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GE - Q2 2012 General Electric Co. Earnings Conference Call

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OVERVIEW:

GE reported 2Q12 continuing operations revenues of $36.5b, operating earnings of $4b and operating EPS of $0.38.

Caution Concerning Forward-Looking Statements:
This document contains "forward-looking statements" – that is, statements related to future, not past, events. In this context, forward-looking statements often address our expected future business and financial performance and financial condition, and often contain words such as "expect," "anticipate," "intend," "plan," "believe," "seek," "see," or "will." Forward-looking statements by their nature address matters that are, to different degrees, uncertain. For us, particular uncertainties that could cause our actual results to be materially different than those expressed in our forward-looking statements include: current economic and financial conditions, including volatility in interest and exchange rates, commodity and equity prices and the value of financial assets; potential market disruptions or other impacts arising in the United States or Europe from developments in the European sovereign debt situation; the impact of conditions in the financial and credit markets on the availability and cost of General Electric Capital Corporation's (GECC) funding and on our ability to reduce GECC's asset levels as planned; the impact of conditions in the housing market and unemployment rates on the level of commercial and consumer credit defaults; changes in Japanese consumer behavior that may affect our estimates of liability for excess interest refund claims (GE Money Japan); pending and future mortgage securitization claims and litigation with WMC, which may affect our estimates of liability, including possible loss estimates; our ability to maintain our current credit rating and the impact on our funding costs and competitive position if we do not do so; the adequacy of our cash flow and earnings and other conditions which may affect our ability to pay our quarterly dividend at the planned level; GECC's ability to pay dividends to GE at the planned level; the level of demand and financial performance of the major industries we serve, including, without limitation, air and rail transportation, energy generation, real estate and healthcare; the impact of regulation and regulatory, investigative and legal proceedings and legal compliance risks, including the impact of financial services regulation; strategic actions, including acquisitions, joint ventures and dispositions and our success in completing announced transactions and integrating acquired businesses; the impact of potential information technology or data security breaches; and numerous other matters of national, regional and global scale, including those of a political, economic, business and competitive nature. These uncertainties may cause our actual future results to be materially different than those expressed in our forward-looking statements. We do not undertake to update our forward-looking statements.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the General Electric second-quarter 2012 earnings conference call. At this time all participants are in a listen-only mode. My name is Chanel 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, Trevor Schauenberg, Vice President of Investor Communications. Please proceed.

Trevor Schauenberg - ***General Electric Company - VP Corporate Investor Communications***

Thank you, Chanel. Good morning and welcome, everyone. We're pleased to host today's second-quarter 2012 earnings webcast. Regarding the materials for this webcast, we issued the press release earlier this morning. The presentation slides are available via the webcast. Slides are also available for download or printing on our website at www.ge.comm/investor.

As always, elements of this presentation are forward-looking and are based on our best view of the world and our businesses as we see them today. Those elements can change as the world changes. Please interpret them in that light.

For today's webcast we have our Chairman and CEO, Jeff Immelt, and our Vice Chairman and CFO, Keith Sherin. Now I would like to turn it over to our Chairman and CEO, Jeff Immelt.

Jeff Immelt - ***General Electric Company - Chairman, CEO***

Thanks, Trevor, and good morning, everyone. The GE team had another good quarter. Let me start by giving you a few of the main points.

First, we are confident in our earnings outlook for 2012. We remain on track for double-digit Industrial and Financial earnings growth for the year. We restarted the GE Capital dividend, returning $3 billion to the parent in the second quarter.

The environment continues to be challenging. The US is stable. The appliance market grew by 1%. With housing starts up more than 30%, that bodes well for the future.

Rail loadings were up 1.2%, and our retail volume in our private label credit card business is up 9%. We saw solid growth in the emerging markets with revenue up 17%, and Europe remains very tough but within our expectations.

Our revenue was strong with organic growth of 10%. Orders were up 1%, and up 3% ex-Wind. And through the first half, orders were up 8%. Orders pricing was up 1.2%, and foreign exchange impacted revenue by $900 million in the quarter.

Earnings grew by 12%, better than plan. Capital, Energy, Oil & Gas, Transportation, appliances were strong. Disc ops continues to be a headwind.

We have a very strong cash and liquidity position. We bought back $900 million of stock in the second quarter and plan to do an additional $3.5 billion to $4.5 billion by year-end.

Margins are improving, and we are on track for margin growth starting in the third quarter and for 2012 and 2013. So overall, the team continues to make progress.

Orders are up 8% year-to-date and consistent with our plans for the year. For the quarter, orders were about flat.

It is important to explain the impact of two unusual items, foreign exchange and strong Wind orders in 2011. Discounting the impact of these factors, orders were up about 3% in the second quarter. And in Energy equipment orders were up about 9%.

Orders pricing was the highlight, with four of five businesses growing, and we continue to build backlog. Europe remains weak, particularly in service. Our orders position today supports our growth plans for the future.

Our investment growth continues to pay off. Growth market revenue expanded by 17% with seven of nine regions experiencing double-digit gains. For instance, China was up 24% and Latin America was up 50%.

Services grew by 2% and backlog grew by $4 billion. And our NPI continues to work. We won big in Farnborough with $17 billion in new Aviation commitments. Our Mission 1 refrigerator sold out, and we have two more appliance products launching in third quarter.

We are expanding our battery plant. Our platform in Russia is resulting in new gas turbine orders and high market share. And we have a very strong product line in Healthcare. Orders growth in the second quarter for MR was up 10%, and CT was up 12%.

And we are adding value in our acquisitions. So in these volatile markets, we are winning commercially.

We made progress on our margin commitments. We expect margins to grow starting in the third quarter, and to be up 30 to 50 basis points in 2012, and 100 basis points over '12 and '13.

At EPG I described our approach to margins. In the second quarter, value gap was a positive $100 million. Service margins grew by 10 basis points. Our acquisitions are ahead of plan, although still a drag overall.

I also said that we would reduce structural costs by $2 billion between '12 and '14 by simplifying GE. And you saw some of that today with the elimination of the top Energy structure.

There are some benefits to that move for investors. With all the acquisitions, our Energy business had become very big and complex. Power & Water will remain GE's largest Industrial business. We are benefiting from a positive gas turbine cycle.

Oil & Gas is about $15 billion in revenue, and we are positioned for rapid growth. And Energy Management at $7 billion has several solid growth platforms.

These moves will allow us to become faster and more focused to win in each market. At the same time you'll get transparency around three large and important segments that all have different opportunity for growth and are led by strong management teams. We expect to eliminate $200 million to $300 million in costs.

Actions like this are always done carefully at GE. John and I have been working on this for some time and both feel it is right for the Company.

As you can see by our second-quarter results, our Energy business is doing very well. We expect the second half in Energy to be very strong, and we are well positioned for 2013 and beyond.

John and I will work on a smooth transition in the third quarter, with three leaders reporting directly to me in the fourth quarter. John leaves the Energy business in great shape.

And cash is a great story. With the capital dividend we're at $6.8 billion in the first half, up 55%. This is ahead of our expectation.

Working capital was impacted as we prepare for high shipments in the second half. We end the quarter with $74 billion of consolidated cash.

And there is another piece of good news. Due to changes in pension funding requirements, our pension cash needs will be reduced by $2.5 billion '12 and '13.

Now let me turn it over to Keith.

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

Jeff, thanks. I'm going to start with the second-quarter summary. As you can see we had continuing operations revenues of $36.5 billion. That is reported up 2%, but we were impacted by the stronger dollar; ex-FX revenues were up 5%.

Industrial sales at $25.1 billion are up 9%. GE Capital revenues of $11.5 billion were down 8%, consistent with our planned shrinkage.

