GE Healthcare

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Drew Ranieri: I think we can go ahead and get started. Welcome, everyone, to another session at the 20th Annual Morgan Stanley Healthcare Conference. I'm Drew Raneiri, one of the medical device analysts here and I'm delighted to be joined by Peter Arduini and Helmet Zodl, CEO and CFO of GE Healthcare. Exciting news with a spinout coming up in 2023. Before we kind of get into that, unfortunately, a quick disclaimer, but please see the Morgan Stanley Research Disclosure website. If you have any questions, please reach out to your sales rep. But Peter, Helmet, thank you for being here today. Maybe it would be helpful just to give some introductory comments, start at the 10,000-foot level of GE Healthcare and just spend a few minutes to introduce the company, the markets, where you're playing, and maybe remind us kind of what the spinoff, spinout milestones kind of look like over the next few months.

Peter Arduini: Great. Well first of all, Drew, thank you for having us here. We're very excited to be here. We did some great news this morning. Some of you might have seen the press release that's out there, kind of 4 pieces of information. The spin, our official week to spinout as a separate company will be the first week of January in 2023. The second piece is we announced our Board of Directors. You can find that online. Ten of us total. Larry Culp will be the nonexecutive chair, myself as CEO and 8 just fantastic other directors. I think as you'll see, as a focused healthcare company, a significant amount of healthcare experience, technology, finance, also portfolio, as well as some deep expertise in the Internet of Things capability. I think we've got a really great group together. It's quite a diverse group as well and obviously I've had the privilege to get a chance to meet all of those.

We also announced that on December 8th, we're going to do an Investor Day here in the city. We haven't really given the details of the time yet, but we'll talk more about that in coming weeks.

And the last piece we've already communicated though is that we'll be trading on NASDAQ when we do come out. With our call sign, we didn't want to make it too complicated, GEHC, so we were able to lock that down,

Look, I'll just start out, Drew, a little bit of the framing of the company. We are a company that does a lot to impact patients' lives. We touch so many different disease states because of the devices that we make and play a really instrumental role in diagnosis as well as into therapy. And we play a significant role in the workflow of most providers around the world. Over 55% of our sales roughly are outside the U.S. Half of those are reoccurring type revenues.

And we focus on innovation to make that difference. We talk a lot about precision health. You'll hear more about that on a go-forward basis. And what is precision health? Fundamentally, the point is that all of us are slightly different. And the more you can be precise in the diagnosis, knowing those nuances, the better diagnosis, the earlier the diagnosis can occur for you. That translates then a more customized, personalized therapy approach as well. And then also, a specific way of monitoring you and managing you, particularly if it's a chronic disease.

What does that ultimately mean? It means that you have better outcomes for patients earlier, when you catch a disease state earlier. It also means for the system, the more precise you can be. Particularly with more expensive therapeutics and other devices, it can be more cost effective. Because who you choose can directly benefit from that, you can be that much more precise.

At a high level, that's the focus that we have. We have a purpose statement that we talk about which is about creating world that has no limits in healthcare. And that's an important piece internally to drive what we do because we can touch in many cases, both the outcome side as well as the productivity side within their system. If you think about the products and services that we do, we're roughly in the $18 billion range of revenue, we have about 4 million installed base pieces of equipment around the world. Many of those are already connected devices. We have a large service organization that not only just break/fix, but offers other types of digital services as well.

And devices such that you are probably quite acquainted with, MRI, CT, ultrasound, x-ray devices, advanced x-ray imaging such as surgical C-ARMs, interventional cardiology labs, interventional labs used in vascular surgery we play a leadership role in. As well as other critical products that are used in a hospital system such as monitoring and anesthesia just to kind of name a few.

Our focus with coming out, and this is one of the exciting parts I think about the spinout, is we believe we have a company here that can be a consistent mid-single digit grower. At its core, that's what I think very important here. There are a lot of interesting trends coming out of COVID that actually are favorable to the devices that we make. On top of the aging population you're all aware of around the world, and what that impact is, as you translate more chronic disease or more follow-up on musculoskeletal or cardiovascular or oncology, means more procedures and advanced capabilities of a lot of the things that we make.

That being said as well, on the topline side, we've invested in the last few years more in R&D. We're seeing more products come out. That's going to feed the near-term growth as well as good commercial execution and the ability to capture more value in the marketplace.

