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PRESENTATION

Operator

Good morning, and welcome to the Third Quarter 2020 General Electric Company Earnings Conference Call. My name is Brandon, and I'll be your operator for today. (Operator Instructions)

Please note this conference is being recorded. And I will now turn it over to Steve Winoker. You may begin, sir.

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

Thanks, Brandon. Good morning, and welcome to GE's Third 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, these 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, thank you. Good to be here with you and Carolina in the same room for an earnings call for the very first time.

Good morning, everyone. I'm encouraged by our progress in the third quarter. Despite the ongoing effects of the COVID-19 pandemic on our year-to-date results, we're building momentum across GE. Our top line remains pressured, but our actions are driving an improved profitability and cash performance.

In the quarter, Industrial revenue was down 12% organically. This was largely driven by Aviation as Healthcare, Renewables and Power were all up. Industrial margin was 5.6%, an organic contraction of 310 basis points year-over-year. Notably, all segments returned to positive territory for the first time in 2 years.

Adjusted EPS was $0.06, down year-over-year but up sequentially. And Industrial free cash flow came in at a positive $500 million. Our sequential improvement was largely driven by better working capital and earnings. While positive and a good sign, we have plenty more work to do here.

Let me focus on orders, down 28% organically, for a moment. Over 75% of this pressure was driven by Aviation as well as part of Healthcare, the places hit hardest by the pandemic. In Power and Renewables, some pressure results from our actions to be more

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selective in our commercial activities and some is timing, where we should see stronger conversion in the fourth quarter. Despite this, our backlog remains a real strength at $384 billion. 80% is in services, where we enjoy healthy margins. And while services are hurting in the near term, they have a long multiyear time horizon and keep us close to our customers.

By business, at Aviation and GECAS we're managing these businesses aggressively and saw sequential improvement. Aviation is on track to deliver more than $1 billion of cost and $2 billion of cash action this year. In Healthcare, we delivered strong margin and cash performance. While pandemic-related demand has moderated, we saw scan data and PDx orders approach pre-pandemic levels. We continue to see CapEx pressure in private healthcare markets, and we're planning cautiously there.

As you'll recall, Power and Renewables were our turnaround story at the start of year. Improved operational discipline and cost-out actions are starting to show. In the quarter, both delivered solid organic margin expansion: Power, more than 700 basis points; and Renewables, more than 200. So clearly, our markets are, by and large, stabilizing, but to underscore the obvious, stability is not yet recovery. We still acknowledge that the full duration, magnitude and pace of this pandemic across our end markets, operations and supply chain is uncertain.

That said, based on what we see today and the actions we've taken, we expect fourth quarter Industrial free cash flow of at least $2.5 billion, with positive contributions from all segments, but how much more really depends on how Aviation fares through the quarter. And importantly, the momentum we're building should help us deliver positive Industrial free cash flow in 2021.

Moving to Slide 3. From day 1, we've known this would be a game of inches. This is still true today. We're focused on 3 areas where we're making real progress. First, we're continuing to strengthen the businesses. As a team, we've been engaged on what matters most, the safety of our employees, taking care of our customers and communities and accelerating our lean transformation.

At the same time, we're focused on what we can control in the near term, driving better operational execution and further optimizing our cost structure. Our more than $2 billion of cost and $3 billion of cash actions started to play out in the quarter, now 75% complete, with our decremental margins, for example, improving sequentially from 44% to 32%.

Second, we're solidifying our financial position. Since the beginning of 2019, we decreased debt by $25 billion. We've continued to maintain strong liquidity and flexibility, exiting the third quarter with $39 billion of cash. Carolina will provide more details in a moment.

And third, we're driving long-term profitable growth even in the current environment. Lean continues to be the strongest common denominator across GE, and this is what builds the foundation for sustainable growth. We're picking up the pace, deploying lean to drive safety, quality, delivery and cost improvement in terms of both productivity and cash generation. For example, this quarter, we held our second lean week event virtually at Gas Power, with more than 1,000 participants across 10 countries and functions. We identified dozens of delivery and cost improvement opportunities.

We're also continuing our efforts to run GE differently, moving the center of gravity closer to where the action is. We talked about GE as 4 industrial segments, but we drive operational improvement at much deeper levels within the organization. You'll recall that we split Gas Power and Power Portfolio within the Power segment. This is working well for us.

We're now simplifying other segments in similar ways to enhance visibility and raise accountability. For example, we're changing the way we manage P&Ls within Healthcare Systems, ranging from LCS to MR to Ultrasound, where we are integrating production and product management to improve delivery. Similarly, we're now transitioning Grid from 1 to 6 operating P&Ls. Importantly, this is not only a cost-out initiative but a way to ensure we're using the right processes, tools and resources to improve execution.

This quarter, we held strategy reviews with each business, planning for the long-term. These discussions focus on how we put ourselves in the best possible footing to play offense and how we win with our customers and for our shareholders. What was evident is that our businesses are focusing. We're setting more impactful objectives designed to deliver profitable growth. Examples include ensuring our gas turbines remain competitive at the top of the power dispatch curve as well as launching next-generation software platforms in our Healthcare Imaging business. The quality of our strategic thinking was much improved versus a year ago. Now we have to execute.

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So let's get into the details on the COVID-19 dynamics at both GE Aviation and GECAS. On Slide 4, you'll see GE CFM departures, which drives our service business much more so than RPKs. As a reminder, we track departures by region and by platform daily. With the third quarter overlapping with much of the summer travel season in the Northern Hemisphere, we saw GE CFM power departures generally improve. We've seen this plateau to down 40% in October versus our January baseline as we exit these typically higher traffic months.

We expect the market recovery will continue to be correlated with departure trends across regions and fleets. China's departure levels are just below the January baseline, and we're watching load factors there carefully. The Americas have remained relatively flat through the quarter but have shown some improvement in October versus July. In Europe, some improvement in July and August has reversed in September and October.

