipment was slightly better. Our teams delivered more heavy-duty gas turbine and wind turbine despite issues moving people and goods across geography. The bright spots in profitability came mostly from self-help. Our countermeasures are taking hold faster in Healthcare. In our longer-cycle businesses, we expect similar improvement through 2020. In Aviation, Military delivered strong results despite supply chain disruption. And in Corporate, we continue to decentralize and reduce costs overall - this will continue in the second half.

I'll now talk to the difference between continuing and adjusted EPS. Some of the typical adjustments include restructuring, non-operating benefits and unrealized mark-to-market and gains, for example, Baker Hughes.

In addition, we have 2 other items. First item, $0.20 of goodwill and related charges attributed to 2 businesses: First is our Additive business within Aviation; and second is our GECAS business. We now have no goodwill remaining in GE Capital. Second item: $0.02 from one-time costs incurred for the multiple debt tenders we executed. This action help extend our near term debt maturities.

To comment on restructuring, we spent $415 million this quarter, up about $100 million year-over-year and about $200 million sequentially. This is mostly attributable to Aviation. In 2020, we expect to spend more on restructuring expense and cash year-over-year, and the benefit from this spend comes through the remainder of '20 and into '21. This is a good thing as we expect sustainable returns from a leaner company.

As Larry mentioned, we're targeting more than $2 billion of cost actions and $3 billion of cash actions this year. We realized more than 1/3 to date, and you will see further results in the second half. In total, we expect 1/3 to 1/2 to be structural cost out, which annualizes to $1.5 billion to $2 billion.

Moving to cash. The tougher macroenvironment also negatively impacted free cash flow. So the underlying dynamics are different in a few ways versus earnings. Before I explain the dynamics, I note that our free cash flow this quarter excludes BioPharma, a consistent cash generator of $300 million or more each quarter. So BioPharma is an important driver of the year-over-year reduction. And remember, this will continue through the first quarter of 2021. At a high level, cash flow was clearly impacted by lower cash earnings. There were also puts and takes on working capital. This is a big focus area as we have opportunities for improvement.

As you'll see on Slide 6, receivables. Collections outpaced new billings in this weaker market. But this wasn't a big swing factor as it was offset by lower monetization. We've made progress, but we expect continued momentum here. Inventory, similar story. It was a slight positive, but given the volume decline, we still need to manage inventory better, a big opportunity for lean.

Payables, a significant use of cash in the near term as we align with the market, especially in Aviation. But we expect that, that should see some benefit here from fourth quarter. Progress payments were neutral. We had inflows from our Military business within Aviation, which offset outflows in Power and Renewables.

Outside of working capital, there were a few favorable timing items. The largest was a $0.5 billion of discount and allowance payments on lower aircraft shipments in Aviation. For the first half, our free cash flow was $(4.3) billion. For the quarter, it was $(2.1) billion. The second quarter was more volatile and difficult than normal to forecast. The end market dynamics, especially in commercial aviation, remain unpredictable and, therefore, the outlook for the rest of the year is uncertain.

Our focus is always on cash flow generation. Our working capital programs are just beginning to see the improvement. Here, lean serves as a great tool. For example, in Gas Power, we've implemented daily management and standard work with regional accountability to track collections. This has improved on-time payments by almost 20%, and we will see more benefits from our cash actions. Together, we expect this will drive better sequential free cash flow in the second half.

Moving to Slide 7. We continue to strengthen our balance sheet and prioritize liquidity in the current environment. We ended the quarter with approximately $41 billion of total cash, $25 billion at Industrial and $16 billion at GE Capital. On top of this, we have $20 billion of credit lines.

We executed several actions this quarter to enhance our liquidity. We issued $13.5 billion of long term debt between Industrial and GE Capital. These proceeds were used to reduce near term debt maturities by $10.5 billion. These actions will be leverage-neutral by the end of 2021. And following this, Industrial has no remaining debt maturities in 2020 and 2021. GE Capital has $5 billion of remaining debt maturities in '20 and $3 billion in 2021.

Strengthening our financial position happens over time. Since the beginning of 2020, we've decreased our debt by $9.1 billion. Since the start of '19, we've decreased our debt by $22 billion. As Larry mentioned, we'll now start to fully monetize Baker Hughes in an orderly, straightforward program over approximately 3 years. We plan to use these proceeds for further deleveraging.

Our financing policy goals remain unchanged. We remain committed to achieving our deleveraging target. However, as we've stated, we expect to achieve those targets over a longer period than previously announced due to the impact of COVID-19.

So moving to the segment results. First, on Aviation. Larry has already provided you with some context on the market, so I'll dive into the results. Orders were down significantly. We have declines north of 80% in both commercial engines and services. For context, airlines have slowed or deferred new engine orders and elective maintenance on existing aircraft. Our orders were supported by our Military business. They had an impressive 60% growth rate primarily driven by equipment and new development orders.

