GE

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Julian Mitchell: Good morning, everyone. Welcome to Day 2, I suppose, of the conference. It's my pleasure to have starting off today, Larry Culp, Chairman and Chief Executive Officer of GE. Larry will have a couple of prepared remarks, and then we'll go to questions.

Lawrence Culp: Great, Julian. Good morning. Good morning, everyone. A little bit of echo there. Appreciate you taking the time this morning to be with us. Good to be back in Miami, as always. And I think you're catching us at probably the best possible time here early in 2023, given that we are almost through our first quarter operating reviews. We were with the Vernova team much of last week. The Aerospace team this week and early next week. So a lot going on in the company.

As many of you know, 4 weeks ago we announced our fourth quarter and full year 2022 earnings. We exited last year and came into 2023 I think with a lot of momentum. You saw mid-single digit growth, really nice margin expansion, earnings growth and nearly $5 billion of free cash flow. We were really proud of that. And that I think was fundamentally the setup for the way we framed 2023. A little bit more commercial Aero helping us drive a high-single digit growth outlook for this year. We will see a more than doubling of our earnings. And we should see cash flow growth, even without HealthCare out of the mix given the adjusted base.

And even already this year, a lot going on. I mentioned HealthCare. We couldn't be more pleased with the way the spin was executed and the market has received the outlook for a standalone healthcare business. So they're off and running, and we couldn't be more proud. Lessons learned for us as we think about what happens from here for both Vernova and GE Aerospace.

You may have seen that we have exited now completely our position in Baker Hughes. That's been a key part of our $100 billion deleveraging over the last 4 years. Particularly encouraged by that, with more to come. You may have seen that we've called $3 billion of the preferreds here recently. We've had our cash flow testing come through fundamentally in line with expectations. So there's a lot happening here that I think bodes well for what we want to do operationally in 2023 and the separation of GE Vernova and GE Aerospace next year. So when we think about GE today, stronger results and fundamentally a simpler story.

I just spent a moment on GE Aerospace. I came in last night from Cincinnati. A lot happening there as well. When we step back, we talk about shaping the future of flight at

GE Aerospace. And we really think we're doing that today, tomorrow and into the future. Obviously with the ramp in commercial departures, our business couldn't be busier supporting our airline customers. If we look at departures versus 2019, currently we're down at a single digit level globally. Really pleased to see that recovery. And we're down in single digits really everywhere except Europe. U.S. is up slightly. And that's really what's going to drive the commercial services business to be in the high teens, 20% zone this year.

With respect to tomorrow, it's all about the ramp, particularly with LEAP, with Boeing and Airbus. I think we're well aligned with both airframers relative to what they'd like us to do this year as they look at their production projections both for 2023 and 2024. A lot to do to work through the supply chain issues that we've talked about a good bit over the last year and I'm sure you've talked with other companies about. All the while making sure that we continue to invest in future technologies that we perpetuate GE Aerospace's leadership, particularly in propulsion, be that the RISE program, the XA100 on the military side of the business. So all in, I think we're going to have a good year. Probably profit comes in at 5.3% to 5.7%, as we shared 4 weeks ago in earnings. We'll see cash flow up with the business, much like Vernova preparing to be a standalone company.

And just a moment on Vernova. I think you saw in 2022, I believe you'll see again in 2023, that strong foundation that we've established with our power business, particularly our gas power business, which has really become I think quite a prolific cash generator, given the size of the installed base, the utilization. Despite all the bumps and the shocks with the energy transition, we think that will continue here this year. And it's not just a cash story. Really pleased with the team coming in a year early with respect to their longer-term margin goals. Last year, we were at a high-single digit op margin rate in that business.

But enough about power. I know most people when they think about Vernova and trying to sort through the trajectory for renewables, I think that's a fair question. I think we left last week's sessions really encouraged by where we are and where we're headed. The action really is 3 quarters or more in the onshore wind business. We know we had an ugly year last year. We've got a couple of tough quarters ahead of us.

But when you look at what we're doing from a market selectively perspective, from a price-cost perspective, the improvements in our field performance, let alone the reduction in our fixed cost, we probably exited on the order of 20% of the team within the onshore wind business in the last 3 or 4 months. All that adds up, I think, to a better positioned business going forward.

And then when you consider the IRA effects that will I think -- I think we're already seeing some of the effects. We're optimistic that we'll see the final Treasury rulings here soon. That really is I think an outstanding setup for onshore wind. Grids turn profitable in the fourth quarter. We'll be profitable modestly here in 2023 with I think a trajectory that's even better. A lot of self-help there, but also, frankly, given our position especially in Europe, broke demand upticks in the wake of what happened a year ago in Ukraine.