In aggregate, the near-term outlook remains quite fluid. And while there's been improvement from the April lows, we're now seeing stabilization at current levels.

At GE Aviation, our Military business remains resilient, but Commercial Aviation is clearly challenged. Under our new CEO John Slattery's leadership, we're progressing on the difficult actions to scale this business for the new market reality. Notably, these actions drove the sequential cash improvement in the quarter.

Looking at these trends we're seeing through October, commercial shipments and shop visits are still down 50% year-over-year. Services are critical to the recovery of Aviation as we generate much of our cash here, especially within narrowbodies, which are more than 40% of our historical revenue. We typically have good line of sight into demand of about 6 weeks out at our internal jobs, but we have less visibility into external shop visits. We're working with our customers to forecast shop visits as utilization recovers, supporting our operations and supply chain.

We made an important organizational move in Aviation Services with Russell Stokes returning to Aviation as CEO of that business. Russell will lead our Aviation Services business in a new role, integrating both our commercial and operations team.

Shifting to GECAS. Similar to Aviation, our performance continues to be correlated with the market. As we said last quarter, 80% of our customers have requested deferrals, and we've approved about 60% of those. At the end of the third quarter, this deferral balance was approximately $400 million, and importantly, we've collected about 85% of what we've invoiced thus far.

We ended the quarter with 29 aircraft on the ground, up 17 -- up from 17 in the second quarter, out of a fleet of more than 950. We're actively working customer by customer through restructurings and, in some cases, repossession. And our commercial team is remarketing aircraft.

We're also taking action to navigate through this volatility. Let me share with you 2 examples. We announced Kalitta Air, who operate a 37-aircraft fleet, as the launch operator on our 777 passenger to freighter cargo conversion program, which features the GE90-powered largest ever twin engine freighter. We've partnered before and we're teaming up again this time with PIMCO to launch a $3 billion venture that provides airlines with financing to help upgrade their fleets at a critical time. This venture also enables us to acquire new and young fuel-efficient aircraft so we can continue providing our customers with the aircraft they need.

We continue to plan for a steep market decline through the fourth quarter and a likely multiyear recovery. Long term, the aviation market has solid fundamentals, and we're committed to a safe return to flight post-COVID. We're working with our customers and industry partners to ensure engineering and operational readiness.

With that, Carolina will provide further insights on the quarter.

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

Thanks, Larry. Diving into the quarter. Our results are better sequentially but remain challenged overall. This is particularly true in Aviation, our segment hit hardest by the pandemic. Though the recovery and path forward would look and feel different at each business,

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market conditions are stabilizing.

We are also driving impact with our cost-out actions. Year-to-date, we've reduced headcount by more than 15,000 or 8%, and we expect to reach about 20,000 or 10% by year-end. And we're seeing operational improvement, especially in Power and Renewables.

Looking at our consolidated results, which I'll speak to on an organic basis. Orders were down 28%. On the services front, Aviation remains the most pressured while Power and Healthcare were each flat. Backlog was relatively flat year-over-year and sequentially with puts and takes between segments. Profitability in our backlog remains attractive as the majority is in services.

Industrial revenue was also down but to a lesser extent than orders, down 12%. Despite the difficult environment, all segments delivered revenue growth except Aviation, and all Industrial segments delivered positive profit in the quarter. Our countermeasures continue to accumulate with a more immediate effect in Healthcare, where the margins expanded 260 basis points. In our longer-cycle businesses, results improved after second quarter lows but at more measured rate.

Turning to EPS. Let me highlight 3 differences between continuing and adjusted. On restructuring, we spent $200 million in the quarter. For 2020, we still expect to spend more on restructuring versus prior year, with most of the benefits accruing in '21. We also reserved $100 million for legacy SEC matters. And on the impairment charge, this was related to our recent decision to exit the new build coal power market within Steam. Excluding these items as well as gains, mark to markets and nonoperating benefit, adjusted EPS was a positive of $0.06.

Turning to cash. We generated $500 million of Industrial free cash flow in the third quarter. Excluding BioPharma results, this here is $200 million improvement year-over-year. Notably, Healthcare delivered strong cash flow conversion due to improved inventory turns, better collections and reduced CapEx.

At a high level, cash flow benefited from positive earnings plus D&A across all segments, and all businesses were up sequentially. We've seen modest improvement in working capital driven by management actions and what I'll call stabilizing volume levels, particularly in payables. While we used $600 million of cash on working capital, this is roughly $1 billion better sequentially and year-over-year.

Looking at the dynamics. For receivables, we saw higher billings. This is typical in our second half and even more true this year due to broader economic environment. However, underneath this, there are clear signs of improvement due to better daily management, such as company pastdues declining 3 points sequentially and sequential improvement of DSO.

Inventory was a source of cash. As we apply lean here, we expect it will be a greater source in the future. On my recent trip to Renewables, visiting Onshore Wind, I learned how the team transitioned multiple warehouses to a pool-based system. This reduced service inventory by $50 million and counting.

Payables stabilized from prior quarters as we cleared the payment cycle of pre-pandemic material purchases. As sales volumes recover, we expect further benefits here. Progress was a use of cash as outflows from shipments outpaced inflows from new orders and milestone payments. This was primarily driven by Renewables and Aviation.

Contract assets were limited impact and other operating flows primarily driven by noncash items in net earnings. This includes the mark-to-market impact from our Baker Hughes position and noncash benefit/cost. We're also carefully scrutinizing our CapEx spend, down $220 million in the third quarter versus prior year.

Year-to-date, Industrial free cash flow is a negative of $3.8 billion. The drivers include lower earnings ex-dispositions, payables related to the Commercial Aviation decline, progress due to higher deliveries and lower orders in Power and Renewables and reduced factoring. With our typical seasonality, we expect the fourth quarter to be our most significant quarter for Industrial free cash flow. As Larry said, we're targeting at least $2.5 billion. Sequential improvement will continue to come from earnings growth, reduced inventory and stabilizing progress.