Our backlog at Aviation stands at $258 billion. This is up 6% year-over-year due to higher CSA commitment, but down $15 billion sequentially. This is largely driven by a reduction in our Commercial Services backlog of $12 billion. This reflects both lower utilization of customer fleet and customer-specific adjustments.

In addition, but to a lesser degree, we had cancellations of commercial engine orders. This includes 795 LEAP-1B and 22 GE9Xs. Significant, but for context, our ending backlog still has more than 10,000 LEAP-1A and -1B units and 600 GE9X units.

Revenue was down more than 40%. The decrease in equipment revenue was driven by Commercial Engines as we shipped 403 fewer units year-over-year. This is partly due to the 737 MAX grounding and slower production. This was offset slightly by Military, which shipped 61 more units year-over-year. Military now represents 26% of Aviation revenue, becoming a larger portion of the business versus pre-pandemic. As expected, Commercial Services experienced a steep decline, down a full 68%, and this is due to lower spare part sales, shop visits and CSA charges.

Segment margin was (15.5)% and was heavily impacted by restructuring and charges directly related to COVID-19. These charges included approximately $600 million related to CSA contracts, reflecting lower engine utilization, anticipated customer fleet restructuring and contract modifications and a higher bad debt expense. Without these charges, margin would have been (1.5)%. Separately, there was another $200 million of supply chain expenses from lower production.

We're making progress here on the more than $1 billion of cost and $2 billion of cash actions. During the quarter, we reduced Aviation headcount by 11% or 5,400 people. Our plan includes a 25% headcount reduction globally. Decremental margin improved sequentially from 62% to 59%. Excluding the COVID-19 charges, this would have been 48%. We have now executed 30% of the cost and 40% of the cash actions. We'll build on this momentum in the second half. As you can see, we're aggressively repositioning GE Aviation, so we can continue to serve customers and perform better as the market recovers.

Moving to Healthcare. The team delivered in a tough market and pivoted quickly as healthcare needs shifted from routine procedures to urgent COVID-19-related care. To support customers, Healthcare dedicated field engineers to ensure the installation and up time of virus-related products. They also moved quickly to deploy new products. 'Mural', for example, allows one clinician to monitor several patients at once, reducing clinician's virus exposure and preserving PPE.

Our PDx business declined due to lower procedure volumes, particularly in Europe and in the U.S. But while April was difficult, PDx saw sequential growth in May and June as procedures increased. And going forward, we expect PDx to recover alongside procedures. But we continue to watch for pressure driven by regional outbreak.

With that backdrop, Healthcare Systems orders increased 3% organically. We saw strong demand for COVID-19-related equipment. This was partially offset by other product line with less correlation to COVID-19. Our pandemic-related demand included a roughly $300 million order from the U.S. Department of Health and Human Services for 50,000 ventilators. In partnership with Ford, we started to ship this quarter with the balance converting in the third quarter.

Revenue was down 4% organically. This is a tale of 2 cities of elevated COVID-19 in demand in HCS, which was not enough to offset declines in PDx and products less correlated to COVID-19 in HCS. Organically, PDx was down 28%, and overall, HCS was flat.

Importantly, segment margin was 14.1%, flat organically. The team faced significant headwinds from a shift away from higher-margin product lines and disruptions in logistics and the supply chain. They offset this with cost savings, including roughly 600 headcount reductions.

Healthcare continues to focus on margin expansion with an eye on serving urgent COVID-19 needs while prioritizing investments for future growth. We're continuing to implement changes to our engineering processes to drive greater efficiency and R&D prioritization. In the second half, we're targeting several hundred million dollars of cost reductions.

Moving onto Power. Even pre-pandemic, this segment has been a turnaround journey. Power's quarterly performance largely reflects commercial challenges related to COVID-19, and this was partially offset by accelerated turnaround actions.

Starting with the market, global electricity demand declined mid-single digit. But both gas-based electricity generation and GE gas turbine utilization were resilient. We saw improvement year-over-year in June. And we saw our CSA billings improve in the quarter.

Total Power orders were down for both Equipment and Services. Equipment orders were down 84%. Our orders activity was impacted by constrained customer budgets and access to financing due to oil prices and economic slowdown. This is especially true in Gas Power. Over the remainder of the year, our current pipeline suggests improved equipment orders, while we expect service orders to remain challenged.

In Power, we exited the quarter with lower backlog. So specifically at Gas Power, backlog was $66 billion, down $4.7 billion sequentially. The team delivered more out of the backlog than what we added through new orders. They also revised our estimates for extra work and upgrade billings in our long term service agreement, which drove almost half of the sequential decline.

Gas Power equipment revenue was up double digits on higher shipments. We shipped 25 gas turbine units, including 5 HA and 10 aeroderivative this quarter. Gas Power Service revenue was down double digits. This was driven by the outage shifts and weaker commercial conversion in transactional and upgrades. While approximately 20% of our first half planned outages were rescheduled, Gas Power still performed outages in 31 countries, return commission projects adding 4.3 gigawatts of power to the grid globally.