So there's a lot happening in Vernova. Certainly, as we get ready for the spin, we need to work through a whole host of internal, what I call wiring and plumbing tasks to set them up as a standalone company, much like we did with HealthCare. The work is similar, incrementally more challenging, but that won't pace what we do with Vernova. The IRA timing truly is a game changer for us, Julian, but again, I think we're going to have clarity there soon. So it really comes down to performance, and we like where we are in that regard.

So the goal with respect to timing remains as it has. Sometime early next year, we'll spin Vernova out, and you'll have 3 standalone GE companies with that common heritage, but also I think significant prospects going forward. So we'll keep you updated later in the year as we get closer on that. But again, I think it's a simpler story. You're seeing better results out of us. And we really believe that when we are three companies, we're going to be even better positioned not only to unlock, but to create more value for both shareholders and customers.

Julian Mitchell: Great. Thanks very much for that, Larry. Maybe first off, you talked about free cash flow. You've guided that to grow by about $700 million this year on a sort of apples-to-apples basis. What's the confidence in that free cash flow growth? Last year, there were a couple of setbacks. How good do you feel about the guide for this year?

Lawrence Culp: Well, I don't think a year ago we envisioned the way the world played out. But I think our confidence every time we guide, Julian, is high. We'd be wasting your time and everyone else's otherwise.

If you look at the guide this year, we're going to come off a base, adjusted for HealthCare, at $3.1 billion. We think we take that up to $3.4 billion to $4.2 billion. How do we do that? That'll fundamentally be an earnings story. Again, with the high-single digit growth outlook, with the strength that we see in services, both in aero and in power, that helps a great deal. Clearly, the deleveraging will help a bit from an interest perspective. And we'll get some working capital effect as well.

So this is largely within our control. Again, I think we all hope we don't see the headline shocks that we saw a year ago. If it happens, it happens. But in terms of what we can control, operationally, I think we feel very good about this being another strong cash flow year at GE.

Julian Mitchell: Got it. And when we look kind of across the segments for that, Aerospace I think carries and corporate carry a lot of the load for that free cash flow improvement. Within Aerospace, and as parts of the guide that maybe look conservative, it's very, very early in the year. So, maybe too early. But I think people often say that the guidance for commercial spares growth in the teens may look low, particularly with what's happening in China at the moment. So maybe talk about that spares growth outlook, and then China specifically, what slope of recovery you're seeing.

Lawrence Culp: How confident are you are. Now you're too conservative. Julian, you're tough here at 8:10 in the morning. I would say from an Aero perspective, we know we have significant backlog on new units. We've talked about that really being a LEAP story primarily in 2023. We expect units to be up 50%. Now, we've got to work through a number of those supply chain challenges in order to keep pace with that, but again, that is on us.

I think what we saw last year was tremendous growth in the aftermarket, including spares. But as the comps got tougher, we saw that growth slow a bit. Still terrific growth, but we're getting close to '19 levels. I think as you look at that guide around spares particularly that you're referring to, we're really trying to tie -- that's tied more to departures. And as we get back to '19 levels here in 2023, both from an aero and a wide-body perspective, we think we're going to see spares more in line with that departure growth rate. If it turns out to be conservative, great. But that's where we are today.

Julian Mitchell: Perfect. And how is the sort of the price element there? You have the volume growth with departures. Pricing is probably pretty healthy this year. Is that fair to say?

Lawrence Culp: Yes. Yes. Both given the contractual adjustments that we have laid in in part of the aftermarket business at Aero, but also where we are, if you will, outside of contracts. Like so many other companies, we were active trying to balance off that price-cost equation. And that'll help us this year. Helped us a little bit last year as well.

Julian Mitchell: And on the volume side, how are you seeing kind of the wide-body market at present? Freighters led that wide-body a couple of years ago. Now it's probably a broader wide-body recovery. And then China's very sort of uneven. Maybe any insights onto the Aero trends there.

Lawrence Culp: Well, I think from a China perspective, we've certainly seen domestic departures skyrocket. That's probably not in-house view. And we're I think well positioned to benefit there. We'll see how that plays out through the rest of the year.