Operating earnings of $4 billion were up 7%. Operating earnings per share of $0.38 were up 12%.

Continuing earnings per share includes the impact of the non-operating pension, and net earnings per share include the impact of Discontinued Operations, reflecting the $0.05 in charges this quarter which I will cover on the next page.

As Jeff covered, year-to-date cash of $6.8 million was up 55%, including the $3 billion of cash from GE Capital.

For taxes the GE rate, 20%, is consistent with the low 20%s rate we forecasted at the end of the first quarter. And the year-to-date rate for GE is 22%.

The 5% GE Capital rate, that is lower than the approximately 10% rate we had previously forecast. The lower rate is largely due to the business property disposition tax benefit that I'm going to cover on the next page.

With the impact on the year from the Business Property disposition, the tax benefits we get with that, that is going to allow us to shrink Real Estate a lot more quickly. We now expect a mid-single-digit GE Capital rate for the year.

On the right side you can see the segment results. Industrial revenues were up 9%. Industrial segment profit was up 7%.

That is driven by the double-digit growth in Energy, Oil & Gas, Transportation; and GE Capital earnings were up 31%. So I'm going to cover each of the segments in more detail in a page or two, but let's start with the other items in the quarter.

As you know, GE Real Estate announced the sale of its Business Properties business. We had $0.02 of tax benefit in the second quarter from the high tax basis we have in the shares of the entity that we are selling.

This transaction is expected to close, hopefully, by the fourth quarter and will result in $5 billion of lower Real Estate ending net investment. The BP tax benefit here is recorded in the GE Capital headquarters' results in the second quarter; so you won't see that in Real Estate, you will see that in Corporate and Capital.

We also added $0.02 after-tax of restructuring and other charges in the quarter. The charges primarily related to continued cost structure improvements at GE Capital, Energy, Healthcare, Corporate; and we also had one-time costs related to the acquisitions.

On the bottom of the page we had a $0.05 charge related to our WMC and Grey Zone reserves this quarter. I will start with Grey Zone.

We did see daily claims reductions in the range of what we were expecting in our models in December and January. But since then we have seen an uptick in the claims number over the last few months and the increases, are above what we modeled. The claim severity, the amount per claim, is running within our modeled expectations.

But because of the higher claims, we booked $310 million of additional reserves. That reflects a slower overall claims reduction rate than we had previously modeled. And we ended the quarter with $695 million of reserve.

For WMC, at the end of the second quarter there were $2.7 billion of pending claims, up from $562 million last quarter. You saw that in the first-quarter 10-Q, that the claims were increasing.

This acceleration in the quarter we think is driven by statute of limitations considerations. But we saw an uptick above what we expected. The reserve that we booked is based on our historical WMC experience, plus it includes an estimate for future claims.

The WMC ended the quarter with $491 million of reserves, up from $140 million in the first quarter. We're going to continue to monitor both these items, but we believe the exposure is manageable.

So let me go on to the businesses. The first business is Energy Infrastructure, and I will begin with the Energy segment.

Energy had a strong quarter in Q2. Orders of $7.8 billion were down 6% driven by the non-repeat of last year's Wind orders.

Equipment orders of $4.4 billion were down 5%. Thermal orders of $1.4 billion were up 10%. We had orders for 30 gas turbines in Q2 versus 41 last year; however, we also had orders for five steam turbines this year versus one last year, and we had higher thermal order pricing.

Wind orders of $900 million were down 37%. Equipment orders ex-Wind were up 9%, and we had orders for 428 units versus 668 last year.

Total equipment order pricing for the Energy business is up 2.7%. Thermal is up 5% and renewable pricing is also up 5%, so a nice turn there.

Equipment orders even including Wind are up 9% year-to-date. So a little bit of this is Wind, and a little bit is just the timing of orders. And at the half we feel pretty good about where we are.

Service orders of $3.4 billion were down 8%. That is driven by lower upgrades in outage services. We did see customers continue to run their gas turbine equipment as a result of the low natural gas prices in the quarter.

Aero services were down as a result of tough comparisons. Last year we booked 10 rental units for Japan. And revenues of $8.6 [million] were up 19%, driven by all the strong volume.

Renewable revenues led the way. At $1.8 billion it was up 160%. We shipped 726 wind turbines versus 269 last year.

And thermal revenue of $1.6 [million] was down 20%. We shipped 31 gas turbines versus 32 last year, with some mix differences. Both gas engines and Aero derivatives had strong volume growth, and service revenue at $3.7 billion was up 4%.

Segment profit of $1.3 billion was up 15%, and that is driven by the strong volume that we saw in the product lines.

On the second business in Energy, Oil & Gas, they also had another strong quarter. Orders of $4.1 billion were up 1%. They were up 6% ex- the impact of the strong dollar.

Equipment orders of $2 billion were down 8% driven by tough comparisons to the last year. However, again, if you look at year-to-date equipment orders for Oil & Gas, they are up 21%; and service orders at $2.1 billion were up 11%. The orders priced index for the business was up 1.8%.

Geographically we continue to see strong growth in Asia Pacific, up 60%. North America was up 27%. Middle East was up 19%.

That was partially offset by Western Europe, which was down 17%. And Australia was where we had the large one-time orders last year, so that gives us some tough comparison.

Revenue of $3.7 billion was up 5%. Equipment revenue of $1.7 billion was flat, and it's up 6% ex-FX. Service revenues at $2 billion were up 10%.

Segment profit, $535 million, was up 11% as the strong volume and positive price more than offset the negative impact of foreign exchange on the business. So overall, a really nice strong quarter in Energy, and we have a very good outlook as we look to the second half.

Next is Aviation. Orders of $5.6 billion were up 5%. Commercial engine orders at $1.3 billion were down 19%. CFM56 orders were up 12% and orders for GE90 and CF34 were down in the quarter.

Military equipment orders of $1.2 billion were up 200% driven by F110 foreign military orders. And the equipment order book-to-bill in the business was 1.22.

Service orders at $2.6 billion were down 3%, driven by commercial services. Our second-quarter average daily order rate, $20.6 million per day, which was down 14%, partially offset by our long-term service agreement orders which were up 5%. The total orders priced index was positive at 2.2%.

If you look from a market perspective in Aviation, the year-to-date passenger traffic is up 6.5% through May. Cycles flown have been about flat over the last 12 months.

However, we continue to see the impact of customers' working capital actions. For example, in Western Europe, our spares orders were down 34%, and right now our expectation for the second half -- this is going to recover somewhat. We don't expect it to get back to last year's levels, but we do expect it to improve over what we saw in the second quarter.

Revenue of $4.9 billion was up 3%, driven by strong equipment volume partially offset by the lower spare sales. We shipped 566 commercial engines in the quarter versus 473 last year. And we shipped 27 GEnx engines, up from four last year.

Segment profit at $922 million was down 4%, as the benefits of positive price and lower base costs were more than offset by the lower spares.

On the right side, Transportation. They delivered another great quarter.

Orders of $1.4 billion were up 2% and for the first half orders were up 29%. Equipment orders of $808 million were down 3%; lower mining orders more than offset higher locomotive orders. Service orders of $590 million were up 10%, and the orders pricing was up 1.1%.

Revenue at $1.6 billion was up 27% driven by the strong volume. We shipped 243 locomotives versus 163 last year. We also shipped 195 locomotive kits versus 94 last year, and mining equipment was up over 30%. For the first half we shipped 402 locomotives, and our estimate for the total year is around 650 units.

Segment profit of $282 million was up 58% driven by the strong volume, positive pricing, and positive service results.

Next is Healthcare. Orders of $4.7 billion were up 1%. This business was also impacted by a strong dollar; up 4% ex-FX.