Based on our current view, we still expect to deliver 45 to 50 heavy-duty gas turbine shipments in 2020 and execute 95% of the outages that were planned for the year. Power Portfolio revenue was down double digits. We think about this as 3 businesses: Steam, approximately 25% of our first half planned outages shifted to the second half. All but 5% of those outages are rescheduled. Power Conversion continues to show underlying sequential operational improvement. And Nuclear, largely a regulated service business, remains stable.

Segment margin of(1.3)% contracted 390 bps organically primarily due to the decline in our highly profitable service volume and some charges. This include approximately $100 million related to an underperforming joint venture for global aeroderivative packaging and $50 million quality reserve on a Power Conversion product line that we have exited. We continue to take cost actions across Power, which includes roughly 800 headcount reductions in this quarter. Gas Power had a positive operating profit this quarter, with fixed costs down 13% year-over-year.

At Renewables, our turnaround efforts are driving underlying operational improvement, better project execution and more cost out. However, our quarterly performance continues to be challenged due to COVID-19.

Starting with the market. Onshore Wind market growth continues to be supported by international demand and the U.S. extension of the production tax credits. So the U.S. government granted an additional year to the PTC-eligible projects that started in 2016 and '17, which now have 5 years to achieve commercial operation.

In Offshore Wind, we're working towards certification of our industry-leading 12-megawatt Haliade-X. We're building a large pipeline of deals to capture secular growth through the decade.

Orders were down 17% organically primarily driven by the U.S. Onshore Wind and Grid. These orders pushed to the second half due to financing and permitting delays related to COVID-19. Indications suggest that these are genuine delays versus cancellations that we are actively monitoring. The team also continues to be more selective on new deals, pressuring growth now, but setting the stage for profit and cash in the future. International Onshore Wind was a bright spot, with orders up over 30%, despite some delays in Europe as well.

Revenue was up slightly organically as our Onshore Wind team delivered nearly 1,200 new units and repower kits, in line with our May guidance. We expect deliveries to increase sequentially again in the third quarter. Grid and Hydro revenues were down primarily driven by COVID-19-related fulfillment delays and execution issues. Our Grid and Hydro factories are now operating at approximately 90% capacity. Renewables overall is operating at 96%.

Segment margin was (5.6)%, with operating profit down slightly. This was driven by supply chain and fulfillment disruptions, currency headwinds and quality-related costs. It was partially offset by better Onshore Wind price, product cost and mix, improved project execution and accelerated cost out. We're making progress on our turnaround. We saw sequential profit improvement in Onshore Wind and in Grid. We reduced employee headcount by 600 and contracted by 500 this quarter. These are encouraging steps forward on the path towards positive margins and free cash flow.

At GE Capital, continuing operations generated a net loss of $522 million this quarter. This excludes the impact of the GECAS goodwill impairment of $836 million after tax and the day 1 cost of $119 million related to tendering approximately $10 billion of debt. We ended the quarter with $101 billion of assets, excluding liquidity. Sequentially, this is slightly higher, primarily driven by unrealized gain in Insurance, partially offset by GECAS aircraft impairment.

We typically complete our annual aircraft portfolio impairment reviews in the third quarter. But in the light of COVID-19 pressures on lessees, GECAS completed a Risk Based Review this quarter. We analyzed the GECAS portfolio based on our customers' probability of default. Those customers with the highest probability represented about 20% of our aircraft operating lease book, our review including a significant reduction in rent and extended downtime. And this resulted in an impairment of $292 million pretax. We'll finalize our annual review of the entire portfolio in the third quarter. We anticipate some pressure on our cash flow assumptions. In addition, we'll continue to monitor for credit risk deterioration.

Moving to our Insurance business. Earnings were higher. We saw a reversal of mark-to-market adjustments and realized gains as financial markets recovered this quarter. We've seen some variability in our recent claims data. We believe this is driven by COVID-19, and this resulted in a lower Insurance loss this quarter.

On the long term care block, we're seeing lower new claims and higher terminations than expected. We believe policyholders are delaying entering care facilities or bringing care into their home. For life block, we're seeing the opposite, higher claims. And we believe that this is driven by higher mortality from COVID-19. It is too early though to draw conclusion on this short term volatility given the long term nature of our insurance. We're in the process of completing our annual reserve adequacy review in the third quarter.

GE Capital ended the quarter with 4.2x debt to equity. We're committed to achieving a debt-to-equity target of less than 4x over time. We still plan to provide the required parent funding in 2020, in line with the insurance stat funding. We anticipate funding any future capital needs for GE Capital through a combination of asset sales, liquidity, future earnings from GE Capital and capital contributions from GE.