From a wide-body perspective, I do think that we'll see us back to '19 levels in all likelihood as we get toward the end of the year. But it will be a little bit of a tale of two cities, as you highlighted. We're seeing freight departures tail a little bit. Still above '19 levels, but softening, as one would expect given the macro situation. But as China reopens, and as, frankly, the Pacific travel opens up more actively, that's been very good thus far for our wide-body activity. And we would expect that to continue through the rest of this year.

Julian Mitchell: Got it. You mentioned that 50% LEAP engine delivery dull. It's sort of ambitious in an industry where we hear a lot about supply chain issues still being quite prevalent. Maybe help us understand how you're seeing that supply chain right now in commercial Aero OE and also on the military side of Aero.

Lawrence Culp: Sure. Sure. And they're similar but different, Julian, as you know. I would say that it's going to be a significant undertaking this year to see our LEAP volumes up 50%. Both GE and Safran, the two partners of the CFM joint venture, are committed to doing that. We've said as much to both our major airframer customers. This is a complicated undertaking. And I just tend not to have a lot of time for folks that want to point to one vendor or one commodity as the only issue. As if we could solve that, everything else is fine.

When you look at how we are ramping LEAP -- and keep in mind, LEAP is a platform where we've got three engines. Two of them, the 1A for Airbus, the 1B for Boeing, basically have on the order of 2,500 parts each. Some sourced, some internally manufactured. You have probably in each family, 150 vendors in addition to 20 GE facilities. And though they share a common name, they're only about 10% of those parts that are common across both platforms.

We have challenges everywhere. We've got challenges in our own shops, be it in staffing, be it in process yields. We have issues with our vendors, some of which you would recognize, some of which you wouldn't. What we've tried to do is avoid the finger pointing. We've tried to avoid the public posturing and just get to work. Let's solve the problems. Let's identify where those constraints are, whether they be in a GE shop, whether they be in a GE supplier or a GE supplier's supplier.

So we have put our engineers into the field where those situations arise. We've even moved labor out of our own facilities into supplier facilities to identify the true bottlenecks, the constraints, break them, and then ramp from there. And we do this across all of our product families. We do it not only by product family, but by part. And we do a

deep dive at a senior level every week. That's our Tuesday morning review on the commercial side. I think we do it Wednesday on the military side. So it's a little bit of whack a mole. I'm not here to tell you that things are a lot better, but they're certainly not getting worse. I think we are better at managing the uncertainty. And that is what is fundamentally behind our outlook for engines more broadly, LEAP specifically.

And that fundamentally holds on the military side. We probably had -- we made less progress in 2022 in that regard. And you've seen that, Julian, in some of our numbers. I think we were disappointed with the revenue numbers that we saw on the military side of things last year. We're off to a good start here through the first 7 weeks of this year. But 7 weeks does not yet make a trend. But we've made a number of changes in terms of leadership. Made a number of process improvements on the military side of the business, which I think will yield sequential output improvements as we go through the year, a year where we should see high-single digit growth within MSO.

Julian Mitchell: Perfect. And as you get that broader industry ramp or recovery in commercial Aerospace, whether it's the sort of the catch-up deliveries on 787 or the narrow-body production ramp, that creates some profit and/or cash headwinds to GE Aerospace, like all suppliers. Maybe talk a little bit about how significant those headwinds could be not just this year, but the year after as well.

Lawrence Culp: Sure. Well, I think the particular, if you want, mix challenge that we have will be on the LEAP. It really won't be on the 87, per se. I think what we've said with respect to new units, that's probably about 250 basis points of headwind this year for us at Aero, simply because with new units far outstripping the aftermarket for a program so early in its lifecycle, we do lose money on those engines.

Now, we have built the business over decades very much with this model, so we know it's really part of the price of admission. Not happy with that. We're going to continue to drive toward a breakeven level and then profitability over the next several years. And at the same time, it's not just new units, Julian. The LEAP activity becomes more a part of our aftermarket business. We've got warranty expense early on. The CSAs, the rate per flight hour, part of that business hasn't kicked in yet. But that, too, will reset itself mid-decade.

So we'll talk about this mix pressure, primarily LEAP, both in OE and service, the next couple of years. But don't think for a moment we're waiting for volume to resettle it. We're working hard on our costs, both on new units and in the aftermarket, all the while making sure that we get the full benefit of all the volume and taking cost actions elsewhere to drive profit growth. And that's why we say we think we may have a flattish margin in early this year while growing earnings on the order of 15%.

