General Electric Company

September 16, 2020
12:45 PM EDT

Josh Pokrzywinski: Good afternoon and thanks for joining us for Day 2 at the Morgan Stanley Laguna conference. I'm Josh Pokrzywinski, the firm's U.S. Multi-industry Analyst. Joining me for this next fireside from General Electric is Chairman and CEO, Larry Culp.

Before we get started I need to read some disclosures. Please note that this webcast is for Morgan Stanley's clients and appropriate Morgan Stanley employees only. This webcast is not for members of the press. If you are a member of the press, please disconnect and reach out separately. For important disclosures, please see the Morgan Stanley Research Disclosure website at Morganstanley.com/researchdisclosures. If you have any questions, please reach out to your Morgan Stanley sales representative.

Larry, thanks for joining us, always a pleasure, especially in this virtual environment, no sun, no sand this year but glad to have you all the same.

Larry Culp: Josh, thanks it's good to be with you. We'll hopefully be together next year in Laguna but we're [hard] by Fort Point Channel here in Boston this afternoon and appreciate the opportunity. It has been a busy third quarter thus far at GE. It's hard to believe it's only been seven weeks since we were together at earnings. We've kicked off our strategic plan reviews with each of the businesses. We started off with our digital business two weeks ago. We're midway through this afternoon the reviews with our Aviation business. We had the entire team together, albeit virtually, last week. The entire GE global team, 200 leaders from around the world, for our senior leadership meeting; really good opportunity for us to come together and just make sure we know how we want to finish out this year and also get ready for 2021.

If I may, I know we want to get into Q&A, but if I could maybe just give you a couple of quick thoughts on what we're seeing and how we're looking forward here, particularly as, if you can believe it, I'm about two weeks away from two years in saddle here. The last six months clearly, like for everyone, has felt far longer but I think as I sit here today feeling very confident about where we are and where we're going despite all of the trials and tribulations that COVID has certainly thrown at us, you know, as I reflect on just where we are here in the quarter, I think we came out of clearly the second quarter, the toughest quarter I think we're going to see hopefully again in our careers, if not our lives, very focused as a team on that which matters most; safety, taking care of our customers and driving cash flow.

Good progress on the $2 billion cost out $3 billion cash action work plan we've talked about repeatedly here over the course of the summer. I think you're going to see that play in to the second quarter or, excuse me, the second half results. Really good set of presentations at the senior leadership meeting, Josh, last week. A little bit of inside baseball admittedly but just we put a real focus on lean and how lean is being deployed to drive safety improvements, quality, delivery and cost both in terms of productivity but also working capital and capex reductions.

So you can see that flywheel beginning to turn in earnest at GE. I think we take a lot of confidence from that. Clearly our markets are, by and large, stabilizing but not in any way rapidly recovering but we're to going to wait on the markets, that's why we're taking the actions that we are. You put all that together, I think net, net we're of the view that today I think we're of the view that we will deliver positive free cash flow here in the back half. That's a good sign we'll get us out of this year going in and next year I think with strength.

But just do a quick runaround the businesses. Clearly at Aviation we got hit hardest there. That's where the bulk of the cost and the cash actions are underway. We talked at earnings, I think, about our departure, data something we look at on a daily basis down 47% back seven weeks ago. We're at 40% year-on-year now; so still way down, but a little bit of sequential improvement but admittedly it's gone a little bit sideways. You see that in some of the other high frequency data around the industry.

Interestingly China's a standout, China's just about back to where it was pre-COVID but I think we're seeing Europe and the America's deal with the outbreak of cases as you well know. But I think we're optimistic that we're doing what we can with what is within our control and we'll come out of the COVID moment with the largest, the youngest fleet in the business.

If I go to Healthcare, the other business that got hit here, we're very pleased with the recovery in scan activity. That has clearly come back. In turn our Pharmaceutical Diagnostics order book has nearly recovered probably down now low single digits compared to the high single digits just a few months ago. So a little bit of room to run there. That team has done a phenomenal job with respect to margins. A little bit of volume in PDx will help but, again, we're not going to bank on a robust market recovery. We're going to have to make our own luck.

Pre-COVID, we knew this year was about the turnarounds, right? Continuing to turn around at Power, picking up the pace at Renewables. Fortunately those businesses haven't really been hit hard here in 2020 from COVID. Their progress continues and I think we're looking for both of them to continue to pursue their restructuring work here in the back half. And I mentioned we kicked off the [strap plan] two weeks ago with our Digital business. We don’t talk a lot about it, I think we'll talk more about it in 2021 but that's a billion dollar P&L that sits within our Corporate bucket; a good business, tremendous improvement the last 12 months I think we're going to be able to talk about growth margins in cash there before too long, in addition to the impact those businesses are having on the rest of the GE portfolio with respect to our digital transition.