At Corporate, our focus remains on decentralization. Corporate and its operating units continued to reduce headcount, which is down 400 sequentially this quarter. Excluding dispositions, about 14,000 headcount has been transferred out of Corporate or exited from GE. In total, this has reduced Corporate headcount by more than half since mid-'18. And some cost reductions we're seeing in the units occurred as they right-size their needs for people and function.

We are also using lean to increase our efforts to simplify and automate processes at Corporate, especially while many employees work from home. This includes the close process, where we continue to shorten the cycle and increase the quality. We also chose a new auditor, Deloitte. I'm excited to work with them and get a fresh view.

In the quarter, adjusted corporate costs were down 66%, which really comes down to a handful of factors. There was continued improvement in GE Digital operations and cost structure. We have lower functional costs and lower new reserves related to legacy EHS issues. While we clearly made progress on reducing corporate expense, please remember that we had some offsets in our number this quarter. For the remainder of 2020, we expect the quarterly adjusted corporate costs to be roughly in line with the first quarter. We have more work to do. Over time, we'll take further actions to reduce costs as we create a nimbler organization.

With that, I'll pass back to you, Larry.

H. Lawrence Culp *General Electric Company - Chairman & CEO*

Carolina, thanks. In summary, this was without a doubt, an exceedingly challenging quarter. But I hope when we look back on this quarter, we'll remember it as one where we rose to a challenge of historic uncertainty and difficulty, to embrace our reality head on, and drive better operational execution while taking actions to derisk the company.

Better earnings and cash performance in the second half are achievable based on what we see today and the aggressive actions we've taken. As Carolina said, we do have work to do, and the environment is still fluid. It remains a game of inches.

I have no doubt we're accelerating GE's transformation for the long term, though. We're increasing our focus on lean and taking action on the factors within our control. That, coupled with our fundamental strengths, our exceptional team, our leading technologies and our global reach give us confidence in our ability to unlock the potential across GE today.

So with that, Steve, let's go to Q&A.

Steven Eric Winoker ***General Electric Company - VP of Investor Communications***

Great. Thanks, Larry, Carolina. (Operator Instructions) Brandon, can you please open the line?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And from Wolfe Research, we have Nigel Coe.

Nigel Edward Coe ***Wolfe Research, LLC - MD & Senior Research Analyst***

Steve, I'll keep this to just 1 question, not 1 question with 5 parts. So just look, obviously, Aviation, it's a very fluid situation. But what's your perspective? Is 2Q the low point? Clearly, the departure trend suggests that is -- that's a very encouraging trend. But I'm curious if you could just give some perspective on the scope for USM spare parts, used spare parts to provide a headwind into the back half of the year. And what's the perspective on shop visits relative to the trend you saw in 2Q?

H. Lawrence Culp ***General Electric Company - Chairman & CEO***

Okay. Well, Nigel, I think you touched on a number of the variables within the industry on top of those that are a function more directly from COVID-19 that make the first part of the question so challenging to answer and to work through, of course, inside the company and inside the industry. I think our view is that we are encouraged by the sequential improvement we've seen broadly around the world, but we're still down over 40% from a departures perspective. China being down high single digits is encouraging. They were first in and first out. Perhaps that suggests some of the potential from here. But I think by no means are we suggesting that things get meaningfully easier from here, at least in the short term. I think this is going to continue to be a challenging environment as governments and the public sort through how to react just broadly to the case trends. It will be a different dynamic country to country.

But with respect to those things within our control, again, we're trying to make sure that we continue to push safety first within our own operations, doing what we can to help align the industry around a safe return to flight. Operationally, tremendous amount of focus, as you well know, on cost and cash preservation, all the while looking for those opportunities to quicken the cycle time within a shop visit to improve productivity. So we're not only reacting to this unprecedented headwind, but they're working through the dynamics that will really dictate how well we perform in the second half in '21 and beyond.

You mentioned USM, clearly, as the carriers make decisions with respect to how they want to transition those planes that are parked in the retirement status, we saw some of that. I suspect we will see more of that over the next couple of years. We think we're well positioned to participate given that USM is a source of material for our CSAs. It has been for many years. So we'll have to see how all this plays out. Again, I don't think we're looking for anyone to do us any favors. I don't think we have a different posture than anyone else in the industry. These are difficult times in commercial aviation, but we'll work through that, all the while doing what we can to continue to feed a strong and growing Military aviation within our company.

Operator

From Barclays, we have Julian Mitchell.

Julian C.H. Mitchell ***Barclays Bank PLC, Research Division - Research Analyst***

My question will just be around the free cash flow. You talked about an improvement there in the second half, which I think you'd always see seasonally anyway. But maybe just if I could try and frame that scale of improvement, your first half free cash flow was down about $4.5 billion year-on-year. Second half of last year, you did about $(4.5) billion. So if we take your comments on improvement in that base number of $(4.5) billion, should we expect free cash flow to be positive then in the second half?

