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Q2 2023 General Electric Co Earnings Presentation

EVENT DATE/TIME: JULY 25, 2023 / 11:30AM GMT

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the General Electric Second Quarter 2023 Earnings Conference Call. (Operator Instructions) My name is Liz, and I will be your conference coordinator today. (Operator Instructions) As a reminder, this conference is being recorded.

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

Steven Eric Winoker ***General Electric Company - VP of IR, GE Aerospace VP of IR***

Thanks, Liz. Welcome to GE's Second Quarter '23 Earnings Call. I'm joined by Chairman and CEO, Larry Culp; and CFO, Carolina Dybeck Happe. GE Aerospace CFO, Rahul Ghai, who will also assume the role of GE CFO in September, will join us for Q&A.

Some of the statements we're making are forward-looking and based on our best view of the world and our businesses as we see them today. As described in our SEC filings and on our website, those elements may change as the world changes.

Over to Larry.

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

Steve, thank you, and good morning, everyone. The GE team turned in another strong quarter with double-digit growth in orders, revenue, operating profit and cash supported by services strength, robust market demand and the lean transformation within our more focused businesses. In the first half alone, earnings have now surpassed our full year 2022 results.

GE Aerospace is growing rapidly as we execute on the ramp for our customers, and GE Vernova is strengthening pre-spin with record orders and improving profitability at Renewable Energy and continued margin expansion at Power.

Based largely on year-to-date performance and expectations for continued strength in the second half, we're raising full year guidance today. Big picture, there's a clear sense of progress, passion, and purpose within our businesses. This was particularly evident to me when I was in France last month. At the Paris Air Show, GE Aerospace shared our bold vision to define flight for today, tomorrow and the future during meetings with customers, suppliers, and investors. CFM's RISE demonstrator program drew a lot of excitement as it aims to reduce fuel consumption and CO_2 emissions by at least 20% compared to today's most efficient engines.

I also saw our GE Vernova team for our Onshore Wind and Grid operating reviews, where we discussed opportunities and challenges with equal candor and transparency. We focused on how we grow these businesses profitably by applying real lean at the point of impact to drive results. We're also seeing lean's impact in our Offshore Wind facility in Saint Nazaire, where the team has reduced cycle times to assemble nacelle roofs by nearly 50% through multiple kaizens. So, while it's still early, I'm encouraged by examples like this across GE Vernova.

Day in, day out, we're increasingly operating as GE Aerospace and GE Vernova. Two industry leaders with large installed bases, where services represent about 70% of GE Aerospace revenue and about half of GE Vernova revenue. In addition to attractive economics, services keep us close to our customers. We understand the issues they're wrestling with and how our technology is performing, which shapes our future roadmaps. And with our businesses executing, we're advancing towards their launches as independent investment-grade companies next year.

When I reflect on how far we've come, it always starts with the team. So a big thank you to the entire global GE team. There's a lot to be excited about as we look forward to the rest of this year.

Before I turn it over to Carolina to take you through our results in detail, let me take a moment to welcome Rahul to his additional role as GE CFO this fall. Since joining GE Aerospace last year, he has quickly become an impactful and influential member of our GE Aerospace leadership team. And so, with our final spin approaching sometime in early '24 and Rahul assuming the CFO job September 1, this is Carolina's last earnings call. She has been a trusted strategic partner through significant deleveraging, improving our operating results and building the financial foundation for our 3 independent companies. We're deeply grateful for her many contributions. So on behalf of the entire GE team and for me personally, Carolina, thank you.

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

Thanks, Larry. It's truly an honor to be part of GE's ambitious transformation, and I'm incredibly proud of the work this team has done to build lasting value. And a special thank you to our Finance and DT teams for their extraordinary efforts.

Now turning to Slide 3, which I'll speak to on an organic basis. In the second quarter, we delivered double-digit growth across all headline metrics. Orders increased 58%, up in all segments. Equipment was up significantly, led by Renewables. This includes 2 large HVDC projects with TenneT at Grid and higher-margin orders at U.S. Onshore Wind.

Aerospace also up with solid Defense engine orders. Services was up 21% with growth in all segments, largely driven by commercial aerospace strength. Revenue increased 19%, with both equipment and services up. Also here, Aerospace led the way as LEAP engine deliveries nearly doubled and services grew. Renewables also grew, led by Onshore Wind and Grid with improved pricing.