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Taking a step back, building a path to sustainable cash flow rests largely on continuing to drive self-help. Across the businesses, we realized 75% of our cash actions to date, and the remainder is coming in the fourth quarter. And we're positioning Aviation to emerge stronger when the market recovers.

Taking a broader view of working capital and looking for additional opportunities. Inventory, just over 2 turns today, is an area we can improve our consistency and performance. Lastly, we expect our runoff items and the level of reduction in factoring to decrease over the next few years. Factoring has decreased by close to $2 billion this year.

Moving to Slide 7. We're making incremental process -- progress on strengthening our balance sheet. Recall our 2Q actions, where we reduced near-term liquidity needs by $10.5 billion. We ended the quarter with $39 billion of total cash, $24 billion at GE and $15 billion at GE Capital. As you know, we're fully monetizing our remaining $5 billion stake in Baker Hughes over the next 3 years. This month, we received the first sales proceeds of $400 million.

In addition, we're reducing debt, and we're evaluating liability management opportunities. Year-to-date, we reduced GE debt by $8.1 billion, including $500 million in the quarter related to the wind down of our commercial paper program. It's important to note that in addition to paying down debt, we've significantly reduced our reliance on intra-quarter borrowing. Our industrial commercial paper program peaked at $20 billion intra-quarter in '17 versus today's balance of 0. Year-to-date, we've paid down GE Capital debt of $3.6 billion, $2.3 billion in the quarter. As previously stated, we expect to achieve our leverage targets over time due to the impact of COVID-19, and our financial policy goals remain unchanged.

So moving to our segments, which I'll also speak to on an organic basis. Aviation, we're encouraged by our sequential improvement, evidenced by positive margins despite the challenging market conditions already mentioned. Orders were down more than 50%. We saw declines of roughly 60% in both Commercial Engines and Commercial Services.

Our backlog stands at $262 billion, up 4% year-over-year. Since the second quarter, we added to our CSA and transactional services backlog while our equipment backlog was down $2 billion sequentially, driven by lower orders and backlog conversion to sales. Cancellations slowed significantly this quarter. We saw about 100 LEAP-1B cancellations, much lower than the 800 or so in the second quarter, significant, but for context, our ending backlog has nearly 10,000 LEAP-1A and 1B engines.

Revenue was down nearly 40% year-over-year but up 12% sequentially. Commercial Engine revenue was down. We shipped 385 fewer engines or less than half of the prior year. This includes 283 less LEAP units. This is partly due to the 737 MAX grounding and slower production.

Commercial Services revenue was also down more than 55%. This was due to lower spare parts sales and shop business. Military revenue increased 7% driven by development sales and service volumes. We missed some engine shipments at the quarter end due to supply chain challenges.

Segment margin returned to positive territory. Sequential improvement was driven by the cost actions and lower Commercial Services charges. This was partially offset by an impairment of roughly $100 million in the JV in our systems business related to commercial market declines. Separately, our supply chain costs were about 30% lower sequentially. We still had approximately $120 million of excess costs due to lower production rates.

Aviation has completed around 70% of the more than $1 billion of cost and $2 billion of cash actions. To date, the business has realized close to $1 billion in cost savings. We completed further workforce reductions, bringing the year-to-date total to roughly 20%. These efforts have improved our decremental margins to 43% from 59% in the second quarter.

Moving to Healthcare. We delivered solid results through better commercial and operational execution. In Healthcare Systems, order declines are moderating, particularly in public healthcare markets, where the governments are prioritizing investments in quality and access. Broadly, global scans have now approached the fourth quarter baseline, and we saw better sequential demand in Imaging and Ultrasound.

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With that backdrop, Healthcare orders decreased 4%.

In Healthcare Systems, orders declined 5%. We saw continued softness in Imaging and Ultrasound demand and significantly lower demand for pandemic-related products. In PDx, recovery continued. Orders were down 2% versus 28% down in the second quarter. Global procedure volumes largely recovered to pre-COVID-19 levels with some variation by region.

Healthcare revenue was up 10%. About $300 million of revenue was related to the delivery of the remaining ventilators ordered by the U.S. Department of Health and Human Services. Excluding this, revenue was up 3%.

HCS was up 12% or 4% excluding the HHS order. Strong execution against pandemic-related product backlog was partially offset by lower demand for products less correlated with COVID-19. PDx revenue was down 2%, a significant improvement sequentially.

Segment margin was up 260 basis points. This was driven by higher volumes, improved cost productivity and SG&A reductions. Healthcare reduced headcount by roughly 600 this quarter. The team is executing well on cost reduction while prioritizing growth investments, with R&D flat to prior year.

Turning to Power. Our performance has been impacted by the timing of outages and the discretionary spending on upgrades during the pandemic, particularly in the Middle East. However, sequential improvement is driven by self-help actions, and there is still significant opportunity for margin expansion. On the market, global electricity demand declined low-single digits. However, gas-based power generation remained resilient, and GE gas turbine utilization was up mid-single digits.

Overall, orders were pressured. Equipment orders were down 35%, largely driven by Gas Power on lower HA orders. However, we saw a significant improvement off low orders in the second quarter, and we expect a strong pipeline leads to better equipment orders in the fourth quarter. Service orders are expected to remain challenged due to customer budget constraints and lower discretionary spend.

We exited the quarter with lower backlog. Of note, Gas Power backlog was $65 billion, down $1.4 billion sequentially, primarily on lower orders due in part to timing and deal selectivity.

Revenue was up 3%. In Gas Power, revenue was up 7%. Our equipment revenue was up double digits, largely driven by our extended scope shipments. We shipped 11 gas turbines in the third quarter, and we're on track to deliver 45 to 50 heavy-duty gas turbines this year. Services revenue was down slightly, largely driven by continued decline in upgrades. We saw some stabilization with typical outage seasonality after the first half disruption. Based on what we see today, we are still targeting to complete roughly 95% of the outages originally planned for the year.

