

Rheinmetall AG
Investor Relations
Conference Call Q2 2018
Transcript



Publication: 07:30 CET
Conference Call: 2 August 2018, 14:00 – 14:52



Content

	Contribution	Course	Duration (min)
	Presentation - Begin	00:00:24	
	Presentation - End	00:18:33	18:09
	Questions:		
1	Sven Weier , UBS AG	00:19:14	8:55
2	Christoph Laskawi , Deutsche Bank	00:26:37	3:38
3	Christian Cohrs , Warburg Research	00:30:27	4:57
4	Florian Treisch , MainFirst	00:35:34	2:40
5	Zafer Rüzgar , Equinet Bank	00:38:34	1:37
6	Harald Eggeling , Oddo BHF	00:40:25 00:51:44	0:14 0:34
7	Richard Schramm , HSBC	00:41:00	4:31
8	Sebastian Growe , Commerzbank	00:45:38	5:58
	End	00:52:46	

Rheinmetall AG Conference Call

00:00:01 Operator

Good afternoon ladies and gentlemen, and welcome to the Rheinmetall AG Conference Call regarding the half year results 2018. At this time all participants have been placed on a listen only mode. The floor will be open for questions following the presentation. Let me now turn the floor over to your host, Mr. Helmut Merch.

00:00:24 Helmut Merch

Good afternoon, ladies and gentlemen. A warm welcome from my side to our Q2 earnings call. Thank you all for joining. As usual, we will start with the presentation and then you will have the opportunity for Q&A.

Before we begin, I would like to remind you that during this call, we will give forward-looking statements, which involve risks and uncertainties as detailed in our disclaimer. Let's proceed with the highlights of the second quarter on page number three.

The second quarter came up with a robust set of figures in both segments. We saw operational sales growth of almost 5% to around €1.5 billion. An improvement of the operating results to €107 million which led to a margin improvement of 1.4 percentage points reaching now a group margin of 7.2%. While the general business environment remained positive we saw quite some discussions around macro topics such as global tariffs, potential ramifications of the introduction of new emission testing procedures and the prevailing discussion on diesel to which I will refer later on.

Defence saw a further positive discussion regarding a potential increase of Defence spending culminating in the NATO summit agreement to align with the 2% target. Bottom line we operate in an interesting market and we present a Q2 very much in line with our expectations as presented at the beginning of May during our Q1 call. EBIT of €99 million includes one-off charges for restructuring in the Electronic Solutions division which I will elaborate on later. Last but not least EPS saw an increase of 23% to €1.24. Moving on to page number four.

Group sales rose operationally by 4.7% to roughly €1.5 billion as already mentioned, mitigated by a negative FX accounting for 2.4%. So the reported growth rate is 2.3%. The operating result improved by €23million or 27% including adverse FX of €3 million. Q2 margin gained 1.4 percentage points to 7.2%. Earnings per share increased by €0.23 to now €1.24, clearly reflecting the improvement of our operational performance and the already communicated decrease of our net-interest position. Let me now continue with slide number five.

The dominating effect in the development of our operating free cash flow was the higher increase in the position working capital and others. In total the position accounted for -€210 million with a top effect coming from a higher increase of inventories and lower receipt of prepayments mainly in the Defence segment. The higher build-up of inventory is required to prepare for the planned sales growth in H2. In addition, we received less prepayments in the reported quarter than in the previous year's quarter. As usual, the turnaround of the working capital is expected for later in the year. On the other hand, we maintained strict control on our capex.

Please move on to page number six.

Net debt amounted to -€429 million after -€219 million in Q1. Obviously the requirement to finance the business-related increase of our working capital was the driving factor. Turning to our equity ratio we can report a further slight improvement of 0.2% to 31.2%.