Adjusted margin expanded 160 basis points, driven by volume, price, and productivity. This was partially offset by mix, inflation, and investments. Taken together, adjusted EPS was $0.68, nearly double what we delivered last year, driven by profit growth in all segments and meaningful deleveraging. Free cash flow was $415 million, more than double what we delivered last year, driven by earnings growth.

Looking at the flows, we reduced working capital from the first quarter. Given the sequential revenue growth and preparation for large second half deliveries, receivables and inventory were a use of cash. This was more than offset by progress payments and contract assets with utilization-driven billings.

At both GE Aerospace and GE Vernova, we're implementing weekly cash management and already seeing some linear progress. Importantly, our first half free cash flow underscores these efforts, up $1.5 billion year-over-year. This includes $0.5 billion lower working capital than in 2022.

Now a moment on Corporate. Adjusted costs were up year-over-year, primarily driven by non-repeat of 2022 timing benefits. We're preparing for stand-alone cost structures, with functional headcount down 10% year-to-date. And for the year, we continue to expect expenses in the $600 million range. We also continue to simplify and strengthen the business foundations prior to the launches of GE Aerospace and GE Vernova. This quarter, we partially monetized our GE HealthCare stake. And today, we announced that we will call the remainder of the outstanding GE preferred stock in September, further simplifying our balance sheet and reducing financing costs.

And we took actions to reduce our exposure to legacy liabilities. As we've disclosed for some time, our runoff Polish mortgage portfolio, Bank BPH, has been subject to ongoing litigation along with other Polish banks. We approved the adoption of a settlement program. And associated with that, we recorded a charge of $1 billion in discontinued operations. Importantly, no incremental cash contributions from GE are required in connection with the charge as the current cash balances at Bank BPH are adequate.

Overall, we're very pleased with our spin progress and first half, which includes adjusted EPS up more than three times compared to a year ago. So given the strength of GE Aerospace and the improvement at GE Vernova, for the full year, we're now expecting revenue growth in the low-double-digit range, up from high-single-digits; $2.10 to $2.30 of adjusted EPS, up from $1.70 to $2.00, and that includes $4.7 billion to $5.1 billion of operating profit. and finally, we now guide for a range of $4.1 billion to $4.6 billion for free cash flow, up from $3.6 billion to $4.2 billion.

And on that happy note, back to you, Larry.

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

Carolina, thank you. As many of you saw at the Paris Air Show, GE Aerospace showcased industry-leading solutions for both commercial and defense across propulsion, systems, and services. Our teams are delivering for customers, both in services and by growing our large, young fleet of 41,000 commercial engines and 26,000 rotorcraft and combat engines.

Today, we're partnering with airframers, airlines, and lessors to drive stability and predictability as they ramp. For tomorrow, we're growing and optimizing our next generation of engines. This quarter, for example, our defense team signed a historic MOU with Hindustan Aeronautics Limited to produce jet fighter engines for the Indian Air Force. And while our commercial business secured major deals with Riyadh Air, Jet2 and more. For the future, we're developing next-generation technologies like RISE, hybrid electrics and sustainable aviation fuels.

As a result of our efforts to embed lean and empower those closest to the action, I'm seeing greater intensity, discipline, and focus. For example, as we discussed in June, while supply chain and inflation challenges persist, we're using a lean tool called plan for every part to implement pull and improve delivery. Sustaining lean efforts like this helped us increase sequential engine deliveries by 35% in the second quarter, including a 40% improvement in T700 from a 25% reduction in lead times.

Looking at the market, departures have almost returned to pre-COVID levels. This rapid growth was evident in our quarterly results. Orders were up 37% with strength in commercial services and defense. Revenue was up 28% with equipment growing at double the services rate. Profit improved close to $350 million or nearly 30%. Margins contracted 30 basis points organically. Volume, pricing net of inflation, productivity were offset by unfavorable mix, increased investments and the non-repeated positive contract margin adjustments last year.

Once again, Commercial Engines and Services was particularly robust with 32% revenue growth. Commercial engines revenue grew 35% with LEAP deliveries up over 80% year-over-year and over 10% sequentially. We're on track for 1,700 LEAP deliveries this year. As expected, the LEAP spare engine deliveries ratio was higher than 2022, but we expect this to normalize in the second half, remaining roughly in line with 2022 for the full year.