So, if you think about where we're going long-term, right, return to flight, precision health, the energy transition, I think the team that was together last week is ready to go. Lots of momentum with respect to lean. Clearly our technology continues to lead. Big news here recently out of Taiwan, another big H win as we help that country on its energy transition plan, Haliade-X and Renewables, clearly the 9X in Aviation. Just a lot of good long-term bets continuing to bear fruit and that all, of course, helps compliment that nearly $400 billion backlog that we have. It keeps us close on a daily basis to our customers. So, a lot of work to do still, Josh, but I'd say as we get ready for the fall here, I think we're feeling good that despite the uncertainties, and there certainly are plenty of uncertainties out there still, the GE team is aligned and making progress on those things that we think are most important for our customers and for our shareholders.

Josh Pokrzywinski: That's an excellent update and a good starting point, Larry, I appreciate that. I guess the first follow-up to that on the free cash flow side, positive in the second half. You know, clearly good momentum there and I wouldn't say the market is doing you any massive favors, especially in Aviation to support that. You know, if I had to think about seasonality, you know, clearly fourth quarter last year was a big quarter within that and a big driver of last year's free cash flow success. Is it fair to think about it similarly this year that you will see, you know, kind of a bit unevenness in 3Q and more in 4Q to support that?

Larry Culp: Yeah, no. I think that we're putting a lot of energy into trying to drive greater linearity both within our quarter and throughout the year in a whole host of areas but no doubt that you're going to see the positive second half be carried here by, I think, a robust finish. We know that working capital has been a little bit more of a drag for us than it should be. I think you'll see that sequentially improve as we work through the rest of the year. Clearly the cost and cash actions I referenced earlier are also similarly back loaded and I think we're making good progress just dampening down the capex across the company. Clearly we want to continue to invest in technology but given the circumstances we can hold some things, we can cut the scope on certain projects. So you put all that together, I think that's really the view that we have as we finish this year and get ready for what we think will be a positive free cash flow in 2021.

Josh Pokrzywinski: Got it. So that's helpful. And that was going to be my next follow-up on 2021. Obviously, you know, if we're speaking in engineering terms, the bridge into 2021 on free cash would be pretty exotic, we'll say. A lot of moving parts especially with working capital and Aviation markets but maybe within that return to full year positivity, is there something that people need to keep in mind as maybe a starting point on, hey, we need to assume that departures get to a certain level or some of the other businesses, normalize? You know, obviously way too early for guidance but maybe a framework for how you guys have internalized that path to positive?

Larry Culp: Sure, sure. Yeah, and I don’t want to try to give you anything resembling guidance but I think the construct, Josh, that we have in mind as we think about 2021 being positive, that ultimately a [way] point toward high single digit, free cash yields on the business as a whole really starts with just running the business better. We've talked a lot about lean but whether it's the commercial frontend and just being better around increasing our visibility around new business, let alone our win rates, as we chase new business, being smart about price, terms, all of that, you know, that's a gradual effort that we think we see in some of our activity, our order books today. More of that as we go into 2021. Certainly operationally we talked a bit about lean. I won't repeat that, but that continues to build momentum and all of that comes on top of, if you will, a little bit more muscular work that we did this year in wringing out $2 billion of costs; that's probably a billion and a half to two of structural affect let alone the cash actions.

And don't forget, you know, we talk about these inheritance taxes, right, some of these cash calls from days past, that was $4 billion of outflow last year. That will be half that level next year so we'll have another nice step down in 2021. So you put all of that together, we're not really waiting for the markets to come back and put the wind we had in our sails even early this year. We know this is going to be a self-help story for a little bit longer, particularly given the Aviation dynamic, but I think that's how we get there and, of course, at this point there's probably $500 million of pension in 2021 baked into that positive construct for next year.

Josh Pokrzywinski: Got it, that's helpful. That was going to be some of, one of, my other questions in terms of some of the bridge items. And just to be clear on inheritance taxes, I was going to save it for later but might as well keep the thread going. From the $4 billion to the $2 billion, last year versus next year, where are we this year? What's the delta, '20 to '21 in your mind?