Equipment orders at $2.7 billion were up 4% driven by strong growth in emerging markets, partially offset by Europe. If you just go around the regions on equipment orders, the US was flat; China was up 26%; Latin America was up 9%; Middle East was up 13%; India was down 8%, but up 9% ex-FX. Europe was the soft point, down 13%, driven by Southern Europe.

And just a few numbers by modality. Global ECG was up 12%, MR was up 10%, Life Sciences were up 6%, and the PET business was down 14%.

Service orders of $2 billion were down 2%, also driven by Europe down 10%. And revenues of $4.5 billion were flat, or up 3% FX-adjusted. Emerging markets were up 11%, offsetting the developed markets, which were down 2%.

Segment profit, $694 million, was down 2% as the benefits of the volume and productivity were more than offset by negative price. And we had execution challenges of about $30 million in Latin America. Excluding those, we would have had Healthcare up about 2% in the quarter.

Home & Business Solutions had another tough quarter, but we did see some positive signs in appliances. Revenues of $2.2 billion were up 2% as appliances revenues were up 10%, partially offset by lighting revenue which was down 8%.

If you look at appliances, retail sales were up 11%. Contract sales were up 22%. As Jeff said, we saw a strong pickup in housing starts.

Appliances saw 5 points of price increase in the quarter. And at the same time, we increased share again, reflecting the benefit of the investments we have been making in new products over the last 18 months.

As you know, we introduced a new bottom freezer refrigerator this quarter. It was sold out. We are doubling the production rate.

And the offset is in lighting. We saw volume pressure in the US and Europe driven by lower incandescent sales.

Segment profit of $91 million was driven by appliances, and the benefits of higher pricing were more than offset by inflation and lower lighting volume.

Next is GE Capital. Mike Neal and the team delivered another very positive quarter. Revenue of $11.5 billion was down 8%, in line with the assets, which are down 7%.

Net income of $2.1 billion was up 31%. That is driven by lower impairments, principally in Real Estate; plus we had some one-time tax benefits that I covered on the other items page. That was partially offset by some of the dispositions we have been making as we shrink GE Capital. I'll cover all of those items by business in a minute.

We ended the quarter with $433 billion of ending investment, already below our original $440 billion target for the year. And we are on our way to about $425 billion for the end of the year.

Our net interest margin was 4.9%, up 47 basis points. There are more details on GE Capital and margins and capital levels in the supplemental deck that we posted this morning.

On the right side you can see the asset quality metrics continue to be good, as delinquencies fell in CLL, Real Estate, and the US retail. They were up slightly in mortgage, and that is a seasonal effect that we see.

A big highlight is the continued improvement in commercial real estate. We also saw strong volume at good margins. We continue to shrink our non-core assets.

And even after paying the $3 billion dividend, our Tier 1 common ended the quarter at 10.1%, up a full point over last year.

So if you look at some of the business results, the Commercial Lending and Leasing business -- if you look, assets were down 7% year-over-year driven by non-core runoff. Commercial volume in the Americas was $7.7 billion, up 2%; and returns on new volume remained at a 2% return on investment.

Earnings of $626 million were down 11%. That was mostly impacted by $60 million of year-over-year pressure in Italy from credit costs. Even with that, our European business earned over $50 million in the quarter; and the Americas earned $527 million, which was down 3%.

Our Consumer results were better than the reported variance shows. Assets were down 7%. That is somewhat driven by foreign exchange and non-core runoff. That is partially offset by $5 billion of growth in the US retail business.

Earnings of $907 million were down 13%, again driven by last year's exit of Colpatria and other non-core assets.

The US retail business had a great quarter. They earned $641 million, up 9% on higher assets and higher margins.

Europe core business earned $154 million, up 13% on lower credit costs. And UK home lending had another good quarter, earning $45 million in the quarter; and the portfolio quality remains stable.

Real Estate was the driver of the earnings growth in the quarter. Net income of $221 million, that is up $555 million over last year. It's up $160 million from first quarter.

The earnings were driven by lower marks and impairments, one-time tax benefits, and lower credit costs. In the quarter, we had $5 million of after-tax credit costs, $19 million of after-tax marks and impairments. That is the lowest level we've had in years.

We sold 55 properties for $700 million, resulting in $53 million of gains. So the improvements that we have seen in liquidity and valuations continued in the second quarter; and as of now, we expect the Real Estate business to remain profitable as we look into Q3 and Q4.

GECAS had another good quarter. Assets were up 2%, driven by strong volume and over 3% ROIs. Earnings of $308 million were down 4%, driven by two small credit losses.

The portfolio quality here continues to be strong. We have $56 million of non-earnings in the whole portfolio, and only three aircraft on the ground out of over 1,500 aircraft.

Energy Financial Services earnings, $122 million, were down 12%. We had $850 million of volume in the quarter at approximately 5% returns.

So another great quarter for GE Capital. If you look at the Q2 earnings of $2.1 billion from a run-rate perspective going forward, I'd take a few items into consideration.

First the BP tax benefits that I covered don't repeat at the Q2 amount as you go into the second half. Second, the third quarter includes our annual GECAS impairment review, which you are all familiar with. Last year the impact of that was $107 million after-tax. I don't know what it will be this year; I just give you last year's numbers for context.

And third, we are expecting that retail reserves will be higher as they usually are in the third quarter seasonally. Last year retail credit costs increased $188 million after-tax from Q2 to Q3. So, with that, let me turn it back to Jeff.

Jeff Immelt - ***General Electric Company - Chairman, CEO***

Thanks, Keith. Now to the operating framework. We want to confirm our operating framework for the year.

We expect Industrial earnings to grow double digits. Energy is going to have a very strong second half, and margins will be positive in the third quarter and for the year.

Capital earnings will grow double digits; commercial Real Estate has improved dramatically; and Europe is manageable. Corporate is on track and we'll offset any gains with restructuring.

Cash expectations are being revised upward because of the capital dividend and pension change. We now expect $17 billion to $19 billion of CFOA for the year.

Organic Industrial revenue growth should continue to expand 5% to 10%, and we will continue to shrink GE Capital. So, we have a very solid outlook for 2012 and good momentum as we turn the corner for 2013.

Finally, I think there is a lot of positive news in this report for investors. We have a solid industrial outlook. We have a big backlog, and margin performance is on track for the expansion we communicated at EPG.

We are getting cash from GE Capital and we will continue to position it to be a smaller, more valuable franchise. We have a lot of cash. We plan to use the $4.5 billion Capital special dividend to buy back additional stock, and those efforts will accelerate in the third quarter.

Meanwhile, we will continue to grow the GE dividend in line with earnings. So in a volatile environment, GE is positioned for double-digit earnings growth and valuable capital allocation, and this is a powerful combination for investors.

Trevor, let me turn it back over to you, and let's take some questions.

Trevor Schauenberg - ***General Electric Company - VP Corporate Investor Communications***

Great, Jeff. Chanel, we are ready to go to the questions right now.

QUESTION AND ANSWER

Operator

(Operator Instructions) Steve Tusa, JPMorgan.

Steve Tusa *- JPMorgan - Analyst*

Good morning. So, just on the Aviation front, Europe down pretty dramatically, but the margin was still okay in spite of that. You said it is going to improve a little bit in the back half. How do we think about Aviation margin as we turn the corner into the back half and in third quarter?

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

Well, I think if you look at the quarter, we were 19% margins, down from 20% last year. Really the good news in Aviation -- the good news/bad news on margins is we are getting tremendous equipment growth and then we have a negative on equipment service mix, Steve.

I would expect that you're going to continue to see that. We have a tremendous backlog on commercial equipment. But you have seen a couple other points in Aviation.