Commercial services revenue also grew over 30%. Internal shop visits increased over 10%, and external spare parts were up over 40%. For the year, we now expect Commercial Engines revenue to grow mid-to-high 20s and Commercial Services to grow above 20%.

Defense improved this quarter, delivering significant growth. Orders more than doubled. Engine output increased with units up over 70% year-over-year. Through the first half, we delivered double-digit revenue growth, and we're on track for at least high-single-digit growth this year.

Looking ahead, we're constantly innovating here as well. Our XA100 is the only engine tested and ready to ensure the U.S. maintains air superiority this decade. This engine is the most cost-effective option to meet the needs of the U.S. warfighter for decades to come. We're pleased the House has recognized the importance of this program by including funding in the National Defense Authorization Act and in the House Appropriations Committee defense bill. We'll be closely watching the Senate as it considers legislation this week.

Based on our first half strength, we're raising revenue growth to high-teens to 20% and operating profit to $5.6 billion to $5.9 billion, up roughly $1 billion year-over-year at the midpoint, and we expect free cash flow to be even stronger year-over-year, in line with our increased profit expectations.

Moving to GE Vernova. We continue to see long-term growth tailwinds driven by the need for more sustainable, affordable, resilient energy along with energy security. And we're encouraged by the team's progress as they use lean to strengthen operations, driving toward a significant inflection in 2024. This quarter, Renewables demonstrated continued improvement. Market demand drove record orders, led by Grid with 2 more large HVDC projects. Even excluding these projects, Grid orders were up over 40%. As expected, we also recognized a large U.S. offshore order, which was included in our backlog forecast at our March Investor Conference.

Onshore Wind was strong again, led by North American equipment growing more than threefold. We serve many of North America's largest developers, and the IRA incentives are helping grow orders significantly this year. Revenue grew 27% organically, driven by higher equipment deliveries across both Wind and Grid. And Offshore revenue tripled year-over-year as we increased nacelle production-with June the highest month to date. Importantly, profit improved year-over-year and sequentially for the second consecutive quarter driven by price and productivity improvements, primarily at Onshore and Grid.

Going deeper into each business. At Onshore, the progress continued. First, we're seeing the impact of enhancing our underwriting rigor and focusing on select markets with fewer product offerings.

Second, we're driving price to manage inflation. As we've seen the past 4 quarters, equipment margins on new orders are coming in higher than current margins, especially here in the U.S. This will help drive improved profitability going forward.

Next, we're improving reliability through our fleet enhancement program. And as of July, we're almost 30% complete, and we expect to be more than halfway done by year-end. Our cost rationalization continues with Onshore headcount down roughly 30% year-over-year. At Offshore, we're improving on the Haliade-X learning curve in reducing cycle times to deliver for our customers as we work through our initial projects.

And finally, in Grid, the top line grew double digits in all businesses with significant margin expansion from volume, price, and productivity. Grid was profitable this quarter and remains on track to turn profitable for the full year.

Looking ahead, we're raising our full year Renewables revenue growth forecast to high-single digits, and we're expecting some sequential profit improvement in the second half, driven by Onshore Wind and Grid.

Turning to Power. Power continues to deliver solid results and reliable earnings and cash flow, providing critical support for future growth at GE Vernova. And at the same time, our multiyear decarbonization efforts continue. Just this month, the Province of Ontario announced we'll work together on the planning and licensing process for 3 more potential new small modular reactors there using our BWRX-300 design.

Looking at the market, GE gas turbine utilization grew at a low-single-digit rate this quarter. Orders grew high single digits with strength from Gas Power transactional services. Revenue declined slightly largely due to Aeroderivative shipment timing. Services, however, continued to grow, and we had higher HA deliveries. This provides stable baseload power to the Grid now and generates future services growth. Power delivered continued profit growth and margin expansion. Price, productivity, and higher contractual outage volume on heavy-duty units more than offset inflation.

Overall, in the first half, Power revenue grew mid-single-digits organically and margins expanded, led by Gas Power services. For the year, we continue to expect low-single-digit revenue growth. And given our second quarter performance, we now expect Power's profit to be even better versus 2022.