Turning to Power Portfolio. Revenue was down 7%, largely driven by Steam equipment project timing. Segment margin turned positive after tough second quarter and expanded 760 basis points. This was primarily driven due to better equipment project execution and reduction of Gas Power fixed costs of 16%. We also saw margin expansion across all 3 Power Portfolio businesses, with the strongest performance in Power Conversion.

Across Power, we're advancing on our cost actions, reducing headcount by roughly 600 this quarter. Additionally, Gas Power is utilizing lean tools to enhance the availability of parts for outages. As a result, on-time delivery is almost 30 points better year-over-year.

At Renewables, which has been the least impacted by the pandemic, we're encouraged by the team's progress. Onshore Wind delivery is near-record volume. Offshore Wind signed its first Haliade-X supply contract with a prototype now operating at 13 megawatts, and our turnaround efforts at Grid and Hydro are continuing.

Starting with the markets. U.S. production tax credits continue to support Onshore Wind in North America. In Offshore Wind, we're building a robust deal pipeline to capture secular growth through the decade. Orders were down 18%. Remember that this can be a lumpy business. Onshore Wind was down driven by tough comps to the 2019 PTC order volume and some North America repower orders

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shifting to the fourth quarter. Separately, there was a large 6-megawatt Offshore Wind order in 2019 that did not repeat.

We expect strong Onshore Wind order growth in North America for the fourth quarter, and Offshore Wind should recognize its first order for phase A of the Dogger Bank wind farm. That said, despite expecting strong fourth quarter order growth, we're focused on underwriting discipline and deal selectivity to drive improved margins and cash flow.

Revenue was up 4% as Onshore Wind delivered nearly 1,500 new units and repower kits. It's up 5% year-over-year and 24% sequentially. Delivering on such significant volume requires strong partnerships with our customers and daily management to ensure safety and site readiness. We also delivered our first Cypress unit and have more than 700 units in backlog.

Segment margin was positive, with operational improvements taking hold. Margin expanded by 230 basis points driven by cost productivity, better pricing and volume in Onshore Wind North America. This quarter, we reduced headcount by roughly 900.

While we're encouraged by the positive margin, it's early and there's significant opportunity to improve further.

At GE Capital, we recently announced that Jen VanBelle, currently our Treasurer, will take on an expanded role as CEO here. I'm excited to continue working closely with Jen in her new capacity.

Looking at the quarter, we ended with $101 billion of assets excluding liquidity. Sequentially, this was flat. Continuing operations generated an adjusted net loss of $61 million.

At GECAS, we generated a loss of $38 million. You'll recall that in the second quarter, GECAS has completed an accelerated impairment review on the riskiest part of the lease book, about 20% of the total. This quarter, GECAS conducted their annual portfolio impairment review, which incorporates third-party appraisal data and updates to cash flow assumptions for the entire portfolio. This resulted in a pretax equipment lease impairment of $163 million. Year-to-date, GECAS has now booked impairments of approximately $500 million against our $29 billion equipment portfolio.

Going forward, we'll continue to monitor credit risk. We acknowledge that further market deterioration could result in additional airline failures over and above those that we have considered in our reviews.

Turning to insurance. We generated positive earnings of $57 million. The financial markets continue to recover, increasing the unrealized gains in our investment securities portfolio and positive mark-to-market adjustments and realized gains. We conducted the annual premium deficiency test, also known as the loss recognition test, this quarter. This has resulted in a positive margin of just under 2% of the current reserves, so not impacting earnings.

Slightly favorable claims experience and premium rate increases more than offset the discount rate headwind. Our rebuild claims curve from 2017 continue to hold. And as a reminder, we'll complete our annual statutory cash flow test, or CFT, in the first quarter of '21.

As it relates to the pandemic, we've continued to see trends in our claims data. On the LTC block, we're seeing both a reduction in new claims and higher terminations. In our run-off Life business, we're seeing higher claims due to mortality. In our structured settlement block, we're also seeing higher mortality.

At GE Capital, we ended the third quarter with 4:1x debt to equity. We remain committed to achieving a debt-to-equity ratio of less than 4 over time.

As noted, in the fourth quarter, GE will provide parent funding to GE Capital of approximately $2 billion, in line with the required annual insurance statutory funding for 2020. Parent support levels are determined by looking across various metrics, including our internal economic capital framework. In '21, we expect an additional contribution from GE to GE Capital to meet our existing insurance statutory funding requirements of approximately $2 billion. In light of the uncertain environment, further contributions depend on GE Capital's performance, including GECAS operations and insurance CFT results.

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At corporate, adjusted costs were down 9%. Functional costs and operations improved. GE Digital continues to optimize its cost structure, now close to breakeven. Corporate continued to reduce headcount, down 400 sequentially and 10% year-to-date. EHS costs and other costs were up, and we expect higher costs in the fourth quarter primarily driven by the timing of the EHS activity.

To wrap up with a final thought. I'm often asked what was my biggest surprise coming to GE. One that comes to mind is the grit and the commitment of my finance team. So we have a lot to work with and a lot to do. Let me share how we are partnering with the businesses to drive better margin expansion and cash flow generation.

First, we're becoming more operational. We're prioritizing fewer important KPIs to help deliver better performance. Examples include on-time delivery as well as product and project costs. We're also changing how we manage these KPIs at the right level, closer to where the business is run. And we're moving towards acting through daily management wherever possible.

Second, we're deepening our focus on cash flow. This includes working capital and the timing of billings and collections. In too many quarters, a significant amount of our cash is collected in the last month or even last week of the quarter.

And we're using lean and automation to improve speed, quality and scale. In our Digital business, for example, over the last year, we've reduced the closing process by 50%. Although we're early in this journey, especially on working capital improvement. I'm encouraged by the process and the progress we're making.

Larry, back to you.

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

Carolina, thank you. Our transformation of GE is accelerating. In September, we introduced a new purpose statement for the company: "We rise to the challenge of building a world that works". This is more true than ever as we continue to deliver for our customers and tackle the world's biggest challenges, from precision health to the safe return to flight to the energy transition.

