Rheinmetall AG
Investor Relations
Conference Call Q1 2017
Transcript

4. Mai 2017, 15:00 – 16:07 Uhr
Good afternoon ladies and gentlemen and welcome to the Rheinmetall AG conference call regarding Q1 results 2017. 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.

Ladies and gentlemen, also a warm welcome from my side to Rheinmetall’s first quarter earnings call. I will present to you the Q1 highlights and financials and afterwards give you the opportunity to ask your questions. Before we kick off, I would like to remind you of the save harbor statement on the following page.

Starting with slide no. 3, with sales of €1.35 billion and earnings before interest and tax of €50 million in the first quarter, Rheinmetall had a good start in the year 2017. Sales increased by 14% and EBIT even by 61%. Our balance sheet has remained strong, with an equity ratio slightly improved to 29.3%. Furthermore, we widened our strategic options by signing cooperation agreements with competent and renowned partners on national and international scale. Now, please join me on page 4 for a closer look at some KPIs.

As you can see from the development of our financial KPIs, we were able to keep up last year’s business momentum in the first quarter of 2017. Both segments increased sales and, even more important, improved EBITDA and operational result respectively.

Let me continue with slide no. 5. Operational free cash flow advanced by €64 million to now €-199 million. Major contribution came from a higher net income and slightly lower cash out for investments. As in the previous year, our CTA was funded with another €30 million. Earnings per share picked up by 75% from 32 cent to now 56 cent per share. Headcount in capacities slightly roused by 2% to now 21,229 employees, triggered by the increased business volume in both segments.

On page no. 6 I will provide you with the highlights of our automotive segment. Automotive had a good take-off on the back of the sales performance in all three divisions. This led to total sales of €737 million and to an EBIT of €62 million in the first three months of the year. In general, the quarter benefitted from a better than expected market environment. Especially Europe showed a light vehicle production growth of 7%. At this point I would like to remind you of the expected annual light vehicle production scenario as recently presented by IHS. According to their latest expectations, annual growth will be almost hundred per cent driven by the first half of 2017. The second half is expected on last year’s high level, but
without a further growth impulse. The activities in China and with our Chinese partners have developed again very satisfactory with improved sales and profitability.

Now, please turn with me to page 7. Sales increased strongly by 13% or €83 million to now €737 million. The currency impact thereof amounted to €10 million; so, currency-adjusted sales growth was roughly 11%. For a proper comparison, we should also remember the low base effect of last year. Q1 of the previous year was impacted by some burdening factors: the out-phasing of the PSA contract, the slow-down of demand for large-bore pistons and the further declining sales in Brazil.

Operating earnings rose by 20% to €62 million, lifting the margin by 40 basis points to now 8.4%. This was driven by the good sales development generating economies of scale. A 15% uptick in the operating free cash flow development was due to the result improvement of €10 billion and lower capex spending compared to last year, which accounted for €8 million.

Now, let’s move on to page 8. Mechatronics´ sales went up by €55 million or 15% to now €425 million. Again the demand for products which immediately contribute to lowering emissions and increasing fuel efficiency, like solenoid valves or variable oil pumps were essential for this success. Please bear in mind that due to the organizational shift of the Lanciano plant in Italy from Mechatronics to Aftermarket, we restated sales figures for last year quarter, Mechatronics of roughly €10 million, correspondingly Aftermarket without an impact on the results. Operational earnings advanced by 26% to now €43 million, yielding a margin of remarkable 10.1%.

Also Hardparts saw a friendly start to the year, the sales increase by 8% to €249 million resulted in 30% higher operational earnings of €17 million. This development is owed to the strong demand in Europe combined with a slight recovery of our Large-bore Pistons business. A stabilization of Hardparts sales in Brazil supported this performance improvement. The Aftermarket business saw a growth of 12% to €83 million and a margin of 8.4% compared to 6.8% in the previous year.