Taken together for GE Vernova, we're raising our revenue forecast to mid-single-digit growth. We're also improving our profit guidance, driven by both Renewables and Power, and now expect a negative $400 million to a negative $100 million this year, an improvement of almost $800 million year-over-year at the midpoint. We continue to expect flat to slightly improved free cash flow. Overall, we're pleased with our progress and momentum but, of course, more remains to be done.

So to wrap up on Slide 7. Our businesses delivered a strong half anchored by missions that matter to our customers and to the world. GE Aerospace inventing the future of flight. GE Vernova electrifying and decarbonizing the world. We're excited about where we are and where we're headed, and I'm confident we're well positioned for success as 2 innovative service-focused market leaders.

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

Steven Eric Winoker ***General Electric Company - VP of IR, GE Aerospace VP of IR***

Thanks, Larry. Before we open the line, I'd ask everyone in the queue to consider your fellow analysts and ask one question so we can get to as many people as possible. Liz, please open the line.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Sheila Kahyaoglu with Jefferies.

Sheila Karin Kahyaoglu ***Jefferies LLC, Research Division - Equity Analyst***

I wanted to ask about Aerospace profitability. When we look at year-to-date margins for the first half, Aero margins are 18.9% and the full year implied guidance is $18.5%. So what are the dynamics of contraction in the second half given the commentary in the release prior was -- the commentary in your release is good market strength, efficiencies are coming through, you've shipped 46% of the LEAPs in H1, slightly ahead of your prior expectation of sequential improvement for the year? So what happens that margins contract in the second half?

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

Sheila, thank you. No, you're spot on. And I think as we referenced, there is largely a mix dynamic in play as equipment revenues begin to accelerate here, vis-à-vis, services. But I think that's an excellent question for Rahul to jump in on here. It's one of the reasons we wanted to have him here with us this morning. Rahul?

Rahul Ghai ***General Electric Company - GE Aerospace CFO***

Yes. Thanks, Larry. Morning Sheila. So first, let me just go back to how good the second quarter was, which you referenced. We had 28% organic growth; Commercial Engine is up more than 50%; Service continuing a really strong run with 30%-plus growth; Defense recovering, as Larry said in his remarks, to be up double-digit on revenue growth for the first half; and profit was up more than 30% year-over-year with margin expansion. And the quarter was better than what we had expected going back all the way to April. So -- but more importantly, as we look to the quarter, it gave us the confidence to raise the full year, and our profit is up $1 billion for the year at the midpoint of the guide with year-over-year margin expansion. So that's a positive change as well.

And relative to April, we're raising the full year profit by about $250 million at the midpoint of the guide with about $400 million of revenue increase. So that's about a 60% incremental drop-through. And that is happening even though most of the revenue increase in our guide is coming from commercial OE as we are raising the commercial OE outlook from approximately 20 to mid- to high 20s. So the business is doing better on execution, and the improvement in the spare parts growth is helping as well.

Now to your question on the sequential view between first half and second half. The key driver of the sequential growth is commercial from -- is coming from commercial OE, which is up probably 60% between first half, second half. And that's a reversal of what we saw last year. Last year, most of the first half to second half growth was coming from commercial services. And within commercial OE, there is a spare install dynamic happening as well with installs being as a percentage of total shipments increasing as we get into the second half of the year. So that's why you're seeing a sequential step-down in margin. But again, it's going to be a really good year. We're going to expand margins and grow profit about $1 billion for the year.

Operator

Our next question comes from the line of Andrew Obin with Bank of America.

Andrew Burris Obin ***BofA Securities, Research Division - MD***

I'll stay in the Power lane, given that there are more illustrious analysts now covering the stock. Offshore, interestingly, you noted favorable year-over-year orders in Offshore, and I thought the commentary was that you were not looking at Offshore orders. And also if you could comment on the industry dynamic because it seems that folks are pulling out of Offshore as the overall pricing dynamic is not favorable. So people are pulling away from contracts. So more color on Offshore would be great. And great quarter, thank you.

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

Thank you, Andrew. You're illustrious in our eyes, rest reassured. I would say with respect to the Offshore orders, again, that was something that we knew we had coming. There were just some details that we needed to lock down, and we were pleased to do that, but really no surprise from what we shared with you out in Cincinnati in March in that regard.

I think for us, we're still building out this Offshore business we referenced what we're doing in terms of production in Saint-Nazaire to begin to flow this backlog, this nascent backlog that we have. We certainly have read and have had direct discussions with a number of customers on both sides of the Atlantic as they prepare for the next decade.