Julian Mitchell: Perfect. And then maybe switching to renewables. I think people were alarmed a little bit by the sort of the scale of that down payment impact on the free cash this year. It's a big number, $3 billion or $4 billion. People concerned about how does that swing around after this year, and also the extent to which it's sort of dependent on developers placing orders. So maybe just try and address that element. How much risk is there around that $3 billion or $4 billion? What are the extent to which there are offsets within that for that renewable cash?

Lawrence Culp: Right. Well, when we talked about $3 billion to $4 billion, we were really trying to highlight the $1 billion between $3 billion and $4 billion that represents a bit of the spread with respect to down payments, given the way we see the order book evolving in renewables, particularly onshore, particularly in the U.S.

Again, the IRA has been signed by the President. This is the best possible piece of legislation we could have asked for from an onshore wind perspective. The final rules are working their way through Treasury. We have already seen customer behavior change in anticipation of those rules. We see that in our backlog. We see that in our pipeline. We see that not only in terms of volume commitments, because I think customers understand that they need to secure that capacity now. We also see it in terms of pricing. So that's all good.

But there is some uncertainty around timing that we wanted to highlight. And it's not a 3 to 4, which I think some people grabbed a hold of. I know, thankfully, you didn't. But it really is a question around timing, because if these rulings lag, we could see some order move out a quarter or two. But fundamentally, given that there are also outflows there, progress on renewables is not going to be I think a major risk factor for us this year in the way that it was last year.

All the while, again, we need to deliver on the order book that we have. We need to do that smartly and well. We think it's a better price. It'll be even better in 2024. And we need to make sure we're managing costs more effectively, both in terms of manufactured costs. But again, the field performance, the warranty expenses that we've incurred in 2023, that's what triggered the charge in the third quarter -- excuse me, 2022, the charge in the third quarter. And the expenses that we will continue to see I think tail off as we go through this year, sequentially.

Julian Mitchell: Great. And then looking at the renewables profit, you had a sort of a $2 billion-plus loss last year in 2022. Sort of breakeven guide next year in 2024. Maybe give us any of the biggest moving parts of that sort of $2 billion swing.

Lawrence Culp: Yeah. Julian, the way I think about the 2022 to let's say the 2024 walk, again, it's fundamentally an onshore wind story. That's going to be 75% of that dynamic. You can take half of that, call it $800 million, and say that's really those things that are within our control operationally. We just hit on a bunch. Selectivity. What we mean by that is making sure that we are pursuing only the business that we really want the business that we know we can perform profitability and well. So that'll really limit certain geographies that we'd pursue, and frankly, perhaps even some customers here in the U.S.

In turn, we need to be smarter about pricing. And I think we've already seen evidence of that, again, in our backlog and in our order pipeline. We are at a dynamic -- we're in a market dynamic now where there is scarcity. So we're trying to make sure we're smart about pricing, even though we went through such a tough 2022. And I think that pricing discipline is something that we're particularly proud of on Scott and the team's part.

We've touched on cost in a couple of forums. Remember, there's material cost where we're hit by a good bit of inflationary pressure last year, and other costs in the factory and in the field that we can -- we're I think managing better today. We talked about warranty expense. That's a function of delivered quality. A lot of organizational process improvements there that we think bear fruit. And there's also the, if you will, the so-called fixed costs where we have adjusted the headcount in that business down on the order of 20% here of late. And those benefits will accrue in 2023 and fully in 2024.

So I think we're doing everything we possibly can and should to run the business better without waiting for the IRA to kick in, knowing full well that it will, and it's a game changer for us.

Julian Mitchell: Got it. And if we think about Vernova will come out as a public company in around a year's time. What sort of scale of liabilities are you thinking will be put on that business at spin?

Lawrence Culp: Julian, I think what we wanted to do first was deleverage to the fullest extent possible. It's why we're so proud of that $100 billion figure I cited earlier. I think we said when we announced this transformation back in the fall of 2021 that we'd really barbell the debt and the other liabilities, meaning HealthCare and Aerospace would carry the load, by and large, to make sure all three were set up to be investment grade and be successful as public companies.

So Vernova specifically really won't carry much. We haven't worked through all of the details with respect to the debt and some of the other liabilities, be it pension, be it EHS. We've got time to do that through the course of this year. But clearly, job one, in addition to having a strong operational performance in 2023, is making sure that come next year, we're in a position to have both Vernova and Aerospace on their own bottoms, ready to stand and stand tall.

Julian Mitchell: As the portfolio has simplified, people have started to look again at long-term care insurance. Could anything happen with that at last? Just wanted your perspectives on that piece.