The R&D as a percent of revenue has leveled off. They are controlling their costs, and the improvements that they have made on everything they are doing with the launch of the GEnx continue to help us as we look at the pressure that the GEnx engines deliver.

So for me, I think if you look, the orders for Aviation were down. Spare orders were down in the quarter, right? We went down from -- in the quarter -- just let me get the ADOR. Last year, first quarter was 23 a day; second quarter was 20.6.

Last year was 27 in the third quarter, Steve. We do not anticipate that we are going to get back to that level. But I do anticipate that -- and the business is forecasting -- that we will be up in the mid-single digits over the second-quarter levels that we saw.

So I think Aviation is one that we are confident about the outlook for the year being a positive in terms of op profit. In the third quarter, there is one item. Last year, we had gain, if you remember; it was about $70 million. That won't repeat.

So that -- in the third quarter, I am not anticipating a really big margin number for these guys. But we do anticipate an improvement in spares over the second quarter, and we do anticipate them to be positive on op profit for the year.

Steve Tusa *- JPMorgan - Analyst*

Got you. Then just one last question on the Energy business. Thermal pricing up 5%. Orders were down, obviously a pretty tough comp.

How booked are you guys from a thermal perspective? How booked are you guys for next year? My guess is your visibility is obviously getting better as you get closer there.

Do we expect more orders here in the second half of the year? Given that I think your book-to-bill is still below 1 in thermal, but the pricing is obviously picking up very nicely, showing the market is tightening, which is a positive.

But I guess how -- can you give us a sense as to how booked you are, if we were to just assume a flat growth year in turbines? How booked are you for next year?

Jeff Immelt *- General Electric Company - Chairman, CEO*

Sure. I don't have the exact turbine number, but I would say right now our business is about flat with what we normally would see in terms of booked orders, and we are about normal on commitments or things that the team is working, as you look to a flat year in gas turbines for next year. We are going to have that big infrastructure meeting in September, and we will give you a nice update there, I would say.

Steve Tusa *- JPMorgan - Analyst*

I mean that should grow, right, next year, I would think? That's got to be part of your --

Jeff Immelt - ***General Electric Company - Chairman, CEO***

I think we will be up a little bit, Steve, but it is still early. I would say the commitments are still early in the process. But I still think the overall market is firming.

Steve Tusa - ***JPMorgan - Analyst***

Great, thanks.

Operator

Scott Davis, Barclays.

Scott Davis - ***Barclays Capital - Analyst***

Good morning. Guys, can you give us a little bit of color on the timing and why John Krenicki is leaving with the re-org?

Jeff Immelt - ***General Electric Company - Chairman, CEO***

You know, Scott, John and I have been working on this for -- I don't know, six or nine months. I think with all the acquisitions and everything, we had kind of a $50 billion company within a company.

I think from our standpoint really as an operating company, I think the idea to get a little bit faster and more focused on those three businesses seemed to be a logical position. And I think John saw it the same way.

We discussed him taking other roles inside the Company, subsequent roles inside the Company. I think his sense is that it is a good time to think about other things that he can do.

John and I have worked together for 25 years. I think this is just one of those natural evolutions in GE that we do as time goes on to better match up with the markets. The business itself is in very strong shape, and in some ways that makes change easier.

Scott Davis - ***Barclays Capital - Analyst***

Okay, fair enough. One of the questions we get quite a lot, Jeff, is where you guys want to be in mining longer-term. Maybe this is a good time to talk about what you want to be, what your strategy in mining is, and where -- what's the end-game? Where do you want to be, and how do you get there?

Jeff Immelt - ***General Electric Company - Chairman, CEO***

You know, Scott, what I would say is that you've got positioning around -- we already have a big business in propulsion. We've already got a pretty big business in power conversion around the mine. It is a -- fits our footprint from a standpoint of product service, global footprint, energy, water. So we have a nice package of products for it.

I kind of look at it the same way I looked at Oil & Gas 10 years ago. I don't see doing big acquisitions. I think we can grow sequentially.

So I would look at it as a good additional segment where we are about $2 billion in revenue a year. We can grow probably 10% in an orderly way, relatively high margins, and do it over time. It is a nice way to leverage our footprint.

But I don't think you are going to see anything big or a sudden from us as it pertains to mining. I just think we look at it as a sequential build.

Scott Davis - ***Barclays Capital - Analyst***

Sure, okay. Thanks. I'll pass it on. Thank you.

Operator

Terry Darling, Goldman Sachs.

Terry Darling - ***Goldman Sachs - Analyst***

Thanks. Good morning. Hey, guys, wonder if you would talk a little bit more about your margin confidence, both for the second half and for '13.

I guess in the second half, Aviation is pretty locked and loaded. But maybe you can come back to the execution challenge on the ramp-up in Wind volumes and how you feel like the supply chain is looking in that context, to start.

Then, Jeff, on 2013, talking about 100 basis points of expansion there, maybe you can talk a little bit about what you see as the drivers there and how contingent that is on the global macro growth rates implied.

Jeff Immelt - ***General Electric Company - Chairman, CEO***

So, Terry, again, I think if you go back to EPG we said 30 to 50 basis points this year, and 100 basis points in total over '12 and '13. Right? I think that is still the way we look at it.

So if you take a look, we go positive in Q3. Energy drives a big chunk of that. I think we are hitting our sweet spot a little bit in Energy, and we see that to be very strong.

We also see good expansion in our Transportation business. We have some easy comps in Home & Business Solutions that make margin enhancement there actually relatively easy.

Keith talked about the Aviation margin outlook. In Healthcare we had some execution issues that shouldn't repeat going into third quarter, so I see Healthcare going positive in Q3 as well.

So we will have basically four of five segments positive in Q3, with Energy actually very strong in that context.

Then if you think about the big levers we have got, we've got value gap, Terry. I think value gap is positive and will remain positive going into '13.

You've got service margins. Service margins continue to be positive both this year and next.

We've got simplification. You have seen what our goals are in simplification, and we are going to continue to work at the GE footprint.

And then you've got product costs. I have got a ton of projects going around the Company to get our product costs down.

So I think on the macro side, we prepared ourselves for a pretty tough year this year, or certainly a volatile year. We haven't been disappointed. We have seen that volatility play through particularly in Europe. And we are going to be equally prepared when we you think about '13.

So I would see margin expansion this year between 30 and 50 basis points. And then next year, I think that will make up for the total of 100. So between let's say 50 to 70 basis points next year.

And then you're going to have between, let's say, '13 and '11 you're going to have at least 100 basis points of expansion over that time period. I actually see that turning the corner and I think third quarter is going to be pretty good.

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

The close in the second quarter, and if you look at the margin performance in Energy and the margin performance across the portfolio, down 20 basis points versus the first quarter down more than that, down 50, I feel really good about the progress we're making.

And we turned the value gap positive. As Jeff said, R&D as a percent of revenue has gone into a positive. Total cost productivity is positive.

And the only issue we are wrestling with is the service equipment mix here in the second quarter. That is a good news problem for us.

So we have made a lot of progress on it, and then the cost-out I think is the adder that you're going to see us really kick in as we get into '13.

Terry Darling - ***Goldman Sachs - Analyst***

So confidence in the margins, despite the softer macro out there. More Company-determined factors in the mix here, I guess; and obviously that is quite positive.

In terms of the macro impact on your thinking on orders over the balance of the year, has that softened up a little bit presumably? Or is there more Company-determined self-directed share gains and so forth there?

I think at one point you had been thinking double digits. We're 8% through the first half. How are you thinking about that?

Jeff Immelt - ***General Electric Company - Chairman, CEO***

I think, you know, Terry, I think our orders -- we basically have said that our organic revenue target is up 5% to 10%. Our orders growth basically supports that.