On the next page [number seven] we continue with our segment analysis starting with Automotive. Automotive again showed a quarter with profitable growth, the major driver being the non-Light Vehicle activities. Operationally, sales increased by 3.6% to €740 million. All three divisions had a strong performance and the result with a quarterly margin of 9.2% stood at the same excellent level as in Q2 2017. Operating free cash flow to sales-ratio of 4.9% came in slightly above the target corridor of 2-4%.

Please turn now to page number eight for the analysis on divisional level.

Mechatronics' sales grew operationally by 3.1%, or €10 million to €417 million. Operating results remained essentially unchanged with a double digit margin of 11%. The major reasons for this effect were new assets that entered into depreciation with the expected SOPs [start of production] in the second half of the running year.

The growth in the division Hardparts was completely off-set by adverse FX effects, leaving sales basically on the same level as last year. Ongoing good demand for our bearings business supported the positive margin trend.

Aftermarket had another good quarter and increased sales operationally by 7.5%. Margin remained on a high level of above 9%. Especially, the regions Europe, East and West, and the Americas performed well.

Page nine highlights our regional sales development: Germany was in relative and absolute terms the region with the highest growth, gaining more than 2 percentage points within our sales split. The other region with a positive development was Asia exclusive China. All other regions reported lower sales in relative terms than in the same period last year. All in all,

operational growth lagged slightly behind the global benchmark of 3.9% of Light Vehicle growth.

Please move on to page number 10. Our Chinese activities reported a sound sales development of operationally 9.8%, clearly above market growth of 8.7%, to now €260 million. This development was driven by the sales growth for our engine blocks and light weight structural parts which came along with an even more positive margin development. A mitigating effect was created by the fixed cost increase related to the full accounting of the depreciation of our new pistons plant in Chongqing. Marketwise, we saw some customers delaying product starts into the second half of 2018. Therefore, we expect an acceleration of our growth rate in the next six month. On the backdrop of the current public discussion, we now want take a look at the most prominent risks for our Automotive business.

The summary of this is on page 11.

After last week's meeting between top US and the EU politicians, the big threat of global trade wars seems to be reduced. However, Rheinmetall Automotive is generally prepared for this due to our approach to supply regions mainly from within the region.

To be clear regarding the consequences of the introduction of new emission standards: As of today we have not seen any cancelations of orders by our customers. In case some certifications will fail, we might however experience delays in orders in the last four months of the year. But long-term, our product portfolio is well geared to meet the challenge of emission reduction.

The effect of the declining diesel registration figures can be observed in our sales as well. In the first half of 2018 we experienced a decline in Light Vehicle diesel sales of 7.5%, which we were fully overcompensate with other businesses, especially with commercial diesel sales. Risks from raw material price variations are well addressed by our hedging policy and we have not seen any issues for our key raws regarding availability or margin dilution.

Let's continue with Defence on page 12.

Order intake in Q2 compares to a strong previous year quarter that benefitted from very high German demand. Major orders are expected now for Q3, especially from Australia. We guided for a flat sales development in Q2, but in fact especially Electronic Solution reported a high sales growth which contributed to a segmental increase of 5.8% before FX to quarterly sales of €754 million. Additionally, guidance was given regarding the expected result development in Q2 and here we saw the anticipated profitability increase in our division Weapon and Ammunition on the back of the sales with higher value contribution and the positive leverage due to

high sales in Electronic Solutions and Vehicle Systems. Electronic Solutions set up restructuring provisions for one of its major sites accounting for an one-off €8 million burden for EBIT and Group EPS, likewise. The operating free cash flow mirrors our ambition to prepare for high sales in H2 2018. Therefore, we are increasing our inventory levels. Furthermore, no major prepayments were received lately in contrast to last year.

Let us now have a look at the divisional development on slide number 13.

In Q2, Weapon and Ammunition reported the expected sales and results development. The substitution of the trading contract in Q2 2017 with a volume of €112 million with high margin sales in Q2 2018 yielded the high leverage effect which increased the operating result by €11 million to €23 million. Operating margin jumped from 3.9% to 9.2% in Q2 2018.