Larry Culp: You know, if we're going to $2 billion next year, assume the step down is more or less equally split between '19 to '20, '20 to '21.

Josh Pokrzywinski: Got it. Yep, that was a fair assumption but 2020 has been kind of a weird year as you have noticed.

Larry Culp: It's not over, Josh. But, Josh, just one quick thing. I just want you to be clear, I want to be clear with you, and we talk about inheritance taxes in a session like that, I think it's important for investors to understand how to think about cash, what we're working on, what really will be a function of time, by and large. But operationally, when it's just us on the inside, we don't spent a lot of time talking about inheritance taxes. They are what they are, they've been coming down very much as anticipated. We focus on those things that are within our control, not those things that we just have to wait out.

Josh Pokrzywinski: Understood, understood. No, I think that's a valid point. You know, on the Aviation business specifically, I guess now with a bit more time since the depths of the downturn and some modest improvement off the bottom, ideally customers are kind of picking up the phone and expressing themselves versus saying, oh God, we don't know, don't bother us. You know, I guess, what have you learned so far about the industry, customer behavior, you know, anything on cancellations, retirements, rotation of fleet, you know, kind of all the elements that go into the stew that need to get sorted out over the next, I don't know, 18 months?

Larry Culp: Right, well, rest assured Josh, we are in a daily conversation with a lot of customers all around the world; both at Aviation and GECAS as we, really as an industry, try to work through this unprecedented challenged. What have we learned? I'm not sure how much of what we have seen is new learning versus, if you will, affirmation of certain things we knew to be true about our customers and our industry. I've been impressed as a relative newcomer how even at these critical junctures, the industry is so hyper-focused on safety, right? And some of that comes in the wake of what happened with the 737 MAX but even with COVID, you can see the industry coming together increasingly with common themes, if not a common voice, around how we assure the flying public that it is safe to be in an airplane. I think we see not only the experience that a number of Aviation leaders have from prior crises but just the sharp operating skills as they try to navigate the near-term pressures, right? Various customers have varying degrees of balance sheet strength. Everyone is trying to work through that smartly, not only with lenders, but also with suppliers like us we see that obviously both on the OE side and on the aftermarket side of the business.

So, it's not pleasant, right, a lot of pressures, a lot of uncertainties out there. We're certainly getting impacted in our biggest most profitable business but that said, it's really just, I think, more of an affirmation that we work with some outstanding customers all around the world and we're doing all we can to help them navigate the uncertainty and the challenge that this pandemic has thrown at us.

Josh Pokrzywinski: That's fair. And I think we're all trying to solve, you know, one particular equation on the Aviation side is, if I told you there was a vaccine tomorrow, what do you think that means in terms of returning to something normal on aftermarket activity? And there's a whole bunch of assumptions in that in terms of green time and pricing and what's actual shop capacity when everyone comes in but is there something that -- oh great the lights are going to go out in here because I don't move enough, is there a common set of assumptions you guys are making in terms of that relationship between when activity can start, vis-à-vis a vaccine, and when you might actually see it show up in the business?

Larry Culp: Well, you know, I would say a few things, Josh, one, having sat on the board of a large global pharmaceutical company for nearly a decade, I'm acutely aware that going into Phase 3 doesn't mean you're coming out of Phase 3 successfully. That said, two of the clinicians I've been in communication with the most, the two clinicians I trust the most on this call relative, are we getting close to a vaccine? Their tone the last six weeks has been I think far more optimistic than it was back in the springtime. So I take some solace in that a vaccine is coming but, you know, I -- whether it's a vaccine or just a return of animal spirits, frankly, I'm of the view that people want to get back to it. Right?

I know how exhilarating it's been for those of us back in the Boston office here to be back at it in a more normal fashion. So, I think we're going to see that play out in the months to come. But in terms of our business, we're not going to bank on a vaccine at this date or that date or really any of the other macro factors that are very much outside of our control. We're just trying to make sure we're doing all we can to stay close to customers, help on the safety front where we can, help them work through whether it be a reconfiguration of their skyline, right, on the OE side of things, let alone what we can do in the aftermarket. As you can imagine, with 38,000 engines, in our install base that we support, we've got a critical role in the short-term and longer-term to help our cusomers navigate COVID, not only as they try to conserve cash in the short-term but to make sure that as we put these planes back up in the air, that they are safe, efficient and fit for purpose.

Josh Pokrzywinski: Has there been any revelation or updated thinking on your relationship and the aftermarket relationship to when flight happens as, you know, again it's still early but whatever view you had three months ago, is that still where you're at today just because we don't know any better?