I would expect our orders to continue to grow for the year. I think FX-adjusted in the high single digits or in that range as the year goes on.

But we built an incredible backlog over the last period of time. So we've got a big equipment and service backlog, and so we have run positive book-to-bill ratios for a long time. So I think some of that has to be factored in as well in terms of when you look at new orders.

Terry Darling - ***Goldman Sachs - Analyst***

Okay. Then just lastly to clean up on WMC, I guess two parts. One, the statute of limitations comment, Keith; you're thinking end of this year is statute of limitations on, what, the '06 vintages? So that is why this doesn't look like it has a long tail?

Then did I hear the reserve really didn't change a whole lot even though the claims went up dramatically? Maybe I missed something there, but can you explain that?

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

Yes. The statute of limitations -- I'm not giving any legal advice, but the limit that we are seeing that people are reacting to is six years. So you're right in terms of the timing. By the end of this year, that gets down to very small numbers of mortgages that are out there past that period. And that, it seems to be what drove the spike in the claims that happened in the quarter.

Our reserve did increase dramatically. It went from $140 million at the end of first quarter to $491 million at the end of the second quarter, Terry.

Terry Darling - ***Goldman Sachs - Analyst***

But the $491 million relative to -- what were the claims in the quarter?

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

Well, we had -- the claims balance was $562 million at the end of first quarter. It went to 2.7.

I think the thing that you can't see in that, our reserve balances anticipate future claims -- Incurred But Not Reported, it is called. So at the end of the first quarter, the balance of reserve relative to $562 million had some future claims estimates in there.

At the end of the second quarter we have increased that estimate of future claims. It is not quite -- it is less than 100% of the known claims balance, but it is a significant number.

Terry Darling - ***Goldman Sachs - Analyst***

So do we just on disc ops -- EPS from disc ops or loss from disc ops for the balance of the year, presumably that number goes a little higher as we move into the back part of the year?

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

Well, we think we have reserved appropriately. I think the problem is that you just have to watch these long-tail liabilities.

We have an anticipate -- we anticipate a significant additional amount of claims in WMC. We will have to see how we do against that. And in Grey Zone, we need to see those claims decline as we go through the second half of the year. Right now, we believe we are appropriately reserved.

Terry Darling - ***Goldman Sachs - Analyst***

Okay. Thanks, guys.

Operator

Shannon O'Callaghan, Nomura.

Shannon O'Callaghan - ***Nomura Securities - Analyst***

Morning, guys. Hey, so, Keith, maybe could you walk through maybe the big components of the $555 million year-over-year increase in real estate?

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

Sure. If you look at the variance on earnings -- let me get the right numbers for you. Lower marks and impairments, so we had $7 million of credit costs. And on a variance item versus last year, that is a couple hundred million dollars of benefit, $256 million on marks and impairments.

We also had -- last year we had Real Estate losses that were not tax effected. So that was something that increased probably the one-time benefits in there a little over $100 million in the quarter for Real Estate.

And, the base income is better from the core business on earnings on both the debt and the equity portfolio. I mean at the end of the day, when you look at it, what really has happened is when you go -- do you look -- global valuations, we did not have declines in valuations on the debt or the equity book; and that just changes the profile of our earnings in Real Estate.

And then you earned a little bit by selling some properties and having some gains.

Shannon O'Callaghan - ***Nomura Securities - Analyst***

So I mean relative to this, you said the tax rate didn't run through that? I mean the tax (multiple speakers) ?

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

No, the sale of BP is not in here; but last year we had losses that were not tax effected. And as a result, this year by having none of that you have an improvement year-over-year in taxes (multiple speakers).

Shannon O'Callaghan - ***Nomura Securities - Analyst***

Okay, but sequentially moving forward it doesn't sound like there is anything that unusual in this 220 number?

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

I think you're plus or minus $50 million, $70 million on a run rate from taxes. Other than that I think if we don't have any valuation changes, and you continue to see the market where we are, we feel pretty good about the outlook for the business.

Shannon O'Callaghan - ***Nomura Securities - Analyst***

Okay. Then just on the pricing in Energy, so you know -- the gas and wind turbines down on units, but the pricing up. I mean last year the pricing was down a bunch in those segments, particularly in 2Q. Was there -- was some of this easy comp, or was it mix? Or does that all feel real to you?

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

Help me out with what you are on. Are you on orders or sales?

Shannon O'Callaghan - ***Nomura Securities - Analyst***

I'm on orders. So I think you said up 5 last year. There were some significant order pricing declines (multiple speakers) orders.

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

Oh, absolutely.

Jeff Immelt - ***General Electric Company - Chairman, CEO***

You know, Shannon, I think there is always some mix pulling through this. And I am not sure that it's going to be up 5 forever.

But I do think we have seen it firming in commitments. We have seen that starting to flow through. And I think we expect a decent pricing environment going forward.

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

I mean you can see it swinging, right? As you said last year Q1, Q2, Q3, down 6, down 10, down 7 on thermal. Q1, Q4, down 12. Q1 was down 1; Q2 was up 5.

You know, our estimate for the year right now is it should be somewhere around flat. But it has definitely changed the dynamics of supply and demand here on pricing for us.

Shannon O'Callaghan - ***Nomura Securities - Analyst***

Just a last clarification for me. You offset the lower tax rate in the quarter with restructuring. GE Capital now is going to be lower for the whole year. Are you going to ramp restructuring to offset the incremental benefit, or how is that going to work?

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

Well, it is in the GE Capital run rate now; you're somewhere in the mid-single digits. So the disconnect in the quarter was the Capital benefits of tax were in GE Capital, and the restructuring was mostly in Corporate.

But right now it will be in the Capital run rate at somewhere in the mid-single digits.

Shannon O'Callaghan - ***Nomura Securities - Analyst***

So for the second half, we now have a lower Capital tax rate than we assumed before. Are you going to offset that 5% difference with some more restructuring? Or is it just going to flow through?

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

I don't have it planned that way. We are looking at restructuring associated with the cost-out, and we are evaluating what we can do to continue to accelerate the actions to simplify the Company and improve our margins. So there are activities we're working on, but we don't have it planned that way, Shannon.

Shannon O'Callaghan - ***Nomura Securities - Analyst***

Okay. Thanks a lot, guys.

Operator

Deane Dray, Citi.

Deane Dray - ***Citigroup - Analyst***

Thank you. Good morning, everyone. For GE Capital and specifically commercial lending, can you comment on net interest margin on new business being written versus business that is rolling off?

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

I don't have that number, Deane. I will have to have Trevor get back to you with it.

Jeff Immelt - ***General Electric Company - Chairman, CEO***

But I think the net interest margin is very positive. Like most of the metrics, Deane, around margins are improving. But I think we can get you --

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

For CLL (multiple speakers)

Jeff Immelt *- General Electric Company - Chairman, CEO*

Yes, we can get you what the flow-through is.

Deane Dray *- Citigroup - Analyst*

Do you have it broadly for Capital? Because that had been a data point in the recovery that we saw significantly better net interest margin (multiple speakers).

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

Well, it's up 50 basis points year-over-year.

Jeff Immelt *- General Electric Company - Chairman, CEO*

Yes, I think NIM captures some of that I think, Deane.

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

Sure.

Deane Dray *- Citigroup - Analyst*

Okay. Then on the Tier 1 common, just to make sure I have the math right. With the resumption of the dividend, that does put some pressure on Tier 1, maybe by 20 basis points or so. But can you calibrate the impact there?

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

Well, the earnings more than offset it in the capital ratios. If you look in the supplemental charts that we sent out, there is a breakdown of the impact on the Tier 1 ratios from earnings growth, foreign exchange, and dividends.