Electronic Solutions increased sales by 40% to €197 million and turned around results from minus €1 million to plus €5 million. Biggest support came from Air Defence.

Vehicle Systems raised sales by 11% to €375million after €337million in the previous year's quarter, even as supply chain issues in the truck business were not fully resolved. Further stabilization of the supply chain is expected throughout the year and hopefully done during Q4. As a result of our regular project reviews, a net-positive effect of around €24 million to €30 million contributed to the result improvement. But additionally, we had to write-off capitalized R&D expenses of €24 million after market opportunities for the project turned unrealistic. So all in all we had more or less two operational one-offs, one positive, one negative. The net effect is around €5 million positive.

Consolidation stepped up on higher intercompany profit eliminations.

Moving on to page number 14 for the details of the order situation.

Order intake in Q2 lagged, as expected, behind last year's quarter, which benefitted particularly from high German orders of more than €500 million. As a reminder, this situation was a result of the government's effort to speed up projects before the election. Adjusted for these German orders, Q2 2017 was on a comparable level with Q2 2018. The order intake in Q3 2018 will paint a completely different picture: We are now expecting an order intake of at least €3 billion, the majority of that will come from Australia. Having this in mind and looking for the pipeline in Q4, I could imagine that we will mark a new historical high in order intake for full year 2018 which could be around €5 billion.

As just mentioned, Australia is becoming more and more important for Rheinmetall Defence and especially for Vehicle Systems. Last week the Australian Minister of Defence announced the decision do extent the

existing truck contract from Land 121 phase 3b to phase 5b. This will add another thousand trucks and keep utilization high beyond the initial contract period until 2020. We are very pleased with this announcement as we understand this as a very positive sign of appreciation of our existing customer relation.

Now please move on to page number 16.

At the Paris Eurosatory fair in June 2018, the presentation of the Lynx KF41 was definitely a major event and a strong confirmation of our innovative power. This vehicle, which has been developed by Rheinmetall only offers an attractive value-for-money alternative for a number of nations who currently seek to rejuvenate their outdated infantry fighting capabilities. Rheinmetall has already presented this vehicle in the current Czech tender and offers the vehicle as well in the upcoming Land 400 Phase 3 process which will be started around Q4 2018. Both tenders are highly competitive, but we think that the Lynx is well positioned and will present an attractive alternative.

Please join me now for my concluding remarks on the guidance on page number 17.

On the backdrop of the first half year's performance, we have concluded to refine our full year guidance. Adverse FX developments pose a major challenge in 2018. In total, we are expecting an adverse effect of around €130 million or 2% on top line level compared with last year, equally shared between the two segments. While the guidance for Automotive remains unchanged, the guidance for Defence will see following adjustments: Defence sales growth for the full year is expected now to come in at the lower end of the original guidance at around 12% and with a pronounced seasonality especially in Q4. We have lifted our operating margin guidance for Defence towards the upper end of around 6.5% compared to the original range of around 6-6.5%.

The group level margin guidance, however remains unchanged. Furthermore, we would like to highlight that running Q3 will report a positive one-off on our EBIT resulting from a real estate transaction in the amount of around €31 million combined with a positive liquidity effect of around €50 million. With these remarks, I would like to thank you for your kind attention and I'm now ready to take your questions.

00:18:37 Operator

Ladies and gentlemen, if you would like to ask a question, please press nine and the star key on your telephone keypad. In case you wish to withdraw your question, please press nine and star again. Please press nine and star to state your questions.

And the first questioner is Sven Weier from UBS. Over to you, Mr. Weier.

00:19:14 Sven Weier

Yes, thank you, and hello Mr. Merch.

00:19:17 Helmut Merch

Hello, Mr. Weier.

00:19:18 Sven Weier

Hi. There's a couple of questions just following up on the guidance you've just given.