Lawrence Culp: Well, I think that we really needed to do two things to set ourselves up to do something strategic. We needed to be in a position where we had a stronger balance sheet. Again, that's where the deleveraging I think is so critical to us. And we also needed to stabilize that liability. You heard the comment earlier about the cash flow test coming in as expected. We really have not had surprises there over the last several years. We don't take that for granted.

So we're preparing to move forward with long-term care as part of GE. We've indicated it would go with GE Aerospace. But I think we're much better positioned today to be a counterparty should the right transaction -- a shareholder friendly transaction present itself. And we'll see how that plays out.

Julian Mitchell: As you said sort of last year, some unanticipated events occurred, and obviously that pressured guidance and all the rest of it, as it did for many companies. As you look at sort of this year and how it started out, you had the reviews this week with a lot of businesses. How do you feel about sort of the cash dynamics, the profit improvement as we go through the year? I think you talked about renewables, a couple of tough quarters of profit, for example, ahead.

Lawrence Culp: Right. I don't think our outlook has fundamentally changed. We're really in a position, given what's unique and special about the commercial Aero recovery, both in the aftermarket and new units, in addition to everything happening around the energy transition, where we're really looking for the short cycle recession. We don't really see many signs of it in the GE portfolio today. And even in some areas like, let's say, grid automation, or even our digital business, our GE digital business where you might think you would see some of that, we haven't really yet.

And I'm not, Julian, guessing we're -- I think we've been immunized to a downturn here. But I think our cycles are such that this really ought to be a good year of growth, and if we execute well, in turn, profit and cash. There's nothing we've seen through 7.5 weeks to suggest otherwise, be it departures on the Aero side, be it utilization in the pipeline build at Vernova. So, so far, so good, but there's a long way to go in 2023.

Julian Mitchell: And lastly, I think before we do the audience response survey, the power business was 80% of the discussion I think when you became CEO. Now it's sort of 1%. Any quick thoughts on the cash flow performance? It was very good last year. There's some lumpiness always with power. How do we think about that cash resiliency?

Lawrence Culp: Well, power was a business I think some people early on said, give it away. We're glad we didn't give it away. So this is a business that should see through the cycle anywhere, call it, 90% to 110% cash conversion, again, largely because of that service orientation. And particularly with where we are in the cycle, we're seeing even better cash flow performance.

We've talked about this year being softer on a dollar's basis. That's really a function of one particular project we're going to see outflows, given where we are in the lifecycle of that project. And we'll see that. But given that it's so heavily a service-oriented business, Julian, we have high confidence that will continue to be a strong cash contributor for years to come.

All the more, frankly, given how the dialogue publicly around gas as a generation source has changed just over the last year. We talk about the IRA, but we can't lose sight of the fact that given the sad events in Ukraine, we think the policy discussions around a lot of the Vernova portfolio -- not just renewables, but gas, nuclear as well -- is in many respects fundamentally better than it was 12 months ago. And that's a good thing for Vernova's prospects going forward.

Julian Mitchell: Perfect. Well, we'll switch quickly to the audience response survey questions. So please, you can wield these gray devices. First question, do you currently own the stock. Just sort of the numbers at the top of the device.

Lawrence Culp: Yes.

Julian Mitchell: Well, you can participate. Your remote control. So 70% no. That's pretty consistent with the companies yesterday.

The next question is around general bias, sort of impressions from this morning or recent weeks. Fairly positive on the whole.

The third question will be around through-cycle earnings growth for GE. And the peer set here is sort of broad U.S. industrials or U.S. multi-industry, if you like, as the reference point. In line as a blend, probably it looks like.

Fourth, this is about excess cash. Not relevant in recent years, but now there's a lot more optionality today. It's all about $100 billion's not enough. There's got to be more debt paydown.

Next question. Valuation multiple. What P/E -- this is sort of a complicated one, obviously, the earnings for GE are depressed right now. So through-cycle is maybe more appropriate for this question of sort of target P/E for GE. So mostly sort of high teens P/E.

The next question is around sort of what's the biggest headwinds? Why don't people own the stock in the room? Or why do you think it should trade at a P/E of 17 and not 23? The biggest question on execution and strategy.

And then lastly I think is ESG, which is a new question this year for all the companies. For context, yesterday, it was sort of 25%, 30% of answers for number 1 and 70% for number 3. So we'll see how this evolves in future years. So pretty representative for GE. Sort of 50%, 60%, no real role yet.

So, great. With that, thank you so much, Larry. Thanks very much.

Lawrence Culp: Good to see you. Thank you, all.