I think we're optimistic about Offshore Wind. I know there was some press over the course of the weekend that talk to some of the potential delays. But at the end of the day, as we think about the energy transition, we think about various ways in which, certainly, the coasts are going to be powered with renewable sources. Offshore has a role to play there. I think what we want to do is build up a business that has a respectable, profitable slice of that market.

Really pleased with the progress we're making in Onshore. I think everything that we said a year ago is playing out in terms of our selectivity, the improvement in the quality of the backlog from a pricing and from a cost perspective. I think the team here, we've talked often about how they're going to run the Power playbook. They've done a really nice job, making sure that we are working through some of the quality issues that triggered the charge that we took in the third quarter of last year. And again, our cost base is 30% better than it was just 12 months ago. So you put that together, you can really see the churn in Onshore.

And Grid, we don't talk a lot about Grid, but really pleased with similar execution against a backdrop where I think maybe more so in Europe, but increasingly here in the U.S., people appreciate how critical grid modernization will be to the energy transition. So we've got 3, as they say in Aerospace, angles of attack in Renewables. Gas continuing to play a vital role. So we like the way that we're positioned Offshore Wind being 1 play amongst many at GE Vernova.

Operator

Our next question comes from the line of Seth Seifman with JPMorgan.

Seth Michael Seifman ***JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst***

So I wanted to ask with regard to the margin rate for Aerospace in the second half, if you could talk a little bit about what role you expect pricing to play there and the extent to which it can offset the mix headwinds.

And then maybe just a technical question. I think you talked about really strong growth in spare parts. And just when we try to think about this and model it going forward, I think if I look in the Q, it's like a low single-digit growth in the spares rate per day, but I think spares were up something like 40% in the quarter. So just kind of how to square those things and how we can kind of measure that and think about it going forward.

Rahul Ghai ***General Electric Company - GE Aerospace CFO***

So let me start with the first question on pricing, Seth. So again, I think the price continues to be a positive driver in terms of earnings growth across both defense and commercial. And we are price/cost positive both in the quarter and expect to be price/cost positive for the year. So the trends continue to be good, and that is similar to what we saw last year. So really no change in terms of how we are driving incremental pricing to cover the inflation that we are feeling in the business.

Now in terms of our spare parts sales, yes, the spare parts sales, you're right. I mean it was really good growth in the quarter, more than 40%. And I would say 3 large drivers of the spare parts growth. First, the price increases that we just spoke about. But it's just not the increases, it's also the discipline with which we are driving the business so that we're making sure that we are extracting the most out of the price increases that we are putting in place.

The second was the customer mix was favorable as well. So that helped drive spare parts sales. And the third, I would say, is if you go to back to 2022, China was really weak last year, especially in the second and the third quarters because of the shutdowns in China. So the year-over-year growth trends were helped by a weak compare in the second quarter in China. Now that dynamic is going to shift a little bit as we get into the second half of the year because, if you recall, China came back really strongly in the fourth quarter to get ready for the reopening in first quarter. So that's going to impact our spare parts growth in the second half of the year on a year-over-year basis.

So overall, I think we're really pleased with how spare parts are trending. Good growth in the quarter and expect continued growth in the second half of the year on a year-over-year basis although at a slower rate.

Operator

Our next question comes from the line of Julian Mitchell with Barclays.

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

Maybe I just wanted to focus on the Renewables business because I guess you had a very strong revenue uplift, but the sort of incrementals perhaps if we're looking sequentially or year-on-year were not particularly strong. So maybe help us kind of parse that out in terms of maybe it's Offshore losses getting a lot wider, and that's offsetting better incrementals, maybe at Onshore and Grid. Maybe just talk through some of those dynamics.

And then as we're thinking about the second half for Renewables and the sort of entry rates into 2024, how do we think about the losses narrowing? Is it sort of linear or there's a step function some time next year because of Offshore mix or something?

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

Julian, let me frame that for you. I think you've got the contours exactly right. Again, I think that in 2023, what we've said all along is that what we really need to see is that sequential improvement in Onshore Wind. And that was really, if you will, the battleground for us this year as we get ready to have Vernova go sometime early next year.