Do I understand you correctly, that you're expecting 12% Defence growth and 3 to 4% Automotive growth including those 120 million or 130 million currency effect that you see for the year, but obviously before any other deviation that we might see in the currency. Is that a correct assessment?

00:19:47 Helmut Merch

Yes. So these two percentage figures are the expected reported growth rates.

00:19:56 Sven Weier

Good, that's clear. Thank you for that. And then following-up on the comment you made on the order intake, there I would have two quick follow-ups, first of all on Germany. Would you expect the same level of orders from Germany in Q4 as you had last year Q2?

00:20:16 Helmut Merch

No. In the full year 2017, we had around €1.6 billion from Germany, and the full year order intake from Germany will be around €1 billion this year. So we lacked roughly up to €450 million in H1 compared with H1 2017, and we will definitely not recover this difference.

00:20:56 Sven Weier

But the majority of the Germany orders will be in Q4, right?

00:21:00 Helmut Merch

Yes, that's right.

00:21:02 Sven Weier

Because, I mean, adding up what you just said, the 3 billion from Australia in Q3 and then quite a substantial amount from Germany, it could also be over 5 billion, right, what you see for the full year.

00:21:16 Helmut Merch

So that was the first time I guided for the full year's order intake, Mr. Weier. So I would repeat that I can imagine a number of around 5 billion. In case we will be better than 5 billion, we would be very happy.

00:21:36 Sven Weier

Good. And then I was just wondering on the phasing of the orders, because, is it fair to assume that some of the H2 order intake will also be for delivery in '19? Because the reason I'm asking is if you look at the backlog phasing that you have at this point for 2019, it's about 200 million lower than you had at this point last year for 2018. So I would suspect because of all the delays you had, this missing point is still coming in the rest of the year so that overall you will be able to grow yourself next year as well. Is that fair?

00:22:13 Helmut Merch

Yes, so that is a fair assumption. So I think partly order intake of H2 has to be delivered in 2019. For instance, if I look for the Australian contract, which will be part of Q3, order intake is also partly to a small extent being part of our sales expectation 2019. But the real ramp-up, I already mentioned it in the Q1 call, the real ramp-up for the Australian contract will be in 2021.

00:23:03 Sven Weier

Okay. Good, and the last point I had was just on Automotive, because obviously you gave the Q2 guidance of an acceleration of growth and it didn't really happen. So, if I understood you correctly, you had some delays and now you seem to be quite confident on Q3. So could you back this up with some more details, please? What happened in Q2 and what happens in Q3?

00:23:28 Helmut Merch

Yes. We saw some delays due to customers' request for some SOPs, and now we expect a major positive impact for our growth by new SOPs in H2. So therefore we expect a positive impact compared to H2 2017, and therefore we reconfirmed our guidance for the Automotive segment. But on the other hand, I just tried to point out very clearly the one and only thing which could impact our forecast in Q4, I would guess, will be the thing around the change in the test procedure, WLTP.

But up to now, for the time being we have no single sign of cancellation. But I think there is a real risk. As you are aware, the Volkswagen group has announced a possible risk of 200,000 up to 250,000 cars. So there might be a risk which could have an impact also on our sales. But for the time-being,

we have no single sign. But as you know, Volkswagen group is one of our biggest customers.

00:25:03 Sven Weier

Although they said their impact is more in August than September, right? So that's within your visibility, I would say.

00:25:10 Helmut Merch

Yes, but actually in July and August we see no triggering event. So therefore I just pointed out that in case we will see some effect in the last four months starting after the summer holidays, September until December, but for the time being we have no single sign of interruption.

00:25:37 Sven Weier

And was that delay in the start of production also the reason why you had another outflow in the working capital side in Automotive, which in Q1 was already relatively big working capital build and Q2 again. Is that caused by those delays as well?

00:25:52 Helmut Merch

Only to a small extent.

00:25:56 Sven Weier

Okay, so is that something you expect to reverse then in the second half on the working capital in Auto?