Carolina Dybeck Happe ***General Electric Company - Senior VP & CFO***

Carolina here. Yes. We do have, as you point out, a seasonality in the second half of the year. So that, we expect to see as well. But it's a bit of a different year compared to sort of normal years for us. So the second half, it will be a combination, obviously, of our cash earnings. But then we also have the working capital dynamics that you sort of mentioned.

If I look through that. I would say that on the receivables side, we expect to see improvements. We've put a lot of work into process and focus on this. We saw it help already in the second quarter, and we expect to see more of that in the second half. And we also have the Boeing MAX payments then. And we believe that monetization will be less of an impact.

Talking about payables. Here to explain the story. So basically, by purchasing significantly lower volumes versus paying old purchases, you create like a hole in the working capital. So that tailwind is sort of gradually gets better in the third quarter, and then we'll see -- sorry, gradually better in the third quarter. But in the fourth quarter, I would see that as a tailwind as the volume stabilizes.

On inventories, we worked hard, but we need to do more. So we believe we'll see better execution there. And here, you do have, for example, the seasonality with Renewables, right?

And then on the progress, we believe that we will see also a headwind in the second half because that will mainly depend on the Aviation orders, right?

And to our point that Larry mentioned earlier, our cash countermeasures, the $3 billion of cash, with 2/3 of that we expect to come in the second half, which is sort of weaved into some of the comments that I had. And we also see continuous underlying improvements. So that's our estimate for now. And we also believe, as we said, that we'll come back to positive cash flow than -- in '21 based on what we see today.

Operator

From JPMorgan, we have Steve Tusa.

Charles Stephen Tusa ***JPMorgan Chase & Co, Research Division - MD***

Maybe just asking that question in a bit of a different way. You mentioned the $500 million of, I think, deferred discount payments in the quarter that would have gone out the door, I guess, was the comment. Can you maybe give clarity on that account? I think other cash flow was relatively strong. And then just all-in, when you kind of mix all this stuff in all these dynamics, I think you also had a $700 million early Defense payment. I don't know how that kind of trends in the second half that helped progress. Can you get to positive in total in the second half? I think that was Julian's question, all-in.

Carolina Dybeck Happe ***General Electric Company - Senior VP & CFO***

All-in. Well, on the AD&A, yes, it was a $500 million in the second quarter. You can think about that dynamic basically that basically as the aircraft are shipped, you pay out the discounts, right? So it will depend on how the aircrafts are delivered.

And then you also asked about the progress payments on -- from the Military. Yes. We did get progress payments from Military. We got, I would say, a bit earlier than expected, because also part of the comments that we had between our estimate and where we landed. But overall, the comments that I made on the working capital are what they are and also the comment on the results, so that still stands.

H. Lawrence Culp ***General Electric Company - Chairman & CEO***

Yes, Steve, I think -- I think Carolina has laid it out. We've got work to do. Again, I think what we're saying this morning is that we came in better than we thought in the second quarter, obviously, a lot of good work. We certainly had a benefit from the lower production schedules with the airframers. But I think as we look at the second half, we're going to drive sequential improvement. We're going to do the best we possibly can, and we'll see where we end up at the end of the year.

Operator

From Bank of America, we have Andrew Obin.

Andrew Burris Obin ***BofA Merrill Lynch, Research Division - MD***

The July comment on Aviation on trends are based on unit volumes, but I think there are some factors that might hurt pricing as well. I think Honeywell highlighted used materials, competition on shop visits, et cetera. So would you expect a meaningful difference between volume declines and revenue decline in the second half in Aviation once you put all these factors together?

H. Lawrence Culp ***General Electric Company - Chairman & CEO***

Andrew, I'm not sure that we would go there today. I think what we're focused on, clearly, is the trajectory around shop visits. We've got better visibility today in the third than we do in the fourth with respect to our own shops. As you know, when we talk about shop visits, some of that activity is performed within our own facilities, but there's other volume that we support through material supply into third parties that do similar work. So there are a raft of factors in play here.

But again, I think given what we see today, we continue to believe the principal pressure that we're all under is how the carriers are going to operate and maintain the existing fleet. There are other dynamics that we haven't talked about, such as green time, that are realities that we need to embrace, realities we need to help our customers manage. So it's going to -- again, I think it's going to be challenging for us and for really everybody in the industry until we have better visibility on a sustained trajectory. That said, we continue to take the actions internally, not only on the cost and cash front, but also operationally, to drive the lean implementation so that we're producing cycle time and reducing delinquencies and past dues to make the most of this COVID period.

Operator

From UBS, we have Markus Mittermaier.

Markus M. H. Mittermaier ***UBS Investment Bank, Research Division - Head & US Equity Research Analyst of Americas Electrical Equipment and Multi Industry Research***

Maybe on the $1.5 billion to $2 billion structure cash out that you've referred to in the prepared remarks, would you say they're structural, obviously, at the 2020 sort of volumes? Or dare I say, as we work ourselves back to sort of like maybe 2019 volumes at some point, how should we think about that? And then how would you model the net benefits of all this over the next couple of quarters?