And then the second piece is we believe that we can grow our margins over time as well, to be a high-teens, 20% margin player. Some of that comes directly from what I just mentioned because of the higher gross margins we're going to be seeing coming out of our products. That's a double benefit lift. It's one of the great things obviously about a MedTech business.

The other aspect is we've got great opportunities to kind of optimize the business. How we think about rooftops, how we think about markets, our portfolios that we're in, as well as just fundamental cost management and where we put our marginal dollar. Which is something Helmet and I have been spending a lot of time on, just thinking about that as our future allocations.

What does that all come together on, Drew? It really comes onto I think it's a great value creation story where we can be a consistent grower. We've got innovation and market dynamics that are going to continue to push that. We can also drive margins with it and I believe for investors, the spin really unlocks a lot of the value that's inherent in what is GE Healthcare.

Drew Ranieri: That's really helpful detail. Thank you. I want to ask about the macro, but before I do, just maybe about the precision health, and you're talking about systems versus products. I mean, GE covers so much, 4 million devices, a lot of that connected. Is the portfolio today capable of doing the precision health like from start to finish? And maybe this goes into like an M&A question down the road, but where do you need to kind of fill those gaps from a portfolio perspective?

Peter Arduini: Yeah, I mean look, everything we do at some level is getting more precise. Is it precise enough to solve a specific disease state issue? In some cases, yes. I mean there's examples in prostate cancer where between the diagnosis procedure and MR, the handoff and follow-up of therapeutics integrated to molecular imaging are much deeper. Other areas, not as much. As you lay that map out and think about what products you have across disease states, where are some of these growth areas that we can contribute? We're in the midst of doing that. I think it's one of the real exciting parts for us as we think more about care areas or disease states. It also opens up a map of how you would think about tuck-in M&A partnerships as well. How do we work the ecosystem to grow broadly?

But we're deeply involved in all of our modalities at some level of precision. In fact, I think one of the really interesting things is just how much of our products now have embedded AI or machine learning. Which in many cases is a proxy for more precise capabilities based on real data and automation to kind of simplify the use for the user.

Drew Ranieri: Got it. Maybe just on top of everybody's minds is just the macroenvironment. Again, you touch so many areas of the hospitals, different geographies, different specialties. But there's kind of been the ongoing debate about hospital customers' concerns about capital spending and some companies are talking about elongated cycles. What is the GE Healthcare view here? Maybe what are you seeing in the field and how are those conversations going with customers and their concerns about operating budgets translating into capital equipment?

Peter Arduini: Yeah, look, coming out of Q2, and we look into the second half, we really haven't seen any significant at all pullback on capital spending. In fact, we're expecting acceleration here in the second half. We've got a healthy revenue base, our backlog is quite solid, and also, our ability to actually see what the order book looks like continues to advance. We're not seeing any of that at this point in time. Obviously, around the world, the dynamics are slightly different. I think China as an example, coming out of COVID, we're seeing more acceleration just based on that market being a little bit choppy. Europe is even slightly different. Post-COVID there were a lot of investments made in outpatient centers and things post, because of the learnings that came out of COVID, so we actually have quite a business book that's going to grow and carry well into '23 for our European growth.

And in the U.S, it's quite healthy. It's obviously a little bit different market, but we aren't seeing any types of pull back within capital. Clearly our customers are keeping an eye on their cash flow and how that plays out, but I think as you know as well, there's all different types of capital, meaning if you're opening up a new facility or it is maintenance capital, a lot of what we do, particularly in our core imaging world, actually increases productivity.

Just to give a specific example, we have a module called AIR Recon DL for MR. And the short answer of it is you can take a 15-year-old magnet that's installed in your facility, upgrade it with this, get state of the art image quality. But in today's environment, even more important, 50% more throughput. For those precious resources that you're struggling to get or expensive, you can actually get that much more throughput during that window of time. The customers see value add in our investment.

Drew Ranieri: Just maybe a follow-up question here, you're talking about acceleration in the back half for capital. I mean, as you are kind of looking at the U.S. specifically, are there specific pockets of capital that are seeing that acceleration or seeing that demand a little bit more strongly coming out of the pandemic and more into an endemic phase?

Peter Arduini: Yeah, and Helmet, you can jump in. I think our core imaging to be able to enable more throughput through the institutions, our CTs, our MRs, our core x-ray business, our ultrasound business as well, for different reasons across different disease states, all of those are actually accelerating here as we look into the back half.