00:26:03 Helmut Merch

Yes, definitely. If you compare it with the previous years, we have also ... during the year we had some build-up in working capital also in Auto. But then we see a corresponding decline more or less in the second half of a running business year.

00:26:25 Sven Weier

Okay. Thank you, Mr. Merch.

00:26:27 Helmut Merch

Thank you, Mr. Weier.

00:26:32 Operator

The next questioner is Christoph Laskawi from Deutsche Bank

00:26:37 Christoph Laskawi

Hi, Christoph Laskawi, Deutsche Bank. Thank you for taking the question.

Two housekeeping ones first on guidance: I'm not sure if I understood what you just said on the sales growth outlook correctly. Looking at the chart, it reads that the forecast is organic growth, so excluding FX impact. And I think you just said it the other way around, so I just wanted to check. You guide on organic growth, right, excluding FX impacts.

00:27:10 Helmut Merch

For 2018 we have this 8% on group level. That means 3 to 4% on Automotive and 12% on Defence.

00:27:29 Christoph Laskawi

Okay. Does that include negatives from FX, or whatever the impact would be?

00:27:33 Helmut Merch

Yes. I just said to Mr. Weier. That it will be the expected reported figure at the end of the year.

00:27:43 Christoph Laskawi

Okay, because I think in the presentation it's stated differently, but I understood.

And then on the special impacts in Q3, the 31 million EBIT, is that on basically a holding level, or will it be in Autos or Defence?

00:27:59 Helmut Merch

No, no. As you probably know, we have a real estate company managing several real estates, and out of this portfolio we made this transaction into a newly formed joint venture, and so we expect this to impact positively on a holding level.

00:28:28 Christoph Laskawi

Okay. Then a follow-up on WLTP. You said you see basically phasing-in in Autos. You said that there were some SOP shifts in the second quarter, and you will see very decent growth then in the second half. Do we get back to an outperformance level of production which we've seen in Q1, which is very good? Do you guide for that? Will you see similar dynamics? And do you happen to know if the start of production of the models that you expect are already certified under the WLTP, or could there be delays still in Q3?

00:29:14 Helmut Merch

So basically, one of our reference points is IHS forecast for Q3 and Q4. Latest prognosis of IHS for Q3 is 4.3% Light Vehicle production growth. And here we expect an outperformance for our Automotive business. I do not know exactly what would be the adverse FX effect, but looking to the

operational growth, I am very confident that we will outperform this IHS figure. And Q4 forecast is around 1.7% done by IHS, and also this growth rate we expect to outperform with our Automotive business.

00:30:12 Christoph Laskawi

Okay. Thanks a lot.

00:30:20 Operator

And now we come to the next questioner. It is Christian Cohrs from Warburg Research.

00:30:27 Christian Cohrs

Yes. Hello, good afternoon. Thanks for taking my questions.

First maybe on the working capital side, you mentioned that you've received lower prepayments. Can you give us or shed some light on what is the nature of why these prepayments are lower? Is it project-driven, customer-driven, any specific customer to highlight?

Secondly, also on Defence, in Q1 you complained also as a reason for the lower top line, the lack of export approvals by the German government due to the long political standstill we had. Did you notice already signs of improvement, or is this problem still in place?

And lastly, Electronic Solutions has posted a very nice swing in profits. I think it was a swing of 9 million in H1 '18 versus last year. I remember that you've had some difficulties in this division, I think legacy problems in Norway, etc. Is it fair to assume that the worst is over, or is there more scope for improvement to come?

00:31:37 Helmut Merch

Yes. First, your question regarding export approval: We are still lacking some approvals, so there is still a delay of governmental activities. We are very near to the relevant authorities, so we expect that there will be a certain result during Q3. But I cannot fully exclude that there will be some issues which could skip into Q1 2019. But for the time being, we are more or less confident that we will get their relevant approvals, but you never know.