Climate change is undoubtedly a massive challenge and one where the technology advancements we deliver for our customers will play an important role. We've also been reducing greenhouse gas emissions from our own facilities since 2004, and we met our most recent goal for 2020 early, reducing our emissions by 21%.

Now we're strengthening our sustainability pledge by committing to be carbon neutral in our facilities and operations by 2030. Our strategy to achieve this is threefold. First, we'll boost operational investments over time to achieve energy efficiencies. Second, smart power sourcing will enable us to reduce our emissions from the grid. And finally, we'll use lean practices to eliminate energy waste.

Separately, we announced that we will pursue an exit from the new build coal power market. This decision highlights the interplay we are seeing between decarbonization, market dynamics and our own business strategy.

Taking a step back. As I reflect on 2 years in at GE, what gives me confidence in GE's future are our fundamental strengths. In what continues to be a difficult operating environment, our team continues to show humility, transparency and focus every day.

Looking across GE, we continue to build on our legacy of innovation, leading with technology. This was evidenced by some big wins in the quarter. Gas Power was awarded a large equipment contract with Taiwan Power Company featuring the 7HA.03, which optimally balances power output efficiency and maintainability. Additionally, Renewables finalized the supply contract with Dogger Bank for what will become the world's largest offshore wind farm.

In Healthcare, we introduced a number of AI-enhanced products to make our customer workflows more efficient, including our Vivid Ultra Edition in Cardiovascular Ultrasound. And Aviation received certification from the U.S. FAA for the GE9X, the world's most powerful commercial engine and designed to be the most fuel-efficient GE has ever built.

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And at the same time, our technologies are uniquely capable of helping solve the climate change challenge. We're raising the bar and reducing carbon emissions and increasing efficiency. We're delighted that Gas Power's 7HA turbines will supply the first purpose-built hydrogen-burning power plant in the U.S. By 2030, the plant is expected to run on 100% hydrogen.

And there's no company with the scale of GE's global reach, brand, talent and long-term customer relationships. In all, we're encouraged by our progress amidst a challenging backdrop. We remain focused on the long term, not only in terms of our ability to perform but to realize our purpose and the full potential of GE.

With that, Steve, let's go to questions.

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

Thanks, Larry. (Operator Instructions)

Brandon, can you please open the line?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And from RBC Capital Markets, we have Deane Dray.

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

Appreciate all the detail here. Since free cash flow is the primary operating metric that we're focused on, I'd love to hear from Carolina a bit more about the goals on inventory. You mentioned 2 turns. What's the target? How much more can you go?

And then maybe, Larry, you can contribute on the thoughts on rationalizing CapEx. I know there are trade-offs that you're making every day here in terms of not wanting to compromise growth opportunities coming out. But where does the CapEx stand in that thought here?

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

Thanks, Deane. So let me start then on the working capital. I think to better understand working capital, you sort of have to take a step back. So I'd try to look at it for the full year so far, and then I'll end with the opportunities because it's sort of one goes with the other.

So it's a big focus area for us. And to start with, we have a lot more to do. I mean there are several large moving pieces in our cash flow, mostly around Aviation and Renewables. So if we start with receivables.

Our year-to-date cash flow is actually impacted by $2 billion lower -- reduced factoring alone, right? So we've used $5.1 billion so far, and $2 billion of that is really reducing factoring. Some was the lower volume, some was our decision. And underlying that, we are making progress on the DSO, especially in Power, Renewables and Healthcare, but we see pressure in Aviation.

But I do see there's a big opportunity also going forward in improving our underlying DSOs, I would say, in all areas. And one good example is how Gas is working with Scott and the team to improve both overdues, and they have significantly reduced their DSOs more than 10 days basically. So there's more to come there in all areas. And then, of course, it will be balanced between the growing sales and also factoring.

Moving to inventory. I would say at this point of the year, typically, our inventory is a significant working capital drag, right, because we build inventory for the first 3 quarters and then we deliver a lot in the fourth quarter. So this year, basically, we started the year by building the first quarter, then COVID hitting and then working really hard to take inventory down. And that's what we continue to do, and it's not that easy to take down inventory fast in a long-cycle business.

So I'd say that we have significant room to improve here. Our turns are 2, so we can significantly improve that. I would say all segments can improve here. And Aviation is working to significantly reduce the size also because of the new realities of the demand. So I would say

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lean will continue to play a big role in improvement. It's not a quick fix, but it's a big opportunity for us here.

I would say the most significant working capital pressure so far is payables and especially in Aviation. I mean simply put, we've been paying our suppliers for higher material inputs in the first half while now significantly reducing the input in the second and the third quarter to reflect the lower demand, especially in Aviation. I mean the account has started to stabilize now, but I expect this to improve as we see the end markets improve.

Lastly, we've seen a lot of pressure on progress so far this year, right? So cash flow from progress is really just a difference between collecting payments for new orders and milestones versus executing deliveries. And in Renewables, as you heard me say, we've delivered record Onshore Wind volumes. So we burned progress faster than collections on new orders. And Power is also pressured and of course, Aviation, considering the new significantly lower demand.

So I would say focusing -- you have to do it business by business and piece by piece. The biggest opportunity as it is now is in receivables and in inventory. And what I would also add to that is improving linearity. So not only looking at it sort of end of quarter and end of year, but having a more stable use through the year. So a lot more to be done, a lot of possible improvements but we'll get there.

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

Deane, I would just add on CapEx briefly. We don't want to ever be in a position where we're under-investing in innovation, dare I say safety or quality. But that said, I think one of the beauties, one of the benefits we'll get from a true lean transformation at GE is we'll just have, I think, a sharper, more critical eye with respect to how we think about capital more broadly, not only in terms of when we need capital, but then when we see a need, how do we go about it, right?