Larry Culp: Well, I think we're clearly closer to that point, just with the passage of time.

Josh Pokrzywinski: Sure.

Larry Culp: Josh, I think you've seen us try to avoid saying we're going to be back at this date or that date for certain. I think there are just too many unknowns at this point but clearly given the departure trends broadly, given what we've seen in China, perhaps the vaccine data and just the restlessness that I think you see out there in so many places. This industry will recover, there's no doubt in my mind about that. It's really a function of time. We know it's going to take a while. It's not going to be next year, it'll be a little while here and, again, I think we just want to make sure we're smart about how we run our business both with the short and the long-term in mind so that we're doing the best that we can during this period of stress but also we make sure that when, if you will, when the clouds clear, that GE Aviation continues to lead this industry and to be a stellar performer both for our customers and for our shareholders.

Josh Pokrzywinski: Got it. I appreciate that. And when those clouds do clear, are there any actions that you've taken today or this year that end up being, you know, kind of initial offsets to that improvement?

Larry Culp: Well, again, when we talk about $2 billon of cost action across the company, $3 billion of cash action, a great deal of that is centered in Aviation. We're going to take out nearly a quarter of our headcount, our team here, during the course of 2020. I mean, really unprecedented even when we saw the volume drops I didn't think we'd be able to adjust that much, that quickly. I mentioned earlier, Josh, we're in the middle of our strategic review with the business, so you can imagine a whole host of important critical issues on the table. We've got a new leader at the head of the table, John Slattery, our new CEO; week three for John. So, I think John and the team are going to be very well positioned to work their way through the rest of this year and really put us on that glide path toward better financial performance when things clear up. But in terms of when that happens, again, I think we're going to be a little cautious but ready; both for this to last a bit longer but also the inevitable recovery.

Josh Pokrzywinski: And then I guess just shifting over to some of the other businesses on the Power side, you mentioned it not getting hit as much.

Larry Culp: Yeah.

Josh Pokrzywinski: Which is sort of easier to conceptualize. But I guess just thinking about some of that deferred service that you had coming out of 2Q, certainly new orders have held up better. Anything that, you know, gives you more confidence or more visibility in that business relative to what you would normally have this time of year?

Larry Culp: Yeah, well it's interesting, Josh. You saw, I think, in the first half about 20% of our service work in Gas Power got kicked forward. We were hoping it would stick to the second half, right, but we didn't quite know at the time. But that's by and large held in there really well. I think we're going to see about 95% of the planned activity we had for 2020 be completed in the year in that business. So that suggests that it was a jolt to the system; clearly all sorts of travel related challenges and completing those challenges for our customers. They have their own COVID protocols but we have found a way to work through that. I think we're encouraged by what we see with respect to new order activity; both in Gas and Renewables. I think we were a little cautious, not just -- not knowing whether the financing markets for new orders would seize up at all, be it around gas or wind but that really has not happened. We've seen some delays here and there but I think by and large what we thought would play out looks like it will here in 2020. And that's, obviously, gratifying.

Josh Pokrzywinski: Right. And I guess on the Renewable side, you know, obviously a lot of moving pieces within the segment itself but is there anything that needs to change in Onshore Wind to get to acceptable margins? I mean, we're -- I don't know if we're in like nirvana markets but they're certainly very healthy and not a lot of industrial end markets feel like they have the kind of momentum as renewable energy. So, in terms of the hand you're dealt, it feels pretty good. What else can you do on your end to kind of get those up to something you'd be more pleased with?

Larry Culp: Well, there's a lot we can do. There's a lot within our control there, Josh. I think you're right. You know, when we talk about Renewables, our Onshore Wind business is the long pole in the tent but we've got a big R&D investment in Offshore Wind which will be a cash drag for us for a couple of years. And we have the turnarounds, the Alstom Grid and Hydro businesses that are projects unto themselves. But if I focus on your question about Onshore Wind, if you think about that as a low single digit business that ought to be a high single digit performer at the OP line. And so it's a little bit like what we were talking about earlier. I think we've tried to improve our upfront project selection in underwriting price terms in certain places, geographic markets probably aren't equally attractive and then we just need to make sure that we're doing all we can in our supply chain and in our project and service execution businesses to deliver on budget, to deliver on schedule in ways that will allow us to accrete those margins.