Looking to the prepayments, here we see a lower level of roughly €150 million, especially at Electronic Solutions. Last year we got some major programs combined with substantial prepayments, and we do not see a similar profile of order intake and prepayment profile in H1 2018. So it is a variety of different things, but there is not a special case of one customer.

Looking to the recovery in Electronic Solutions, we had also in Q2 an additional operational hit coming from Norway. But now I think the worst is

over, and we should see starting from 2019 a better situation, and this gives us also a confidence during 2019. Electronic Solution should clearly improve on the EBIT performance, also having in mind that we set up a restructuring case in one of the major sites over the next two years, and this gives us this roughly 8 million hit, non-operational, but we will see the first positive impact during 2019 with a further acceleration in 2020.

00:34:28 Christian Cohrs

Okay, that's clear. Maybe just one follow-up with regard to the export approval. You mentioned that you expect a certain contract approval in Q3, but it also could skip to Q1 '19. Assuming the worst case, does this contract mean any harm to your 12% revenue growth guidance?

00:34:53 Helmut Merch

Mr. Cohrs, we also have a profile combining chances and risks, and this could be a risk. And we are looking and working on chances in order to mitigate those risks. So I can shed a better light on this specific situation during Q3 at the end of November this year.

00:35:22 Christian Cohrs

Okay, fair enough. Thank you very much.

00:35:29 Operator

Next up is Florian Treisch from MainFirst.

00:35:34 Florian Treisch

Yes. Hi all. Once again, I'm from MainFirst. I may be risking to ask a question for a second time. I just jumped in right at the start of the Q&A from the Conti-call.

So the first question would be: you mentioned these positive effects from project reviews in Vehicle Systems and Defence. You also highlighted this meaningful impairment at the same time. Can you quantify the positive effect, or was it a negative effect in the end? And at the same time, can you give us a view on what is something like a normal quarterly runrate as you seem to be not mentioning these effects. Now it's obviously having a big positive impact for Q3, but at least a positive impact.

And the second one, you have probably answered that already, but on the lower Defence revenue guidance. I believe you gave this Q2 Defence guidance. You left a quarter with around 30 million more revenues while flat-guided, so, in theory you even get some tailwind to your guidance, but you still reduce it. I just heard there's obviously one order you mentioned in the call. Can you please repeat what your statement was here on why you were lowering the top-line guidance here? Thank you.

00:36:48 Helmut Merch

Yes. So firstly the net positive effect of the result of the project revenues and the substantial impairment was roughly 5 million in Q2. And regarding the reduction of the guidance in Defence, I would state the following: It is not a reduction. We originally guided between 12 to 14%, and now we've precized and refined this statement and we see more the 12% than the 14%, and I tried to elaborate on the negative FX-effect, which gives us a burden towards 2017 of nearly 2% points, and therefore I think we see this still in the range of our corridor. But I think 14% is actually out of reach, and therefore we say we are able to reach the 12%.

00:38:04 Florian Treisch

Okay. Thank you very much for clarification.

00:38:10 Operator

Ladies and gentlemen, at the moment there seem to be no further questions. So if you have any additional questions, please press nine and the star key. And the next question comes from Zafer Rüzgar from Equinet Bank. Over to you.

00:38:34 Zafer Rüzgar

Yes. Thank you for taking my question. There is only one question left, and it's regarding Weapon and Ammunition. We saw very strong revenue growth in Q2 with around 30% increase if we exclude the trading contract in the previous year's quarter and a very strong operating margin in Weapon and Ammunition. Does this change anything on your view for Weapon and Ammunition in the fiscal year 2018?