And I think all in all, we saw that sequential improvement, again, a function of a better backlog being shipped from a pricing, from a terms and conditions perspective. Some of that's a function of our selectivity. Some of that's a function of just improved market conditions. We know we are delivering a higher-quality product to customers today. That's reflected in our cost performance, let alone the restructuring that has been underway there. And that really continues.

And I'd also suggest that beyond what you see in those numbers, what I see in our operating reviews really gives me confidence that the team is running this business than we would want them to run it, and that bodes well both for the back half improvements that are part of the guide here, but also getting us ready for next year.

Again, a similar rollout in Grid. We've been at -- we've been running the Power playbook there for the last couple of years and having them turn profitable, not that that's the goal. We want to be a strong contributor here. I think it's another proof point of progress. You're right, Offshore Wind does begin to negate some of that progress as that mix effect takes a hold with the uptick in Offshore revenues improving and thus, the revenue recognition and the losses there as we work through that initial backlog.

But we knew that was part of the start-up of Offshore Wind. So we see sequential progress. It's muted a bit perhaps in your eyes because of the Offshore effect. I mean, Offshore was roughly half of the loss in the second quarter. But given the progress in Onshore Wind, given the progress in Grid, given what we know we're going to be able to do an Offshore Wind next year, we feel very good about the progress and the momentum that we're making at Vernova or at Renewables at large.

Rahul Ghai ***General Electric Company - GE Aerospace CFO***

So just to add into what Larry just said. So if you look at Vernova, we are raising both the revenue and the profit guidance for the year. About $150 million of the profit raise is from midpoint to midpoint, and it's coming both with Power and Renewables contributing to the rate. About 1/3 of that is from the second quarter performance in Power driven by the strength of the Services business, and about 2/3 from Renewables in the second half of 2023 with the improvement in both Onshore and Grid. Onshore mainly because of the backlog margins improving and in Grid from volume and productivity. So good progress in both businesses year-over-year and on a sequential basis.

Operator

Our next question comes from Robert Spingarn with Melius Research.

Robert Michael Spingarn ***Melius Research LLC - MD***

Larry, maybe on the product development side, perhaps a little high level. But Airbus has said that an A220-500 is a matter of when and not if. And they've also openly talked about the desire to add a second engine to the family. And so given that, that aircraft would directly compete against the MAX 8, do you feel the need to get the LEAP-1B on to the A220 family?

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

Rob, I thought your multi-series coverage on that specific topic and how the 2 airframers are going to play out their narrow-body product strategy here really captured well the critical questions that we're all wrestling with. As you probably can respect, we're in deep with both of our airframer customers relative to our own product road map and technology road map for that matter, i.e., RISE, and how we can work together as they evolve their own product strategy. So specifically to the A220-500, I think we'll keep our comments private. We'll have that conversation with Guillaume and his team. But obviously, as we evolve our product portfolio, we want to be on all the critical platforms that matter in the decades ahead.

Operator

Our next question comes from the line of Deane Dray with RBC Capital Markets.

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

First of all, thank you to Carolina and wish you all the best.

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

Thank you, Deane.

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

Larry, I know you talked about the Renewable orders that were booked in terms of profitability. But can you generalize a bit and talk about the range of customer modifications within these orders that were booked that had been a problem before, too much variability versus steering customers to a more standardized offering? Does that readout in these orders?

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

Deane, we should have mentioned that earlier. Thanks for asking about that. Part of what we've tried to do in addition to our selectivity effort in terms of the types of opportunities that we pursue is also make sure that, frankly, we are driving more standardized offerings. I would say that we are seeing probably more in the order book than in the P&L today the positive effect of that.

I'd also say coupled with that is just a, frankly, a more conservative forward estimation of cost. And that will play out over time. We'll see how conservative those estimates are. But I know that the team for the last several quarters is really not that too far into the future vis-à-vis the cost position that we anticipate having when we deliver on this growing backlog.

So you put all that together in addition to the quality improvements that we put across the sharply reduced cost structure that we have in the business. I think that's why we've got, particularly in Onshore Wind, the optimism we do about the back half and profitability in 2024.

Operator

Our next question comes from Jeffrey Sprague with Vertical Research Partners.

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

Just a follow-up on Renewables maybe. Just love to get your thoughts on the trajectory of free cash flow. I'm kind of stuck with the same language, right, flat to improving. But I'm wondering if inside that, given the better trajectory of profitability apparently and what looks like some decent orders that should be coming with deposits attached if in fact the free cash flow outlook for Renewables has improved for the year and if you have anything to share about how you view 2024 playing out. Thank you.