Carolina Dybeck Happe ***General Electric Company - Senior VP & CFO***

Yes, Markus, you're raising an important area for us, and this is the cost and the cash actions. So with our cost and cash actions with a $2 billion of cost and $3 billion of cash actions in the year, right, 2020, and basically, the $2 billion of cost flows through to cash and then there's additional cash actions like CapEx and other working capital parts.

Now that we have worked through sort of where we are now, what we can say is that 1/3 to 1/2 of those $2 billion are structural cost out. And that actually annualizes to $1.5 billion to $2 billion. And we do see, of course, the biggest chunk of that is in Aviation, but also in big parts in the other parts of the businesses, and we see that as true structural cost out. And it's basically changing the way we do things.

And if you think about it, part of the whole lean transformation is to change the way we do things, so that we do them in a better way and, therefore, also have a sort of structural way of taking the cost out so that they would not come back even with the volumes improving. So it's basically helping our decremental margins now, but we're also expecting that to help our incremental margins as markets come back with volume growth.

H. Lawrence Culp ***General Electric Company - Chairman & CEO***

Markus, I would just add that I think what Carolina has framed well there is the efforts that are underway. But right behind that, we are continuing to look for opportunities and efficiencies. And that's just the nature of kaizen, really, right? With the passage of time, you see more, you can do more, you build that momentum. So as we continue to look to just drive efficiency overall, but at the same time, deal with these headwinds, you should expect us to root out as much cost as we can and to preserve and generate as much cash as possible. But in terms of the hard targets for today, I think Carolina has laid that out.

Operator

From Citigroup, we have Andy Kaplowitz.

Andrew Alec Kaplowitz ***Citigroup Inc., Research Division - MD and U.S. Industrial Sector Head***

Larry and Carolina, I just want to follow up on the decremental margins, particularly in Aviation. You mentioned you were at 48% in Aviation, excluding the charge. And you only delivered 30% of your cost actions so far. So when you talk about the runway for improvement, how much more did you have here? And does your decremental have a chance of getting down into the 30% to 40% range as you go into the second half of the year here?

H. Lawrence Culp ***General Electric Company - Chairman & CEO***

Andy, I would say that there is a lot that's in-flight, pardon the pun, with respect to improving the cost structure in Aviation. What we've clearly been hit hardest from a volume perspective and internal margin perspective in, in services. I don't think that the sequential improvement that we see in the second half is going to take us into a zone that starts with a "3", but I think we will be in a zone with a "4", with the third quarter showing us some modest improvement. And I think we'll see even more in the fourth.

Operator

From RBC Capital Markets, we have Deane Dray.

Deane Michael Dray ***RBC Capital Markets, Research Division - MD of Multi-Industry & Electrical Equipment & Analyst***

Can we get some more color on the Baker Hughes exit plan? Just a little sense of the structure. I'm just not clear whether are you locking into a price? Or is that subject to market pricing during the next 3 years?

H. Lawrence Culp ***General Electric Company - Chairman & CEO***

Well, Deane, I think what we wanted to highlight today is we're going to take the next step toward full monetization here. We're going to do it over a multiyear period, as you saw. And the program, at a high level, is basically designed to enable us to sell our shares, basically the VWAP over, call it, the next 3 years. We think this makes sense in this environment. Clearly, we started the monetization of Baker back in the fall of '18, nearly 2 years ago. But this allows us to be, I think, still patient and disciplined while we divest this noncore piece of the portfolio, and that sets us up clearly to redeploy that capital. And I think we're excited about the enhanced financial flexibility that it will give us.

Carolina Dybeck Happe ***General Electric Company - Senior VP & CFO***

Yes. I would just add to that, that it's sort of technically, we call it, it's called a structured forward sale. And it's really that you sort of go quarter-by-quarter, but you're not bound by it, but that's how the plan works. And by that, you also get sort of the average share price over that period.

Operator

And from Vertical Research, we have Jeff Sprague.

Jeffrey Todd Sprague ***Vertical Research Partners, LLC - Founder & Managing Partner***

I wonder if we could just -- wonder if we could get a little more color on GECAS and the process there. As you indicated, just customer events dictated, you had to take some actions in the second quarter. Can you give us some idea of what percent of the portfolio was impacted by that and some maybe order of magnitude of what we should expect and kind of the residual value assessment in Q3 for GECAS?