Deane Dray *- Citigroup - Analyst*

Then lastly, Keith, can you comment on how the tax benefits should help provide some ability to take down GE Capital assets faster? Would that be towards the red assets? And is that still about $80 billion in expectations for the balance of the year?

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

Yes, I think the example we're using here is Business Properties. We had an opportunity. We have a negotiated transaction to sell $5 billion of Real Estate assets.

The fact that there is a tax benefit associated with the structuring enables us to remove $5 billion of assets that are earning around $50 million. So it is just a one-time transaction and it's an example; but I mean for us, shrinking $5 billion of Real Estate is a good move strategically for the GE Capital business.

Jeff Immelt *- General Electric Company - Chairman, CEO*

You know, Deane, if you think back over the last three years we have beat every commitment on the size of GE Capital. And one of the things I said at EPG is that I think we are all aligned behind it, to continue to make GE Capital smaller and more focused. We are going to continue to do that, and I think BP is a good transaction for us.

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

The red ending net investment is about $75 billion. It is down 17% year-over-year, and the BP transaction is a good example of the team continuing to do a good job of running these assets down.

If you look at the supplementals you can see the dividend was 60 basis points on the Tier 1. The earnings added 30 basis points. And that is pretty much why we went from 10.1% to 10.4% from Q1 to Q2.

And even with that, though, if you look year-over-year, we are at 10.1%, a full point up -- even with the dividend -- on Tier 1 common.

In addition when you look at total capital, the preferred stock that we issued enabled us to build our non-common Tier 1 capital and still enabled us to pay a dividend of $3 billion to the parent to keep the capital ratios above what we think we need to have.

Deane Dray *- Citigroup - Analyst*

Great. Thank you.

Operator

Steven Winoker, Sanford Bernstein.

Steven Winoker *- Sanford C. Bernstein - Analyst*

Good morning. Hey, so first question on the order growth rates. How much -- to what extent did acquisitions contribute at all to that number? What would it have been organically?

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

Total it is about 2 points.

Steven Winoker *- Sanford C. Bernstein - Analyst*

2 points?

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

Yes. Most of the acquisitions now as you get through the second quarter are all in the run rate.

Jeff Immelt *- General Electric Company - Chairman, CEO*

It was -- and FX was what? About --?

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

2 points.

Jeff Immelt - ***General Electric Company - Chairman, CEO***

2? So about 2.

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

Yes.

Jeff Immelt - ***General Electric Company - Chairman, CEO***

So it was kind of flattish.

Steven Winoker - ***Sanford C. Bernstein - Analyst***

Okay. Then on the GE Capital reserving front, I think that was page 9 in the supplemental. You talk about the environment continuing to improve; reserves coming down to 1.86% now from I guess 2.26% in the second quarter of '11.

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

Right.

Steven Winoker - ***Sanford C. Bernstein - Analyst***

Just give us a sense maybe on the environmental side. You know, I mean obviously a lot of this is driven by the US and by your activity that you are seeing. But at the same time we are seeing so much uncertainty and volatility globally, and with what is going on in Europe.

You guys have a fair bit of assets over there, so how are you thinking about this? Being able to take reserves down relative to (multiple speakers)

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

No, the reserves aren't being taken down. The write-offs are in excess of the reserves. We had about $100 million of impact on the balances of reserves from FX.

But we are -- if you look at the numbers by business, the delinquencies are down in every single set of our operations except for the mortgage, which is up seasonally. Non-earnings are down in every single one of our businesses. Our write-offs are down in every single one of our businesses. Quarter-over-quarter and year-over-year for all three of those metrics.

So we continue to have a portfolio that shows improvements in its performance. And I think you are getting to run rate levels of new provisions on new business.

The only thing that will change that will be the mix between retail, which obviously has higher reserve levels than the commercial, which has lower reserve levels.

Steven Winoker - ***Sanford C. Bernstein - Analyst***

But are you seeing -- the question is in terms of the progression through the quarter maybe, or any kind of risks as you look out, where you feel like that provision rates is in any way at risk as we head into what is potentially a more difficult macro environment?

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

Well, we have been in that environment for quite some time in Europe. I think the team has had to take a lot of operating actions, right?

We have been very prudent from a risk perspective on increasing our underwriting standards. We have lowered our open lines on credits that were less creditworthy. In Europe, I mean, it is a full-court press from the risk team about reducing our exposures in places where we don't want to have them.

We had to add reserves and take some provisions in Italy. I think that is a tough place.

A previous quarter we had some in Hungary, but that stabilized. That was really a legislative change on mortgages.

We are watching the Spain consumer business. That is obviously a tough place.

But things like the UK continue to perform. The non-earnings are down, delinquencies are down. Delinquencies are up a little bit seasonally, but not any -- they are less than what normally we would have.

And the main drivers as we shrink that book, the non-earning assets and the delinquencies are a higher percent. It is not that they are going up in terms of dollars.

So I think the risk team has done a really good job in cooperation with the operating team. But right now we are at sort of run rate levels. If we have specific things that happen, we will reserve more.

The biggest change you are seeing across this portfolio was obviously the improvement of Real Estate values globally, both debt and the equity book in the quarter. From a valuation perspective on the work that we did on the assets that were covered, had increases in the valuations. That is the first time in years versus pressure we've had in the equity and the debt book for almost four years here, Steve.

Steven Winoker *- Sanford C. Bernstein - Analyst*

Okay, that's helpful. Then just maybe a last comment on China. What are you guys seeing a little more broadly in terms of demand over there and that trend, given the --?

Jeff Immelt *- General Electric Company - Chairman, CEO*

You know, Steve, we're in a little bit of a different sequence because we are more long-cycle-oriented stuff. So I think the revenue was up 20% plus in the quarter. Orders slightly below that, but still pretty strong.

And Healthcare is very strong. There is a conversion between coal and gas in the power sector. There is the -- Aviation remains pretty strong.

So we are on more -- we're not on the short-cycle side. We are more long-cycle driven in China, and we still see a decent environment for (multiple speakers).

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

Just give you some numbers. The revenue was 1.4; it was up 24%, as Jeff said. If you look at the Energy it's up 34%; Aviation was up 26% in the quarter; Healthcare was up 24%.

The orders are a little slower. They are up 6, but there are also -- a lot of -- some of the backlog is what we have there. So this is a pretty good performance. We expect a very strong performance across the year for China.

Steven Winoker *- Sanford C. Bernstein - Analyst*

Okay, great. Thank you.

Operator

Julian Mitchell, Credit Suisse.

Julian Mitchell *- Credit Suisse - Analyst*

Yes, firstly on Energy, it is a fairly odd disconnect where your service orders are down and the pricing on the equipment is up. Is there some risk, I guess, that you had a big catch-up on service spares, and that has now run out of steam? Because I guess the improving fundamentals behind equipment orders and therefore pricing you would think should reflect in service as well.

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

I don't think there is any risk of that. I think what we saw in the business in the quarter from an orders perspective were that the customers are running their gas turbines as a result of the low natural gas pricing. If you look at the revenue in Energy in services it was pretty solid in the quarter.

So our team has a positive outlook as a result of the current operating environment. And for us it is a question of when does it come through.

Julian Mitchell *- Credit Suisse - Analyst*

Okay, thanks. Then on the Healthcare, I guess that was the business that had pricing down. How worried are you about the ability to drive earnings up year-on-year in the second half? I understand that the Latin American mis-execution normalizes; but pricing is running at what? Minus 1.5 (multiple speakers)

Jeff Immelt *- General Electric Company - Chairman, CEO*

You know, Julian, pricing is about -- that is just kind of the nature of the business because a little bit is on the -- you're a little bit on the computing learning curve. So that has been kind of the nature.