Because there's so many -- I was in a facility just last week, for example, I won't name the business, they'll know who I'm talking about, where it was clear that as we were tackling a particular project in that business, that I'm not sure we had the shortest leash on the team with respect to capital, right? We were looking at other measures of success.

So as we implement that philosophy more broadly, I think we'll have an opportunity to spend less. On the other hand, of course, we're going to look for every opportunity we can put money to work smartly around new products, around new technologies, let alone enhancing safety and quality in our facilities and in our field operations.

Operator

From JPMorgan, we have Steve Tusa.

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

Just a quick follow-up on that receivables comment. Note 4 seemed to have a lot of activity on that front. You said that the factoring was a headwind in the quarter. Maybe it was a headwind in the year. Can you just maybe clarify that?

And then also, the messaging in July was definitely not confident on positive free cash flow in the second half. And the messaging with regards to the options pricing suggested that there was also not much improvement through August. So I guess like what happened timing-wise in September that really kind of flipped the switch on that? Or was it just you guys were just incrementally cautious sitting there in kind of late July?

I'm just kind of curious. You talked about linearity of cash flow through the quarter. And it just seems like this is kind of a big inflection here late in the quarter given some of those dynamics.

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

So Steve, why don't I start with the factoring? In the quarter, our factoring balance is slightly up, $8.1 billion versus $7.7 billion in the previous quarter and with penetration basically flat. But year-to-date, it's almost $2 billion decrease. And that's when you look at the working capital of $5 billion usage. $2 billion of that is decreasing factoring, and we expect to continue to do so.

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

Steve, I would say that what we've been dealing with given the COVID dynamics is a host of uncertainties; with the passage of time, have become less so. I think our last public comments suggested we thought the second half would be positive. We never talked about a specific number with respect to the third quarter. And again, given the progress on the $2 billion of cost actions, the $3 billion of cash actions, I think what was a very strong quarter on the part of our Healthcare business and the lack of any further deterioration of note in Aviation allowed us to put the quarter that you see here, the $500 million of free cash, together.

I mean I would just add, I think we're encouraged by the turnarounds at both Power and Renewables. We came into the year knowing that 2020 was going to be an important year for both businesses to demonstrate traction in that regard. And whether you look at the sequential improvements, whether you look at the year-on-year margin expansion or the setup particularly for our Gas Power business going into next year when we think we'll be cash flow positive, I just think there's a lot of progress in those businesses despite some of the timing dynamics that we've seen, particularly with respect to outage execution, again, more back half loaded than first half loaded.

So it's a game of inches. We've never been in a more challenging environment. But I think as the year has played out, certainly, as the fall here has played out, we're again encouraged by what we see from the businesses broadly but are taking little for granted.

Operator

From Deutsche Bank, we have Nicole DeBlase.

Nicole Sheree DeBlase ***Deutsche Bank AG, Research Division - Director & Lead Analyst***

So maybe we can talk a little bit about inheritance taxes. That's part of the bridge from 2020 to 2021. Can you just maybe talk about an update as to where that stands?

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

Sure. Nicole, I think we used that phrase from the early days when I joined the company just to describe some of the things -- some of the legacy issues that we were wrestling with. But we don't talk about those dynamics the same way internally, and I think we need to start talking about them in the way that is more aligned with how we're running the business so you've got a better sense of those things that we have control of versus those that are running off, right?

We've talked previously about those headwinds decreasing from $4 billion last year to $2 billion next year and a host of issues, right, legal pension, supply chain, finance, recourse factoring and, of course, restructuring. I think as we come in here to the fourth quarter, I think we're doing better in 2020 than we thought. And we know next year's restructuring cash is going to be higher given the announcement around the new build coal exit and some of the additional Aviation actions. So I think the lift next year is going to be a little less than what we thought but on balance over the 2 years in line.

I think as we go forward, let's think about 3 things: one, restructuring, which we're going to continue to evaluate on expected returns. I think those are very much within our control. Carolina mentioned factoring, right? Better part of $2 billion year-to-date of a headwind from a factoring reduction. Those are actions that I think are largely within our control. And then the other items that should come down over time, whether it's some of the U.K. and Alstom-related pension dynamics, some of the legal settlements that are a little harder to predict, but I think on balance, it's part of the setup for us to deliver positive free cash flow in '21.

Operator

Up next, we have from Goldman Sachs, Joe Ritchie.

Joseph Alfred Ritchie ***Goldman Sachs Group, Inc., Research Division - VP & Lead Multi-Industry Analyst***

So guys, look, it's great to see the progress that you're making just across the entity and specifically on free cash flow. I know there's been a lot of focus there. But maybe just kind of focusing on the $2.5 billion number for the fourth quarter.

Larry, your MO historically has been to be conservative when you set goalposts like this. And as you kind of think about the 4Q number, there's -- I'm trying to understand how much of it is within your control, whether it's your higher-margin businesses, improving the cash

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restructuring actions that you have coming through. I'm just trying to understand exactly how much is already within your control versus what you need help with from the market to get to $2.5 billion plus in 4Q.

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

Sure. Joe, I appreciate that feedback on my MO. We're just trying to build and improve here at GE.

But when we say at least $2.5 billion in the fourth, I think what we're saying is that, again, we're going to see the cash -- the cost and cash actions that we've talked about previously play through. I think we're going to see sequential improvement in profit in 3 of the 4 segments. I think Renewables is likely to be more flattish in that regard, right? And as we get the $2 billion of costs fully implemented, that should play through and be a cash flow benefit.

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

Yes. And I would add to that the comment on working capital then. We have typical Q4 seasonality. That holds this year as well, especially from Power and Renewables. And then we have our own management actions. So I see for the fourth quarter really benefits on the working capital primarily coming from continued inventory reduction and a lift from payables as the volumes start to normalize, although on a lower level.

We expect to see sequentially improved progress collections or basically a sort of drag, especially with Gas Power and Renewables, more than offsetting the Aviation pressure. I think on receivables, we have a headwind just because of the sort of Q4 sequential growth, but we continue our collections work. So that one will also depend a bit, sort of collections versus factoring.