Our Renewable segment, Onshore Wind as well have been involved in this restructuring that we've mentioned a couple of times here. So I just think we need to run this business in a robust disciplined way, right, not assume that the tailwind that we do have in Renewables is going to deliver us to those margins and I think with the passage of time you're going to see better profit and, more importantly, better cash performance out of that business.

Josh Pokrzywinski: Understood. And then just shifting over to the balance sheet side, obviously interest rates haven't done you a lot of favors there this year, but anything you can share with us on the pension side or long-term care if we just snap the line on where we're at on interest rates as well as the asset side of the house which is just a little harder for us to get visibility in.

Larry Culp: Sure, sure and we're going to skip over Healthcare there. But, you know, again, I think Healthcare is on a very nice upward trajectory here in the back half. Really pleased with the way they have maintained margins. So you put all of that together, clearly, we've got two businesses we knew were going to require some work. We're getting that work done in Healthcare, recovering nicely, I think the focus will be on Aviation.

With respect to the pension, clearly the discount rates that we're looking at there probably, call it 65 bips of pressure given what we've seen with interest rates and credit spreads, but keep in mind the asset performance is going to help us a little bit of an offset there but we know that is something we're going to need to work through and true-up for everybody at year-end.

With respect to our insurance exposure there, working through that as we've talked about in the past. I think we're encouraged by some of the rate increase work and progress that we've been able to put up; COVID, as you might expect, has been a little bit of a positive with respect to the life care business there. We're in the process right now, as we have the last couple of years, here in the third quarter going through the gap or the stat [test] so we'll have news there at earnings. And the test that puts the pressure on the business, or at least can, the cash flow test is the one we do early in the new year.

So, a little bit of news to come there but I think by and large, no major surprises percolating there, given what we know today.

Josh Pokrzywinski: Got it. And yeah, I didn't mean to skip over Healthcare but it's not a very squeaky wheel. So, I'll let you take credit where credit is due.

Larry Culp: Well, it's all -- the work the team is doing, Josh, but it's an important part of the GE story.

Josh Pokrzywinski: Understood.

Larry Culp: So I just -- I wanted to make sure that we got a good word in for them.

Josh Pokrzywinski: Agreed. Couldn't discount that. I guess maybe just shifting to the culture and some of the internal changes you're making. How has that kind of evangelization process gone? I hear the stories of you kind of walking through plants and this just taking 140 steps and I can do it in 30 and kind of going sell to sell. But at some level you'd want to have, you know, kind of the old shampoo commercial where she told two friends and she told two friends and there's kind of geometric growth.

How has that played out, you know, across the enterprise and how satisfied are you that that's starting to really take hold versus something that needs a lot of spearheading?

Larry Culp: Well Josh, in the spirit of Kaizen, right, the way I learned it, at the knees of the masters, you're never satisfied.

Josh Pokrzywinski: Sure, constructive dissatisfaction I'll say.

Larry Culp: Right, but a lot of progress. That's why I referenced the senior leadership meeting earlier. We went for three days, did it virtually. So call it a little more than half a day, each of those three, there -- it was very little about me or really any of the senior folks. It was more about putting the spotlight on operators in the businesses who were using lean to drive better results through transforming the way they do the work that they do and ultimately it's not only about results, it's about culture.

We talked about our new leadership behaviors; humility, transparency, focus. Right, those are easy words to say but what does that really mean? And what does that mean today at GE? These presenters got up, if you will, they're the folks from the shampoo commercial and just told brilliant stories about how we can simplify a number of our finance processes to enable better linearity around cash. We had one of our general managers talk about how he's using lean to really dramatically reduce the capital appetite in his business. We had some of our commercial leaders come in and really talk about similar tools being used in the commercial world to enhance visibility, drive win rates. This is a big business, we operate in long-cycle spaces. So, none of this is going to happen overnight but it was such a marked difference, Josh, for me sitting in the audience seeing those presentations compared to a year ago where we were really trying to just scratch out those examples so people could take what we're working on and sharing in our training sessions and really see it and have people, GE veterans, they could go to, to benchmark and to get a little coaching from. So, it will be better next year and it will be better the year after that but I think we're moving. I really do.

Josh Pokrzywinski: Understood. Appreciate your time here today, Larry. It's a pleasure as always. Thank you for all the updates. I know it's a difficult business environment to be operating in so thanks for the transparency there. And hope to do this all live and on a beach next year.

Larry Culp: Let's do that, Josh. Thanks for having us.

Josh Pokrzywinski: Thank you very much, Larry. Be well.

Larry Culp: Have a good conference.

Josh Pokrzywinski: Thank you.