00:39:06 Helmut Merch

No. I think, as you know and always reported in various reports, Defence is a lumpy business, so we see this fluctuation on and on in the various quarters. Basically you know that Weapon Ammunition is the most profitable division within Defence, comparable to Mechatronics in Auto. So around 9 to 10% EBIT performance, and in Q2 we had a good sales development and a favorable product mix, so therefore we saw this nice EBIT margin of 9.2%. But actually for the running year we expect for Weapon and Ammunition a margin around 9 to 10%, so there is no change for full year guidance or full year expectation for Weapon Ammunition.

00:40:09 Zafer Rüzgar

Okay. Thank you very much.

00:40:17 Operator

And now we come to the next questioner. It is Harald Eggeling from Oddo BHF. Over to you, Mr. Eggeling.

00:40:25 Harald Eggeling

Yes, thank you. Could you please elaborate a bit on what is behind the €4 million in other net financial income please? Thank you.

00:40:35 Helmut Merch

€4 million in other financial net income - please wait. I have to look for the details, so I will keep the question and I answer later.

00:40:47 Harald Eggeling

Thank you.

00:40:54 Operator

And we come to the next questioner. It is Richard Schramm from HSBC.

00:41:00 Richard Schramm

Yes, good afternoon, Mr. Merch.

00:41:04 Helmut Merch

Good afternoon.

00:41:05 Richard Schramm

Quick one concerning the strong boost in the order inflow in Defence you signaled. How does this affect the margin quality of the order backlog going forward? The improvement we have seen here in Q2 and respectively first half, even excluding this €5 million special effect was quite impressive, but can we expect this to be taken forward for the second half, or should we be a bit more careful of margin development here compared to the previous year, which was pretty strong, especially with a view to Q4?

And also in context to this very strong back-end loaded deliveries in the current year, you mentioned I think in your release also that there are some problems in the supply chain. Can you rule out that there aren't any problems if volume is pushed up in the coming quarters here massively? Or is there a certain risk that you might have problems in delivery from third parties which could endanger here the schedule for the rest of the year? Thank you.

00:42:36 Helmut Merch

Yes. So starting with your last question, we saw some first relief in Q2, but the mentioned supply chain issues in Q1 are not completely solved. So we have to tackle with this issue during the next six months. We improved our communication and our discussions with our sub-suppliers, but on the other hand, we are dealing with very big companies, so I cannot exclude that there could be also some issues during 2019. But anyhow, we're improving our expediting procedures, and therefore we see that the problem for this year should be fully kept up during H2.

Looking to the margin quality of order intake, I think I guided now for the last two or three years that the price quality and the margin in our new order intake improved in the last two or three years. So the margin quality in our order backlog therefore will be better. And this is one of the drivers that we guided for a mid-term EBIT development between 6 to 7%. This is also only one outflow that we are able to specify our margin guidance around 6.5%.

And comparing our expectations regarding H2 development with H2 2017, we can say that the margin in H2 2017 was around 9.5% operational margin. In order to reach our 6.5% full year guidance in Defence, we have to reach in H2 2018 around 8.9% operational margin. So in case everything will go into the right direction, there could be also a little bit room to move. And I think here we should be on the safe side.

00:45:16 Richard Schramm

Thank you.

00:45:22 Helmut Merch

Yes. Anything missed, Mr. Schramm, or?

00:45:26 Richard Schramm

No.

00:45:27 Helmut Merch

No? Okay.

00:45:29 Richard Schramm

Nothing! Thank you.

00:45:30 Helmut Merch

Thanks.

00:45:33 Operator

And the next questioner is Sebastian Growe from Commerzbank.

00:45:38 Sebastian Growe

Yes, thank you. Finally, good afternoon everybody, and three questions from my side.

The first one is on Electronic Solutions and on the restructuring. Can you just provide some more clarity, what is behind this charge that you have been booking? So is it a capacity adjustment? Is this just laying off, I may phrase it this way wrong, people, and is there any risk of seeing additional charges? I know normally if you would clarify then you would need to book a provision, but do you think really the 8 million covers a lot, if I may put it then this way?