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

And Joe, I would just add that when you ask about the market, some of the things that are outside of our control, I'd really say we're going to look to do the best we can across the board and probably have a little bit more variability or uncertainty at Aviation, right? Departures is an important measure for us. We'll see how that plays out. I think we mentioned in our prepared remarks external shop business where we don't have as much visibility compared to what we have with respect to our own activity. Shipments out of the airframers triggers our AD&A obligations, a working capital dynamic there that could go against us.

And I think we've shared before that we have past due, particularly on our Military business. We're not happy with that. We can clear some of that. That will be helpful. If we don't, obviously not.

So a few things that are still in play. But I think, again, between the cost and cash actions, earnings, working capital that Carolina highlighted, we think at least $2.5 billion is the right outlook at this point, given what we know and don't.

Operator

From Wolfe Research, we have Nigel Coe.

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

So I guess we've covered cash quite well here. So let's move on to Power. I think you mentioned, Larry, that the pipeline of activity and potentially orders in 4Q looks pretty good in Power. So maybe just talk about what you're seeing there.

And on Gas Power Services, I think you said sort of flattish to maybe slightly down in Gas Power Services. I'm wondering, as we go into 4Q, as we start getting some significantly easier comps, do you think that we are moving into kind of growth mode back at Power Services? And maybe just give us some indication of how the different pieces there are tracking.

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

Sure. I think that in contrast to last year, Gas Power that was more front loaded from an orders perspective, we'll see things be more back loaded there. I think some of the wins that we have referenced should convert into orders in the fourth quarter. That's what we talked -- when we talked about the conversion, that's what we were alluding to.

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So we think that we're looking at a 25 to 30 GWmarket over time. That will bounce around. But I think as we exit this year, we're encouraged by what we see, both from a pending orders perspective and from a pipeline view.

With respect to services, Nigel, I would say the story is not wildly different here in late October utilization, has been fairly consistent. We've seen that read through to CSAs. I think Carolina referenced the pressure we have seen. I think a function of COVID, frankly, on upgrades, at least in part. We need to evolve the product road map, but we know we had some opportunities in the Middle East, for example, that have just been pressured and then some given the oil price dynamics. And then there's the transactional dynamic.

What I'm probably most encouraged by -- and we referenced the strategic reviews. We were with the Gas Power team just a few weeks ago. Scott has reset his Services leadership, so we have new leaders in, in many of the critical roles. I was just really encouraged by the way they're getting back to some fundamentals. We need to improve our execution, both operationally and commercially in the transactional book. The same thing applies with respect to upgrades, even though that will be tougher.

I had the opportunity -- they took me on a little field trip a few weeks ago. I went to a CSA site and a transactional site. Fascinating to see how the differences in the work play out, given the nature of those transactions.

So we need to show you that we can take better care of our customers if we can get back to driving a little bit of growth in this business. It will never be our best grower, but we think we can do better and we can get good conversion on that activity. And that's what we aim to show you in the coming quarters.

Operator

From Barclays, we have Julian Mitchell.

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

Maybe just wanted to circle back on to working capital, I'm afraid. So look, this year, it looks like it's maybe a $4 billion headwind on cash. Last year, it was about $3 billion. So it's sort of $7 billion cash out over 2 years. Given everything you talked about earlier in this call, should we expect a very material tailwind there next year?

And perhaps more specifically, in Aviation, it's puzzling in a way on the outside that working capital has been a headwind there, whether the market is very good or very bad. And you've seen 3 years in a row of working cap headwinds at Aviation. Given we've got 2 months to go until next year, what can you tell us about your expectations for Aviation working capital next year? I'm assuming some of these supplier terms that are written and so forth start to become a bit easier next year.

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

Yes. Well, thanks for the question. No, you're right, we've had a significant use of working capital. Of course, the reality is that you have to take working capital into context with the business and how it's growing or not growing, right? So it's been a significant shift this year from the beginning of the year with strong growth and then the rest of the year, in many places, working on reducing to the new level.

If we look at next year, again, specifically for Aviation, a lot will depend on how the top line develops in Aviation, right, because that also shows on the receivable side and also the level of the DSO. We are working and John Slattery and the team are working very hard on improving our collections and the processes to the collections. So I would say, on the receivable, it's really a function of where the top line will be as well as our efforts in factoring plus underlying improvement on the DSO.

On the inventory side, having started with a strong growth trajectory and now working to take it down, there's clearly more to do on the inventory side for the team in Aviation, and they are working on it. And it's not a quick fix. So we expect to see improvement next year on the inventory to sort of come to the new lower level.

Then on the payables side, I mean, this year, payables for Aviation sort of took the big adjustment on lower levels. So it's been a big drag for Aviation this year in payables. But going forward, with sort of stabilization of the situation, we would expect the payables also to be a positive progress. Well, it's going to be a mix of how much goes out and how much comes in, right? So it's very dependent on the order

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situation, but it is not being as big a drag as it is this year.

And you'll remember we had the big MRO order also from Military that we got in progress this year, which is sort of going to be used next year. So I would say that's all 4 of them. So good opportunities both on inventory and receivables but also on payables, more as a function of the situation and progressing sort of more market dependent.

Operator

From Citigroup, we have Andy Kaplowitz.

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

Larry, so you've talked about positive cash flow for 2021. I know everybody's sort of asking about it. Maybe if there's a finer point on the bridge into 2021. You've obviously got these cost actions in Aviation. You've talked about the inheritance taxes. Is there any other sort of puts and takes that we talk about by division?

You did have very strong cash in Healthcare. So can you talk about the sustainability of that as you go into 2021?

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

Okay. So maybe let me start then. Rightly, as you said, I mean, earnings is going to be a key driver, and we will see some gradual improvement in some of the end markets, like in Aviation and Healthcare.