The CM rates are still pretty strong, and I think in some ways it's a little bit of apples and oranges. So I think we see a US Healthcare market that is kind of flat, maybe up a couple points. As Keith said, Europe is very tough, but the emerging markets in Healthcare are pretty dynamic.

So I think at EPG we said Healthcare would be 1-plus to 2-pluses, so up single to double. We still think Healthcare is going to have a good, solid second half of the year.

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

You know, the orders if you look at the book-to-bill in the quarter were 1.11. At the half, it is 1.08.

They built a little bit of backlog. They need to execute. That is what we're looking for in the second half here, Julian.

Julian Mitchell *- Credit Suisse - Analyst*

Great, thanks. Then just finally, the Industrial CFOA was down year-on-year on Q2. Is that just around working capital relating to Wind orders, or --?

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

It was really two things. We had about $200 million of pension funding; we haven't had that before. We expect that to be about $400 million for the year.

But as you know, in the K we put out it was going to be $1 billion for the year. So $600 million better for the year than we said.

And then we just built inventory. We built $1-billion-plus of inventory in the Energy business, and as you said it is mostly related to the Wind.

THOMSON REUTERS

In the second half here we are going to deliver close to 1,800 to 2,000 Wind units, almost the full amount of volume we had for all of last year. So we've got a good outlook here in the second half in Energy, and Wind is going to be a big part of it.

Jeff Immelt - ***General Electric Company - Chairman, CEO***

Let me just go back to what Keith said on pension just to make sure you guys understand it. So originally I think our funding for this year was going to be $1 billion.

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

$1 billion, yes.

Jeff Immelt - ***General Electric Company - Chairman, CEO***

Now it is $400 million, so that is $600 million better. And I think we put in the K for next year --

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

$2.1 billion.

Jeff Immelt - ***General Electric Company - Chairman, CEO***

We put $2.1 billion.

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

Could be $200 million.

Jeff Immelt - ***General Electric Company - Chairman, CEO***

Now we think that is going to be --

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

$100 million.

Jeff Immelt - ***General Electric Company - Chairman, CEO***

-- extremely small. Maybe less than $100 million. So that's a big benefit in cash over the next two years that investors should understand.

Julian Mitchell - ***Credit Suisse - Analyst***

Great, thanks.

Operator

Jason Feldman, UBS.

THOMSON REUTERS

Jason Feldman *- UBS - Analyst*

Good morning. So, regarding the discontinued operations charges, WMC and GE Money Japan, are there other divested finance assets where there is still recourse or retained liability that have the risk of popping up like this? Or are these really the two big ones that are out there?

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

These are the two.

Jason Feldman *- UBS - Analyst*

Okay. On Wind, obviously it is challenging today. It's a cyclical market, and the production tax credit expiring.

But how do you feel about that business longer term, given changing economics with low gas prices and a fairly crowded competitive environment in Wind?

Jeff Immelt *- General Electric Company - Chairman, CEO*

You know, we said that the next year we anticipate $0.03 down versus this year in Wind. So we are kind of getting ready for that.

The industry is reforming outside the United States right now. So we have got some big orders in places like Brazil and Canada and Australia, Turkey, places like that.

We have navigated the cycles as well as anybody. I think we probably make as much money as the rest of the industry combined or something like that. And we have a pretty good window on the future, so we haven't --

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

Return on capital is almost infinite here.

Jeff Immelt *- General Electric Company - Chairman, CEO*

We haven't over-invested, we've got a very flexible supply chain, and so I think we are just going to ride the wave. But we do think that it's $0.03 headwind next year, and we are already taking actions to be able to offset that.

Jason Feldman *- UBS - Analyst*

Okay. Then lastly, you mentioned the potential $5 million of Real Estate divestitures. There was the EverBank deal a couple of weeks ago.

Has the environment for potential asset sales improved materially recently? Or is it just now is the right time and you've had unique opportunities and are simply taking advantage of what is out there?

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

Sure, it's a steady improvement. You have seen us talk about the valuation changes in Real Estate quarter-to-quarter-to-quarter, and this is just another sign that the market is getting better. We were able to move $5 billion of Real Estate assets at a gain to the Company in total. And the team is going to continue to work on that.

So I think yes, valuations have continued to improve. Liquidity is coming into the marketplace. If you've got a good property with a decent lease you can extract a good price in this low interest rate environment.

Stabilization of valuations in Europe -- the valuation in Europe was better than we anticipated as we closed the first quarter. And we expect that to continue.

Jason Feldman - ***UBS - Analyst***

Great, thank you.

Operator

Christopher Glynn, Oppenheimer.

Christopher Glynn - ***Oppenheimer & Co. - Analyst***

Thanks, good morning. Question on the different margin factors in the back half of the year. Year-over-year and versus the one half. We are looking at volume leverage, better price flowing through, and the anniversary of the acquisitions. Can you gauge what are the relative imports there?

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

Sure. I think Jeff said it. Value gap is going to be positive. That is the difference between the pricing we are getting and the raw material inflation that we experience, or deflation. That is positive 100 in the second quarter. We expect that to continue.

R&D as a percent of revenue we have talked about that a lot. We have peaked as a percent of revenue. We still are at a very high level in terms of percent of revenue, but it's peaked in terms of the impact on margin.

Our total cost productivity, which is our ability to continue to deliver new volume and take advantage of leverage, was positive 0.4 in the second quarter. We expect that to continue.

And the one dynamic that we are working our way through is the equipment and service margin mix. And as Jeff said, we expect margins to go positive in the third quarter, and will be positive in the fourth quarter. To get to the 30 basis points we need an average of about 80 basis points in the second half, and that is what our teams are working on right now.

Christopher Glynn - ***Oppenheimer & Co. - Analyst***

Okay. Then on the turbine Flex launch in the second half, how are you viewing that now? Is that impacting current demand? And how do you view the lag to regaining some share and competitive parity?

Jeff Immelt - ***General Electric Company - Chairman, CEO***

You know, Chris, I think the Flex launch is going well. We've had some great wins in Japan in the second quarter that were fantastic.

And I still think our gas turbine share is going to be somewhere between 40% and 45%. So we want to retain historical averages for that, and we will continue to invest in new NPI in the gas turbine product line as well.

So, again I think this is really important for us and Flex has gone well. And I think you will continue to see strong NPI efforts from GE.

Christopher Glynn - ***Oppenheimer & Co. - Analyst***

Great, thank you.

Operator

Jeff Sprague, Vertical Research.

Jeff Sprague *- Vertical Research Partners - Analyst*

Thank you. Good morning, guys. Hey, I guess I really don't understand your pension funding strategy. I mean I understand the obligation has gone down under this law change.

But your annual benefits payable, like $3 billion a year, other companies have remarked -- yes, the law has changed but we don't want to let ourselves get further behind. Just kind of surprised, the posture you are taking there.

What -- how do you see pensions playing out then as we look further beyond 2013?

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

Well, we have taken a lot of actions here. I think the most important action that we took was we closed the plan to new employees, Jeff. You may not be aware of that, but as a result of that action the change in the future liability is dramatically -- the curve has dramatically changed. It is a huge amount of pressure we have taken off that pension plan in terms of the earnings rate that has to be realized over time.

I think the benefit payments are less than what you talked about. I don't have the exact number, but it is not as high as what you said.

And our team is working on a risk-reduction strategy. We are not going to full risk-reduction in terms of going 100% to risk off and bonds; but we are reducing our risk-seeking exposures as we become additionally more funded from an ERISA gap perspective.

So the team has got a good asset allocation plan. They've got a good track record on returns. We have cut the future tail of this liability by closing the plan to new employees.

You know, we were going to fund $1 billion this year, we were going to fund $2 billion next year. Our anticipation, we will be fully funded in a couple years.