Rahul Ghai ***General Electric Company - GE Aerospace CFO***

So let me start, Jeff, with 2023 first. So on Renewables for full year, in the current construct, what you'll find is kind of flattish to last year, $150-ish million positive from earnings, right, with huge growth in earnings minus the charge that we took last year and good progress on Onshore Wind here, especially with the progress payments. Grid's doing well, but it's coming -- it's getting offset by the Offshore from absence of progress payments and the way the contract assets are playing out. So overall, Renewables, think of that as kind of flat year-over-year for full year.

And then if you go to Power, the fact is Power free cash could be slightly down year-over-year. Again, positive earnings from cash, but it's getting pressured with these contract assets because as the revenue growth happens, we burn through the contract assets that are sitting on our books because the revenue exceeds the billings. So that's what's happening on the Power side. So, it's good for the business. The revenue growth is happening. The outages are helping. It's driving good revenue growth, but has a temporary negative impact on free cash. Now obviously, as we get into 2024, we'll provide more guidance as we get towards the end of the year into next year, but we do expect strong sequential improvement year-over-year in Vernova business overall.

Operator

Our next question comes from Nigel Coe with Wolfe Research.

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

So just wondered if maybe we could just dive into maybe 3Q and look at some of the moving pieces for both earnings and free cash flow. And on top of that, just this $1 billion charge on the Polish Bank, is that just writing down the remaining net asset value in that business, no cash? And does that clean up litigation there?

Rahul Ghai ***General Electric Company - GE Aerospace CFO***

Yes. So on Poland, Nigel, I didn't fully follow your third quarter question, so let's come back to that. But let me start with Poland. So we've been working to simplify the legacy liabilities, and it's a meaningful step forward in that direction prior to spin. We are approving a settlement program, and that significantly reduces our exposure to future losses. And as Carolina said in her prepared remarks, there's no incremental GE cash from taking this reserve as the bank has adequate cash balances. So we feel good to get this as much as we can behind us. Obviously, the situation is evolving. But at this point, it's a really good step forward as we clean up and simplify all the legacy liabilities.

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

And the 3Q question was just guide, just how are we thinking about 3Q guide overall.

Rahul Ghai ***General Electric Company - GE Aerospace CFO***

Yes. So on third quarter, expect high single-digit revenue growth in the quarter and then EPS range of about $0.45 to $0.55 with sequential profit growth in both Aerospace and in Renewables. And we will see a pretty strong growth in Power in the third quarter on profit, and expect the margins to go up 3 to 4 points on Power. And if you look at the EPS that we're providing, the range that we're providing of $0.45 to $0.55, that's about 2x what we did last year even if we exclude the charge. So, it's a significant improvement from that.

And for Aerospace, going back all the way to prior questions, profit will be up sequentially, but the margin rates could be down slightly given the majority of the first half to second half increase is coming from commercial OE. And then Renewables will continue to see sequential improvements, given Onshore Wind and Grid performance. And then as I said, Power, given the outage activity in the third quarter, we do expect good improvement there and free cash. And the free cash kind of flat to up slightly in the quarter with earnings growth and working capital reduction offsetting the AD&A headwind.

Operator

Our next question comes from Andrew Kaplowitz with Citi.

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

Carolina, thanks for your help.

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

Andrew, thank you.

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

Could you give us a little more color into the improvement you're seeing in your Defense business? You talked about orders more than doubling. Revenue was up 31%. Has Defense growth and profitability really turned the corner for you guys? And how do we think about its contribution to growth and margin over next couple of quarters and into '24? I know you said, Rahul, that you expect at least high single-digit growth for Defense, but does GE Defense now have an extended runway for growth?

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

Andy, maybe I'll start. As we indicated in our prepared remarks, and I think we have through the last several quarters, demand is not our fundamental challenge in the Defense arena, throughput is. And the supply chain challenges that we've talked about and everyone talks about certainly apply to Defense. I think we've had some particular issues that have challenged us, especially so with the first quarter numbers. I think we're really encouraged by what we have seen recently, not only with the T700, but with a host of platforms where our material flow in our own facilities is better. We are improving yields in a number of key operations that allows that flow to take place.