Drew Ranieri: Got it. Maybe a question on utilization. This is selfishly another MedTech debate what's going on with you have MCOs kind of pointing to lower utilization and MedTech companies are saying, everything is kind of normal to pre-COVID levels. But I mean again, you're touching so many areas of healthcare worldwide, just maybe shed some light on what you're seeing from hospital utilization trends or anything you can kind of provide on an overall procedure environment.

Peter Arduini: Yeah, as you know, we don't specifically track procedures at the same level say as an implantable company. But particularly in our pharmaceutical diagnostics business, we make the vast majority of the injectable pharmaceuticals for imaging and molecular imaging and so we see that. And I would tell you, I think we still see increases in demand in what we're looking at. We know that there are significant backlogs to get studies done in many European countries. Some of that is tied to lack of equipment to access. And what I hear in the U.S., in some cases, there's still a lot of pent-up demand but it's managed based on the amount of labor that a lot of the providers can bring in. I think there's still a reasonable, healthy amount. Now is it pent-up? The discussions of, are there things coming post-COVID that people now with diseases are caught up to the procedures that they missed? Are they sicker? I don't know if we've got that type of detail around it, but we clearly see that the procedure volume is continuing still to grow from our perspective.

Drew Ranieri: You kind of touched on this in your prepared remarks, but I think GE has partnered opportunities somewhere around $75 billion, give or take. At least that's how you kind of framed it. I mean to grow kind of AGR, LMGR, I mean it's about I think a billion dollars a year of incremental sales. Maybe just help or walk us through or walk investors through GE's kind of growth algorithm in a little bit more detail. Maybe what you expect from a segment level, if anything, or any kind of details, directions you can provide.

Peter Arduini: Yeah, let me start and then Helmet can correct me if I miss something here. I would say, to your point, $18 billion, if you want to grow mid-single digits, whatever, $900 million to $1 billion plus, something in your calculus, right? I think the first part starts with, from a growth standpoint, the investments that have been made over the past few years in R&D. And we're began to see the fruits of more and more products coming out to the market. I can think of 4 in ultrasound, half a dozen or so in imaging, multiple in PCS as well. Probably 10 to 15 products that could be $100 million contributing products over the next few years per year. Not all of those will hit at the same level, but having shots of goal with a product portfolio like that of new products that are differentiated, that's a big deal.

We've been fortunate that we've been increasing our win rates in the marketplace in the last few years and so that translates with the largest service organizations, really among any of the other peers out there into higher capture rates with service revenue as well. So that would be second piece of it. And then, just look, good commercial execution. I mean I'm really focused with our teams on making sure we get the best within the organization. How we think about win rate visibility, how we think about our prospecting capabilities. And with a lot of that focus, we've been able to advance our capabilities, getting price in areas that we honestly haven't been able to get price in the past. That would be the combination. What else, Helmet, would you add to that?

Helmet Zodl: Yeah, Pete, I would just think, as you mentioned, the service revenue, but the element of recurring revenue that we have in our business is about 50%. And if you think about half of our revenues are recurring, this is anything from break/fix needs for service in a business. And the increase in volume on the capital equipment side is really helping that flow through over time. But also, the PBX business or other supplies and often the digital business which is very important, that really brings all of our products together and links it on the digital side into it. Those are really key drivers.

One important aspect is really innovation at the end of the day I think in all of this. I brought the products here, we couldn't bring a CT because it wouldn't fit in here, but I brought our small product which is our Vscan Air. This was a product, it's a mobile ultrasound, it wirelessly connects basically to the clinician's phone and it's integrated into the backend of the network and into the hospital. This product was announced about a year ago and throughout this year I would say it took a leading position both in terms of volume and also in terms of price in this category. This category didn't exist for us before, so within a year we made this a product that is really leading in its space which we are really quite happy about. This is the level of innovation that we look at.

Peter Arduini: And just to play off of Helmet's Vscan Air, this is a good example about expanding markets. We are the leader in worldwide cardiovascular as well as in OB/GYN and other areas. This is really considered point of care ultrasound. You can imagine a lot of stenographers or such would like to use this device. But where this device really plays out is in the hands of a primary physician. Across town in many of the med schools, they'll be teaching how to use this. Instead of going to your stethoscope first, you go to Vscan Air. And then creating that digital ecosystem, those images acquired at the bedside or the clinic, then come and are integrated into a digital structure in that institution. When that patient comes in and you're on a more sophisticated system, all that is linked. And that's one of the advantages I think that GE Healthcare brings in kind of solving some of these ecosystem issues out there. We can scan you later, afterwards.