This change in ERISA funding doesn't really change our outlook much on what we think we are going to do in terms of how we get to fully funded in that pension plan. And we are not seeking additional risk to do it.

Jeff Sprague *- Vertical Research Partners - Analyst*

All right. I was just looking at the annual report that says $3 billion in 2012 and actually shows it going up the next four or five years, not down, but --

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Keith Sherin *- General Electric Company - Vice Chairman, CFO*

I don't think that is $3 billion. That includes all our healthcare costs, that includes retiree and employee healthcare costs. It is about $1 billion on pension, Jeff.

Jeff Sprague *- Vertical Research Partners - Analyst*

Okay. It says principal pension plan.

Just on GECAS, obviously all the NEOs and everything were so new last year that there was no impact, and obviously you're going to roll up your sleeves in Q3. But you obviously gave us a heads up to be on alert for this. Is there some early thoughts on what we should expect?

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

I don't have any signal from the team of anything unusual. We continue to reduce our exposure to older assets, as you know. And we have taken some impairments quarter by quarter by quarter on some of the older assets that are less fuel-efficient.

Our fleet is in pretty good shape in terms of that, the percent of older assets. And I don't anticipate anything abnormal here in the third quarter, Jeff.

Jeff Sprague *- Vertical Research Partners - Analyst*

Right. Thank you very much.

Operator

Nigel Coe, Morgan Stanley.

Nigel Coe *- Morgan Stanley - Analyst*

Thanks, good morning. Just wanted to turn attention to Energy margins in 2013. I think everyone knows that Wind is going to take a bit of a step down in 2013. How confident are you that you can maintain margin or even grow margin with, let's say, $2 [million] less volume?

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

Well, just on a Wind basis alone, if you remove the Wind business at the margin you're going to have a margin increase.

Jeff Immelt *- General Electric Company - Chairman, CEO*

That's cheating. But that's --

Keith Sherin *- General Electric Company - Vice Chairman, CFO*

Well, that's reality. I mean we're getting penalized for this year, Jeff, but we're not going to have it next year.

Jeff Immelt *- General Electric Company - Chairman, CEO*

Well, let's step through it. Let's (multiple speakers) again. Value gap positive; so you're going to have pricing ahead of deflation. We see pretty good headwind on that.

I think we're going to have a good services mix next year. I think we like the way services could line up for next year.

Structural costs down. Again you're talking about -- you know, guys, I would reiterate; we have said we're going to take $2 billion of costs out in '12, '13, and '14. And we are on our way to doing that.

That is going to take -- G&A as a percentage of revenue is going to go down a couple hundred basis points around this place. So you're going to get some structural cost out.

So you're going to have good value gap, you're going to have positive mix, you're going to pretty good service, and you're going to have structural cost down. I think that is a pretty good line-up.

Nigel Coe *- Morgan Stanley - Analyst*

Right, but looking at Wind in itself. I know it's a highly variable cost business. If we go down from, say, 7 to, say, 5, what happens to Wind margins next year?

Jeff Immelt - ***General Electric Company - Chairman, CEO***

Oh, I would bet that Wind -- just intra-Wind, right, Nigel? That's what you're asking?

Nigel Coe - ***Morgan Stanley - Analyst***

Exactly, yes.

Jeff Immelt - ***General Electric Company - Chairman, CEO***

Yes, Wind margins will probably go down a little bit. But it's really a de-verticalized business, and so I think it's not going to be what you'd think. But just because of the volume we have this year, my hunch is that the margin rate just intra-Wind will probably go down slightly.

Nigel Coe - ***Morgan Stanley - Analyst***

Okay, and then moving to the broader Energy business, the move back to positive pricing on orders is great news. Can you just remind us, what is the lead time on pricing in the order book? When do we start to see that coming through the P&L?

Jeff Immelt - ***General Electric Company - Chairman, CEO***

Next 12 to 18 months.

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

(multiple speakers) 18 months, yes. By product line.

Nigel Coe - ***Morgan Stanley - Analyst***

So 1Q '13? And then, stripping out Energy management, so that is a $6 billion BU, I think; will be a smaller segment by far. Is the intention to grow that?

If were thinking about the sources of acquisition funding going forward, should we view Energy management is up there, top one or top two?

Jeff Immelt - ***General Electric Company - Chairman, CEO***

I think there are segments within Energy management, Nigel, that we like, that we might do some of the smaller acquisitions in. I think the key thing is again to give investors kind of a pure-play on the power generation side, a pure play on the Oil & Gas side, and a pure-play on the Energy management side.

I think that is what many people have been asking for, and that is what you are going to get in the structure.

Nigel Coe - ***Morgan Stanley - Analyst***

Okay. Then just finally, I don't want to get too deep in the weeds of Corporate expenses. But it's a tough line to model, and it seems to be running above the $3 billion ex-pension guidance for fiscal '12.

Are we still running towards that, Keith? Or should we expect that to come down in the second half of the year?

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

Say that again?

Jeff Immelt - ***General Electric Company - Chairman, CEO***

The $3 billion Corporate; and we still running to the $3 billion Corporate for the year? (multiple speakers)

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

Yes, $3 billion Corporate for the year, yes. You're about $1.5 billion at the half, and there are some ups and downs on one-timers, but that is the estimate for the year, yes.

Jeff Immelt - ***General Electric Company - Chairman, CEO***

Yes.

Nigel Coe - ***Morgan Stanley - Analyst***

Got it. Thanks a lot.

Keith Sherin - ***General Electric Company - Vice Chairman, CFO***

I just want to -- the pension out of the Trust is about $3 billion. I'm sorry, Jeff, you - Jeff Sprague. Sorry about that.

Trevor Schauenberg - ***General Electric Company - VP Corporate Investor Communications***

Chanel, we're a little over our hour. Why don't we take one more question and then close out?

Operator

Steve Tusa, JPMorgan.

Steve Tusa - ***JPMorgan - Analyst***

Hey, sorry, I just had a follow-up. So on the Energy services, decline in orders -- what you are saying is they are running their plants so you are not seeing the normal pace of orders. I guess that would suggest that I mean at some time they have got to service these things if they are running them for longer hours. So is that actually -- that's actually a push-out (multiple speakers) business ?

Jeff Immelt - ***General Electric Company - Chairman, CEO***

Yes, I think, Steve, like the flow orders that would tend to happen in shutdowns and stuff like that are slower, because the guys are running the plants. So I think that's --

Steve Tusa - ***JPMorgan - Analyst***

But that has got to come at some point, right?

Jeff Immelt - ***General Electric Company - Chairman, CEO***

Good news. Again, with cheap gas prices everything we have thought about this is true. Guys are running their plants hard, and they are pushing out service and stuff like that. And I think that will come back at some point.

Steve Tusa - ***JPMorgan - Analyst***

Right, right. Okay. I just wanted to clarify that. Thanks a lot.

Operator

No further questions at this time. Mr. Schauenberg, do you have any additional remarks?

Trevor Schauenberg - ***General Electric Company - VP Corporate Investor Communications***

Yes. Thank you, everyone. The replay of today's webcast will be available this afternoon on our website. We are distributing our quarterly supplemental data schedule for GE Capital as we always do today.

Just a couple, few announcements here regarding investor events. Jeff Immelt will be hosting a GE Infrastructure Investor Meeting which will include all of our Infrastructure business leaders. The meeting will be held on Thursday, September 27 in the New York City area. More details regarding the event will be sent in the upcoming weeks. We hope everyone can make it.

Finally, our third-quarter 2012 earnings webcast will be on Friday, October 19. As always, we will be available to take your questions today. Thank you, everyone.

Operator

Ladies and gentlemen, that concludes the presentation. Thank you for your participation. You may now disconnect. Have a great day.