Carolina Dybeck Happe ***General Electric Company - Senior VP & CFO***

Yes, sure. If we start then with the second quarter impairment, basically, given what we're seeing in the market, we decided to make a risk-based approach in the second quarter. In the third quarter, we have the big one. But in the second quarter, we decided because of what's happening in the market, to look -- you can say, start by looking at our customers and choosing the ones that we felt were highest risk. And that's basically from that angle. Then we took their assets, and we looked at or tested significantly lower utilization and possible repossessions and not getting funding from government, right? And with that, we could see that roughly $300 million was -- as an impairment. And if you take that in perspective to the whole portfolio, that was around $6 billion of our whole portfolio of operating leases, which is around $30 billion in total. So those $292 million pretax was the impairment for the second quarter.

And then if we then look at the third quarter, I would say that that's a little bit different. That's basically looking at the whole balance of our portfolio, actually, including the 20% we've reviewed. And here, we have a full annual impairment review. I won't bore you with the details, but I can tell you, it's very detailed and a very thorough process where we have 3 different appraisals on each aircraft that's incorporated. We update all the assumptions on discount rates and maintenance cash flows, et cetera. So it's a much bigger process. But I would say we do anticipate pressure on our cash flow assumptions and the value sort of driven for possible elevated repossession and a prolonged recovery for the industry. And we'll continue to monitor credit risk impairments, I would say, as we go over the year. Larry?

H. Lawrence Culp ***General Electric Company - Chairman & CEO***

Yes. I think you covered it well. We thought that we would take an early look at that highest-risk portion of the portfolio, roughly 20%, as you said, Carolina. And then we'll just run through our normal-course process here in the third quarter, and we'll update folks later. But I'm pleased that we pulled that forward given the environment that we're in. I think that's very consistent with our effort to be transparent and on top of these things. But more work to do, normal course here in the third.

Operator

From Gordon Haskett, we have John Inch.

John George Inch ***Gordon Haskett Research Advisors - MD & Senior Analyst of Multi-Industrials***

So just going back to kind of the cancellation discussion that you guys talked about or Carolina, you mentioned, I think with the LEAP, I mean, there are mounting 737 MAX cancellations. And I'm just curious if you, as in GE, you're on the hook to have to repay any of the downpayments or progress payments you may have received. Maybe you could size that risk for us. And by extrapolation, do you think any of your Aviation previous progress payments are at risk, just given the aviation environment due to COVID and what you're seeing?

Carolina Dybeck Happe ***General Electric Company - Senior VP & CFO***

If I look at what we have then on progress and cancelations for Aviation, let's start by looking at the progress collection balance that we have, right? It's $5.5 billion, and it's a liability because basically, it's prepayment for us. And this is largely Commercial Engines. And the largest portion of this is LEAP-1Bs. And I would say that the second quarter progress refunds were very small, and we're not expecting a significant impact in the second half.

If you think about how the flow is, our risk is sort of limited to refunds on straight-out cancellations. And of course, we coordinate with both the airframers and our customers since the situations are pretty unique. And I would say that the cancellations we have done, but the airframer is the lead on negotiating new terms. So if the airframer agrees to refund progress, also GE and CFM would be required to refund.

Operator

From Melius Research, we have Scott Davis.

Scott Reed Davis ***Melius Research LLC - Founding Partner, Chairman, CEO & Research Analyst of Multi-Industry Research***

If we kind of isolate the businesses, I mean Aviation, Power, Renewables had just rough macro; Healthcare, a little bit more stable. Is there -- is the Healthcare business cash flowing at levels you would find consistent with profits?

H. Lawrence Culp ***General Electric Company - Chairman & CEO***

Scott, I think we're pretty pleased, by and large, with Healthcare's performance, just given the mix of dynamics there, right, both from a top line perspective. We had -- if you just look at orders, for example, we have positive orders in HCS despite all of the downdrafts, largely a function of the COVID products giving us that backfill. Clearly, PDx was way down. But the team did a really nice job with that volume mix pressure to really respond quickly. A little easier in a shorter-cycle business like Healthcare to take the cost actions that we did that allowed us to hold the op margins flat. And we had decent cash performance there.

I think as we get into the second half and really, as we think about the recovery from here, despite the pressures at Aviation, folks are going to need to remember that we've got a good Healthcare business that's going to get better, both in terms of the macroenvironment and our operation and management of it as well as the turnarounds that are underway in both Power and Renewables. So that's really a large part of the self-help story, in addition to what we've talked about, in addition to what's happening and the way we're managing at Aviation.

Carolina Dybeck Happe ***General Electric Company - Senior VP & CFO***

And I'll just add a comment on Healthcare because you have to remember that we sold BioPharma. So basically, we had $300 million of cash flow every quarter from BioPharma that's obviously not going to repeat as of this quarter. So you have to sort of take that into consideration when you look at Healthcare.

Operator

From Oppenheimer, we have Christopher Glynn.

Christopher D. Glynn ***Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst***

We saw book value come in a little in the quarter, and you have some 3Q processes underway. Longer term, I guess, accounting adjustment may be 2022 for Insurance. Just wondering in terms of asset sales, what's the market and what's the scope of remaining potential asset sales where you'd expect a ready market to sell that book? What's the state of play with asset sales?