Drew Ranieri: I was going to ask if every analyst gets to have one of those. But no, it's fascinating technology. And just as you are kind of thinking about digital, and maybe kind of shifting to sites of care, be curious how you're thinking about monetizing digital assets. And really, how key or how critical of a growth driver will be moving to physician offices or moving really kind of outside the hospital as you're thinking about your mid-single digit growth opportunity down the road?

Peter Arduini: Yeah, so I think there's -- I would unpack that in kind of 2 questions there. I'd say digital assets and then how do we think about it from critical care out into other alternative sites of care. On the first piece, as someone said, we do about a little over $1 billion today of software sales. Some of that has a subscription component to it. Some of that is transactional. But all of it has very high margins and is growing at a high rate. Our focus of all of our devices being smarter and integrated with those capabilities so that the mix-up of products brings higher margins and growth because of it, is a big focus.

We think of, when we think about that ecosystem, kind of think of it as D3. Smart devices, a focus on how they integrate into a disease state, and then digital connectivity between the 3. Smart device, integrated to disease state, and then integrate the digital around that. Many of our devices coming out today already have significant amount of artificial intelligence and machine learning algorithms built within that to make the device more capable. Many of them already are connected. How do we actually bring other data in and connect them between modalities is the key part. I think one of the big transitions that's an important one on how we think about patients and who we support going forward, is this idea of care pathways or disease states. Again, back to my earlier example, if you think about prostate cancer as a journey from diagnosis to therapy, or breast cancer, outside of the obvious reasons of a man or a woman, the different technologies, the different products throughout that way, how they interact, how the data hands off, how you integrate multimodal data into that, we think we are in a very good position to play a significant role.

We don't think we're the complete answer, which is why our platform, the Edison platform, is an open platform for multivendor integration. There are very few customers anymore that just buy from one vendor. And when you get into broader domains of disease state, it takes a village of many different companies to do that. And so that's our approach. And via either subscription or SaaS models down the road, we have quite a few of our products that we're moving in that direction. As Helmet said, 50% some recurring today. In a future world, you're going forward to see that recurring revenue increase as we evolve the model.

But to your other point, Drew, on moving out into the other areas, many people, I'm sure people in the audience, have an Apple watch or a Fitbit or something and you're collecting all this great data. You might have had the experience of you go to your doctor, you've got all this longitudinal data and the doctor says, let me look at your blood pressure today and a couple of other things, and they don't look at the data. Why is that? Not because they don't want to. It doesn't fit into their workflow. What our view is on that type of health approach is, how do we work with the care structures today and bring devices that can be used in the home or alternate sites, but ultimately connect back into how diagnosis, how therapies are delivered.

I'll just give you a simple example We did a partnership just recently announced, AliveCor. Some of you may know the cardio lead, 6-lead ECG system that you can use at your home to check. There's other products that are out there that do this, but we're going to integrate that into our MUSE database. MUSE is the largest ECG database in the world, used by cardiologists all over. Integrating that data back into MUSE so that if you're working with your cardiologist and you're on a 12-lead back at the institution, you go home and they're checking you for A-fib, your arrythmia, you can check that data then gets directly integrated in. It's part of that care pathway.

Economically, if they don't know, they send you out and say maybe we're going to put you on a couple of meds because we can't tell. That's an example of more precision and an alternative site and digital integration to add value for a caregiver. Those are just some of the examples that we see because of our position and our scope and scale of what we can bring to patients.

Drew Ranieri: Got it. Great. Maybe to shift gears to margin expansion, I think the way that you kind of framed it is high-teens to 20s kind of operating margin. You are kind of in the mid-teens right now, but maybe what levers are in place to drive margin expansion? You talked out recurring revenue to some degree. Is there a minimum commitment of what you think you can do annually? And just to toss in another one, obviously we're dealing with the microenvironment, so can you help frame kind of what the impact has been from maybe inflation and supply chain? And if things are stable or improving into the back half of this year into next, how quickly can GE Healthcare really see recovery in the P&L?