The second question is on the working capital and also on the flood of orders that you are seeing for the second half of the year in Defence. Especially Australia will add more than 3 billion in my math. Can you comment a little on the prepayment profiles for these very orders, or would that be a sensitive disclosure? If so, I would be happy to have some indication here.

And then lastly on the order book and on the visibility you have going into 2019, obviously, if you really hit 5 billion for the full year and we end up with a guidance of 3.4 billion, then the order backlog is really slowing to a standing level of 8 billion. My question then is how much coverage roughly would you have or how much of that order backlog would be going into 2019? And the background of the question is that I've seen that for 2019 you have now 2 billion roughly in the book, and I think in quarter one it was still 2.2 billion. So normally that has been building up and not going down. So maybe you can just help with reaching, so to speak, the expectation of 2019. Thank you.

00:47:15 Helmut Merch

Yes. Okay. So picking up the last question here was a switch from a customers' request from 19 to 20, so as it was a volume of around 150/160 million, therefore we saw this decrease. But on the other hand, picking up one question of Mr. Weier, I guess that from order intake in H2, there will be a lot turning into sales in 2019. But I'm sorry that I don't want to speculate about order book coverage end of 2019. This figure we will comment and disclose during our analysts conference early March next year. But anyhow, we are committed to further growth in 2019 compared to 2018.

Can you remind me of the first two questions, Mr. Growe?

00:48:30 Sebastian Growe

Before coming back to the question one and two, if I just may try it another way. You obviously had more than 10% growth estimated indication for 2018. I think that the indication at the Capital Market Day end of last year

was that that was basically also your run rate thinking so having doubled digit growth for the next three years. Is that still something that you would feel confident with, without really pushing you onto really one figure in absolute terms, i.e. a billion figure, but the growth rate of around 10%, if it still is kind the easy baseline scenario, if I may phrase it this way.

00:49:06 Helmut Merch

Yes. So basically if we reach this 12% growth this year and we had to comment on a CAGR of 10%, it could also include that the following year will be high single digit growth. And then 2020 could be a year again with double digit growth, so let me put the answer this way.

00:49:32 Sebastian Growe

Okay. Okay, fine. Yes, then the reminder for the question. Electronic Solutions to start with and on the restructuring, either capacity or more personal related.

00:49:42 Helmut Merch

Yes. Okay. Electronic Solutions reviewed the need for capacity for the coming years, and we made an organizational reshaping in so far that we decided that roughly 100 people will leave the company during the next 24 months, and this will reduce the cost base and will be one of the elements in order to improve the operational performance of Electronic Solutions. So more or less, this 8 million will cover this issue. I will not exclude that the potential 1 or 2 million will come during H2, but this is not actually been foreseen. So more or less this 8 million should be the case.

00:50:41 Sebastian Growe

Okay, understood. And the last question was on the prepayment profile, if that is possible to disclose it for us.

00:50:45 Helmut Merch

Yes. So here I beg your understanding that we are obliged not to disclose anything around the Australian order intake. So what I can say is that every party is ready to make a final signing, but the concrete day or date will be not disclosed so far. So here Australian government is clearly in lead, and when the Australian government will make this statement public, then we also give our statement to the media.

00:51:34 Sebastian Growe

Alright, understood. Thank you.

00:51:41 Operator

Mr. Merch, there are no further questions.

00:51:44 Helmut Merch

But one answer is still missing, for the question of Mr. Eggeling. So I try to get the answer. One moment please.

00:51:54 Operator

Yes.

00:52:04 Helmut Merch

So mainly this effect, Mr. Eggeling, is depending on positive FX effects, to put it in a nutshell.

00:52:17 Harald Eggeling

Okay, thank you.

00:52:18 Helmut Merch

Yes, welcome.

00:52:25 Operator

Mr. Merch, there are no further questions.

00:52:28 Helmut Merch

Okay. Then thank you all for joining us and giving your questions, and have a good day. Bye-bye till our next call in November.