And we talked a little bit about PFEP, a plan for every part, how that helps us implement pull and turn improved deliveries. So our signals to not only our internal supply base, but also our external supply base are better and more clear. We're not just trying to work against past due, but really targeting what we need when we need it. And that has, in turn, I think had some early impact here. And to the extent that we're able to do that, do that productively, and we've certainly seen, I think, improvements not only in traditional material price cost, but also beginning to see some labor productivity improvements, all of that accrues to our good. But as long as we're able to continue to drive this output level, we'll see that high single-digit top line number and, in turn, the goodness that will follow out from a margin and from a cash perspective. Rahul, anything you'd add there?

Rahul Ghai ***General Electric Company - GE Aerospace CFO***

No, Larry, I think you covered it. I think it's good to see the recovery happening in the second half -- in the second quarter kind of puts us back on track for the full year. And we're seeing good demand and good improvement in year-over-year delivery. So we expect a good half in the back half of the year.

Operator

Our next question comes from the line of Joe Ritchie with Goldman Sachs.

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

Carolina, thank you for all the help throughout the years.

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

Thank you. Thank you.

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

So really my question -- well, congrats on all the progress you're making, cleaning up the balance sheet with the pref redemption, the Polish mortgage announcement today. I'm just curious from this point forward, how are you thinking about capital allocation pre-spin? And then any color that you can give us on just the progress of the spin? I know you said early 2024, but just any other hurdles that you see from here to there.

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

Joe, I would say that there really isn't any change in our perspective this morning with respect to the spin and the capital allocation decisions that we'll take between now and then. We've talked about Vernova launching sometime early next year. That is still very much the case today. We've talked about that really being a function of their performance, not necessarily our readiness, because the teams that are focused on the separation work had, I think, real success with HealthCare, are rerunning that playbook here and are exactly where we would want to be in the middle of July.

So as we look forward, again, I think we're really encouraged by what we have seen in the first half results and in the second half outlook. Still work to do, right? There's a negative operating loss there that none of us feel great about. But I think what we've said is the way we'll define winning is sequential improvement business by business. And what we've seen in Onshore and Grid, I think we can all be quite proud of.

With respect to capital allocation, job 1 remains a successful standup of all 3 of these companies. And while you've seen us continue to make progress on some of the specific initiatives like the monetization of the AerCap stake, likewise with HealthCare, you mentioned the prefs, thank you, even the -- well, just you put all that together, we're very much going to be in position from a balance sheet perspective to not only launch but then allow each of the respective Boards at Aerospace and Vernova to shape the contours of a capital allocation policy fit for each business. So that may be a little boring perhaps here in the near term, but this team is hyper focused on what our overarching priority is over the next several quarters, and that is the successful spin of GE Vernova and successful standup of GE Aerospace.

Steven Eric Winoker ***General Electric Company - VP of IR, GE Aerospace VP of IR***

Liz, we have time for one last quick question.

Operator

This question will come from the line of Chris Snyder with UBS.

Christopher M. Snyder ***UBS Investment Bank, Research Division - Analyst***

I appreciate the time. So I want to ask on Renewables. Revenue was up 12% in the first half of the year. And with the full year guidance calling for high single-digit revenue growth, it's I guess implying like a fall down to low singles in the back half of the year. Can you just maybe talk about what's driving that? Because it doesn't seem to jive with orders up well over 100% for the first half. Thank you.

Rahul Ghai ***General Electric Company - GE Aerospace CFO***

So the orders don't help much this year, Chris. I mean, that's mainly -- those revenues, those orders will kind of play out over '24 and even '25. So -- and what you see between the first half growth and the second half growth is just basically project timing. It's just a question of which projects are getting executed and how those projects play out. So -- but again, it's good progress, feel better about the year, raising guidance on renewables, on revenue growth. So it's good progress. And the orders that we -- and the orders are obviously very, very strong, and that helps '24 and '25.

Steven Eric Winoker ***General Electric Company - VP of IR, GE Aerospace VP of IR***

Thanks, Rahul. Larry, any final comment?

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

Steve, thank you. No, I would say simply to close a strong first half in 2023. And frankly, I've never been more confident in our path ahead as we prepare to launch both GE Aerospace and GE Vernova. Thanks everybody for your time today and your investment and support of our company.

Operator

Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.