Helmet Zodl: Maybe I will cover that one. When you think about it, we obviously have seen implications only on the margin performance in the first half. But as Pete said earlier, we are really focused on the topline growth, so mid-single digit growth and the margin expansion in the teens into the 20%. Whatever the levers we are pulling here to improve that margin, I would say first and foremost it's about innovation and growth which is (inaudible). I showed you one example here with Vscan Air, there is many of those out there, and the investment that we do in R&D is one lever for this. The second element I would say is also around pricing. Obviously, we're all seeing now in our industry the impact from pricing into our business. That's really something that we have been improving on. In the second quarter, actually for the first time in quite a long history, we have seen positive price flowing into revenue into our performance. We feel really good in how we are moving our pricing forward. Again, what works for both our customers and our sales.

And thirdly, I would say it's really about LEAN and optimization. LEAN is really a mindset we have across the company. And its starts not only at the development side or the G&A, but it's really close to the entire activity that the teams are doing. I can give you an example here. For example, what we are doing for our platforming. Using platforming, to have less parts, using more common parts across the portfolio quite frequently. When supply chain, when we're changing from shipping basically through warehouses or something, even though our multi warehouses, going for that and shipping o our customer. Which improves again productivity, improves speed for our customer. These are really activities we are taking.

Then the last one I would add is G&A. Reducing G&A spend and shifting G&A spend into R&D and to fuel the growth of the overall company and the topline. These are really the key elements that we look at to drive those improvements. It's a little bit too early to talk today about commitment on margin expansion. As Pete said earlier, we have our Investor Day coming up here which we will talk and go in a little bit detail on that, so we'll save that for that time.

Drew Ranieri: I had to ask through. I had to ask. I'll ask another one. That 20%, is that end goal or is there kind of this is the first leg of the GE story as a separate company?

Peter Arduini: I mean I think we'll see, as we evolve as a company, I think obviously the 17% to 20% would quite a strong performance. I think as we think about how we would fund growth, the growth probably has a stronger prominence than the overall margin, but both of those are very important for us to be able to gain, so we'll see. I think if we are successful with our goals to become a much larger digital player integration, I think there's significant amount of opportunity beyond that when you think about what that actually means. That's fu rather down the road, but I think it's one of the reasons that we're all excited about what GE Healthcare can be in the future.

Drew Ranieri: Maybe just to come back to M&A for a moment, but maybe how are you thinking about strategic financial criteria as you're approaching M&A tuck-ins versus more transformational deals? And then kind of, Peter, in your past life, there was a lot of pruning and portfolio optimization. Just how are you kind of thinking about that aspect for GE? Are you happy with all of your children?

Peter Arduini: Yeah. My personal children I'm very happy with, just to say. The first part of it, it's kind of early to talk about -- we'll talk more about capital structure and how we're thinking about when we get to the Investor Day in detail. But look, philosophically, M&A is an important vehicle for a company like us. I think we've got a great ecosystem that we work in. It's one of the great parts about MedTech that so many smaller companies are incubated come up through. And when you start having more of these longitudinal views about either partner or acquisition, even if you're not buying, how you plug those in to solve the bigger issue, again, we think we can play a major role in it. We're probably more of tuck-in type of a viewer. We've got lots of things to do. But I think M&A is going to be always an important lever for us.

And I think, again, broadly, partnerships, distribution agreements, are also going to be on that list. I talked about this idea of multivendor approach. We want to demonstrate that you can make good money as a partner that we don't own as well. And I think that's an important distinguishing part about how we want to think about what platform means and how to integrate it.

On the portfolio, I'm just a big believer, a little old school on the fact that you've got to constantly look at the portfolio and pressure test it. What's growing? And the things the that are really growing, are you giving them the monies and the feed that they really need? Should we put more there? Should we squeeze other areas here? Is this asset better in someone else's hands than in our hands? We're looking at all of those things. And I'd say we have a great portfolio, but expect to see in the future that we will probably take a different view as we move forward on what we want to bring in and maybe some things that we'd shuffle around.

In the near term, it's more about the products that we have, simplifying them for our sales team and our customers. Like a lot of MedTech companies, we have a lot of SKUs, and if we had 30% less in a given area, we would manage the mix of the gross margins higher and we could simplify the sales process. And we're doing that. And because of that, we're seeing I'd say greater productivity with our sales teams and I'd say a little bit higher win rates.

Drew Ranieri: Unfortunately, we have to cut it right here, we're out of time. But Peter, Helmet, this has been a great conversation and thanks for kind of introducing us to GE Healthcare. Looking forward to December 8^{th}?

Peter Arduini: December 8^{th}. We hope that all investors and analysts will be able to make it. Thank you very much, Drew.

Drew Ranieri: Thank you. Thanks, everyone.