H. Lawrence Culp ***General Electric Company - Chairman & CEO***

Yes. I would say, Chris, with where we are today, particularly on the heels of the BioPharma transaction with $41 billion of cash and I think with lots within our control operationally to improve performance from here, we're not spending a lot of time on additional asset sales, right? I think we know we've got to bring these leverage numbers down. We've remained committed to our financial policy in that regard. No change. It's just going to take us a little while longer, both on the Industrial side and to a lesser degree, on the Capital side. But we're going to move forward with this portfolio with the aim of creating as much value as we can over time.

Operator

From Crédit Suisse, we have John Walsh.

John Fred Walsh ***Crédit Suisse AG, Research Division - Director***

So there's a lot of puts and takes as it relates to kind of cash flow good guys and bad guys. You did make this comment that you think Industrial free cash flow was up in 2021. I'm kind of just wondering if there's any way to frame the order of magnitude if we were kind of to remove any kind of volume lift just from some of the timing around restructuring cash, BioPharma, inheritance taxes, et cetera, if we already start positive before anything else. Or if we're -- all of those items aggregate to something negative and we need that volume lift to come through and help cash into next year.

Carolina Dybeck Happe ***General Electric Company - Senior VP & CFO***

Okay. So let me do that. But as you say, there are a lot of good guys and bad guys and puts and takes. But we say we return to positive free cash flow in Industrial free cash flow in 2021, and that's based on what we see today, right? So in addition to some gradual improvement in end markets, there are really a number of items that give us this confidence.

I would say the first and very important one is that we deliver on our 2020 cost and cash actions, right? So annualizing $1.5 billion to $2 billion of structural costs out, it flows to the free cash flow. And then as you mentioned, we also have the reduction in inheritance taxes, a lot of that on the Power side, with the say, deferred monetization and what have you. That would be basically a $1 billion year-over-year improvement in '21.

Then on the businesses gaining traction. I would say Power, it's more of a continued turnaround story, right, cost out and keep the fleet running. Renewables, also turnaround on Grid and Hydro, better project execution. We have the Haliade-X orders. And we see some growth on the international markets that I mentioned in my previous comments. Healthcare, well, early signs of better trends. We saw most improvements through the quarter. And here, we also have the program where we are working on improving our fixed costs. And what was a margin expansion activity is now a margin preserving activity, and then will also help in margin expansion. And I think this is super important, this operational self-help and really working with the lean transformation that then takes hold in the whole company because that improves both the margin and the profit, but also the working capital. And we've just seen the start of sort of us gaining traction there. And you will see that in our results over time.

Commercially, Larry, maybe you want to comment on that?

H. Lawrence Culp ***General Electric Company - Chairman & CEO***

Well, as I mentioned earlier, I mean, we just think that there are going to be opportunities amidst the pressure of the moment, really across the portfolio to smartly create new programming and products. You see that particularly in Healthcare right now, given the way the team has responded around not only the ventilator and patient monitor opportunity. But the way, frankly, we've been able to deploy some of the digital products in a more meaningful way than we might have otherwise despite all the time and money that we have put into the digital health care effort.

So Carolina, I think you covered it. It's really about sequential improvement from here. Again, the environment remains challenging. But with respect to those things that are within our control, we think Healthcare is well positioned to lead. The turnarounds in Power and Renewables continue, and we're expecting a multiyear recovery in Aviation.

Operator

Okay. And for Morgan Stanley, we have Josh Pokrzywinski.

Joshua Charles Pokrzywinski ***Morgan Stanley, Research Division - Equity Analyst***

Larry, could you help us out with maybe a teams element in terms of that Aviation recovery over multiple years. What would you expect to be kind of the normal lag between departure growth and shop visits? Obviously, there's a lot of elements of maximizing green time and USM and retirements, a lot of factors at work. But what does normal look like? So we can -- we try to understand the baseline for some of those other moving parts.

H. Lawrence Culp ***General Electric Company - Chairman & CEO***

Yes. Josh, I'm not sure we really have a working definition of normal, if you will, right? If we went back and we looked at the way this has played out for us over time, right, whether it be 9/11, the crisis or -- I mean, every time that we've seen these sorts of pressures, the dynamics have been different every time out. So I think the best that we can share today is that as the airlines are working through what this means, not only in terms of their fleet plans and their cash -- their own cash preservation efforts, their maintenance programs going forward, we'll continue to be under some pressure in services. I just don't think there's any -- really any 2 ways about it. So despite the improvement in departures and that sequential uplift. I think we're mindful that this is going to continue to be challenging for us in 2020, and that won't be the end of it.

Steven Eric Winoker ***General Electric Company - VP of Investor Communications***

Brandon, we are out of time at this point. So I want to -- I'm going to thank everybody then, and we're going to have to move on. But again, we'll be available for follow-up questions as needed.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference. Thank you for joining. You may now disconnect.