A big, big part is our self-help, the 2020 cost and cash actions, right? We talked about the $2 billion this year in cash and -- sorry, cost and $3 billion in cash. But that annualizes to $1.5 billion to $2 billion of structural costs out, and that flows down to the free cash flow, right? So that will be a carryover for next year on that. And we're working to increase that number, should be said.

I talked about factoring. Factoring has been a significant headwind in 2020. So we don't expect this to repeat at the same level in 2021. Also, the non-repeat of the Aviation payables outflow as the market stabilizes will help. It will be partially offset by progress.

And then we'll have what we talked about -- what Larry mentioned on inheritance items. We see less of a lift from that in '21.

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

Andy, and I would just -- I think we've got the line of sight that Carolina has talked about. We're going to go through detailed reviews with the businesses here in November to put a finer point on all of that. But to me, I hope what you see a little bit here in the third quarter, I think what we're going to demonstrate in the fourth quarter is this operational transformation is gathering momentum and. A number of the things we've talked about commercially, be it just increasing visibility, enhancing our win rate while being more selective, turning that into better underwriting and then ultimately, execution particularly in and around projects in Power and Renewables, all of that -- the cumulative effect of those small wins, again, that game of inches, daily management, I think, is what we aim to deliver here.

Operator

From Vertical Research, we have Jeff Sprague.

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

Larry, good to hear your voice. It's nice to see the positive cash flow. Can we just spend a minute on the SEC here? I guess the question is kind of the basis on which you reserve $100 million.

I mean do you have visibility on that number? Was it just untenable to not book anything given the fact that this has now been formalized? And just your comfort that that's kind of in the right ZIP code of what the total cost might be?

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

So Jeff, as we have disclosed, we've been cooperating with the SEC on its investigation on several legacy matters, and they relate to insurance, long-term service agreements and the goodwill charge at Power in 2018. And we recorded a reserve in the third quarter of

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$100 million. And we believe that that's appropriate under the circumstances, and that's to address all of the issues covered in the SEC investigation.

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

So that's based on some kind of historical analysis of prior situations. I guess that's really the question, how you derive that number.

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

Jeff, I would -- as Carolina said, I think we're cooperating with the commission, and I think we take that reserve at that level, given our view on what's appropriate given the circumstances. And other than that, we really are not at liberty to say more publicly.

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 just on Power free cash flow, please. If we -- I understand sort of the moving pieces in the near term here. But if you look at the glide path specifically in that business, you provide a lot of helpful granularity, I think, in the appendix on the Gas side. So I'm kind of intrigued by the exit on the new builds for -- on the Steam side. So how much of your capital infrastructure in place within Steam do you need -- or fixed cost, I should say, do you need to kind of keep that business going, I guess, on the service side, if you're saying you're exiting ultimately the new build side?

Because we have not really focused on the fixed costs that you have within Power on the Steam side. I am just wondering how much upside there could be on the overall Power fixed cost base here going forward.

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

Markus, you're exactly right. When you think about the Steam business, right, we've got both, if you will, capacity that serves the coal new build market in addition to the Nuclear business and a service platform that serves both markets. I think that that's a business that has been challenged, where we have not necessarily made all the progress we have made in Gas Power. Part of the announcement that we have signaled with respect to the new build exit with respect to coal will allow us to take more cost -- more fixed costs, as you say, I don't believe in fixed costs, frankly, but the cost there that we can lean out. And then we'll continue to look for opportunities throughout the rest of that portfolio.

So the teams made progress. A number of legacy dynamics in play particularly in Steam, so we're not yet where we are in Gas Power but working very hard. And I think as we remix that business more towards services, we'll shed that cost, and it will be a better contributor to GE going forward, albeit one that's unlikely to have a robust top line growth trajectory.

Operator

From Bank of America, we have Andrew Obin.

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

Just a question on Aviation. You had lower charges around long-term service agreements in third quarter versus the first half. How much of the CSA book has been renegotiated given lower scheduled flights?

And sort of a broader question, and I think Larry sort of talked about working with customers. How do you work with your customers to keep them from sort of going to the third parties in this environment in Aviation?

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

So Andrew, to start with the CSA charges. They're lower than expected. Well, I think we should keep in mind that in the second quarter, we really took an aggressive look at all our CSA contracts in relation with what happened -- what is happening with COVID and our expectations going forward. So we took a $600 million charge for COVID impact.

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This quarter, we saw some impact, but that was from higher costs coming out of the CSA margin reviews. It's about $100 million, but that's no change to our earlier forecast on the outlook on the CSAs, right? I think it's important to remember these CSAs models are really long term in nature. And it's really bottom-up modeling, and it's sort of estimated future billings versus future cost to serve up to 15 to 20 years, right?

So with that said, we are mindful of the situation. We are, of course, monitoring the sort of current utilization trends and looking at, well, bankruptcies, frankly. But we haven't seen anything that is -- that changed our estimates for the second quarter, and that's why we don't have any other impairments on the book in the third quarter.

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

Andrew, with respect to how we serve and how we compete, I would just add that it's important for everyone to remember that we have an active network of partners that do shop visits for the airlines that we supply into, right? We don't do all that work in our own shops. So that support continues.

I think part of what we wanted to do having Russell slide over to Aviation, take on that more broadly defined Aviation Services business is to make sure that we are synchronizing better what we do from a repair and overhaul perspective with the commercial side of the business. So whether it be helping carriers execute different scopes, be it providing better delivery to our third parties, managing green time, as everybody is, as we work through cash conservation with the airlines, that's just a set of daily operational issues that, that business has managed and managed well over really decades. I think we're seeing particular pressure here today, but encouraged by what we see already with Russell and the team managing through the COVID period here.

Operator

We're out of time at this point. We will now turn it back to Steve for final remarks.

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

Thanks, Brandon. Thanks, Larry, Carolina and everybody for dialing in. As always, my team and I will be available for follow-up.

I know we're past the hour, but appreciate you staying with us and look forward to speaking with you. Thanks very much, everybody.

Operator

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

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