As you can see on page no. 9, on the left side, global light vehicle production in Q1 rose by 4.2%. Unlike in former years, the largest growth impact didn’t come from China, but from Europe with a growth of 7%. The light vehicle business of Rheinmetall Automotive grew by 14%. Responsible for this development was a good demand for our emission technology and the base effect of the weak previous year quarter, as already mentioned. The biggest drivers for the non-light vehicle business were the increase of Aftermarket, the improved market demand for trucks and the already mentioned, large-bore pistons recovery.
On page 10, we have compiled our regional development and compared it to the regional light vehicle production growth according to IHS. While we were able to outperform every market, the regions with the highest dynamics were outside Europe. North America saw the successful market introduction of one of our Mechatronics products. That is a tandem pump. In Asia on the other hand, growth was driven by our Hardparts sales in absolute terms, while Mechatronics showed a more dynamic development, however from a low base.

On slide 11, let me finish the chapter on Automotive with a remark on our business in China. China experienced a relatively slow market growth of only 3% in the first quarter. Sales of our activities in China in the local currency Yuan increased by 8% and in Euro by 6%. In Euro, our joint ventures generated a relatively modest growth, but our fully consolidated companies grew by almost 42%, which is mainly driven by the dynamic development of Mechatronics products in China, especially the solenoid valves. On the earnings side the JVs raised EBIT from €14 million to €16 million and the wholly foreign-owned companies from €2 million to €3 million.

Now let me proceed to our Defence segment on slide no. 12. All key indicators except the order intake improved. Sales grew by more than 16% or 14% currency adjusted, raising the margin by 160 basis points now to minus 1.6%. Although the order intake in the first quarter lagged behind the previous year, we are confident that in full year 2017 we can generate an order intake at least on sales level. In the first three months we signed agreements with several international companies to team up for key projects which offer promising potential in modernizing military forces. We are convinced that these steps will improve our competitive position and will represent a strategic advantage for Rheinmetall.

On page no. 13 you see that order intake declined by almost 60% to €391 million. I will elaborate on this development in more detail in a moment. Business momentum in general looked positive. On the backdrop of a strong sales increase of €86 million, the segment was able to improve earnings by €7 million. Cash flow developed in the right direction. Defence reduced the negative operating cash flow by €32 million to minus €72 million.

On the next page, no. 14, I would like to provide further insights into the operational development of the divisions in the first quarter.

Weapon and Ammunition increased sales by 7% and reached break-even in the first quarter. Electronic Solutions produced slightly lower sales and stable, however still negative, earnings. Vehicle Systems benefitted especially from the ramp-up of the Australian Land 121 truck order and achieved - for the first time - a positive Q1 result, amounting to €1 million. On the consolidation line, we show the ongoing cost for our international network.
Now, let’s turn the page to slide no. 15 for the details of the order intake and backlog development.

Order intake in Q1 was low, because we could not repeat the very high order intake of last year, including the two orders for Air Defence and the Leopard upgrade for Poland together amounting for a volume of roughly €520 million. But we are not concerned about this development. Especially in Germany, we are expecting orders to be approved by the budget commission of the German Parliament before the summer recess. So, as already mentioned, on a full year scale, book-to-bill will return at least to a ratio around 1.

The timely distribution of the order backlog confirms the high order coverage for the next years and - as you know - we are actively bidding in a number of large ticket tenders in other countries where we expect the final decisions within in the next 18 up to 20 months.

Now we move to slide no 16. During the first quarter, we signed MoUs with the objective to set up joint ventures with companies from the United States and Germany. Furthermore, we have entered into a cooperation agreement with an Austrian company. All three agreements mark important steps for the future of our business.

While we are currently evaluating potential fields of cooperation with Raytheon in a number of activities, we have decided to team with Rohde & Schwarz in order to lay ground for one of the most important tenders of the Bundeswehr, their future digital communications and battlefield management systems called “MoTaKo”.

The cooperation agreement with Steyr Mannlicher from Austria is progressing well and we intend to submit our bid for the tender of the next German assault rifle. Deadline for this submission is end of May.

Finally, let us now turn to page 17. With the Q1 figures for 2017, we are presenting to you a positive sales and earnings development. However, we see that assumptions concerning the macro-picture 2017 have not changed since our last analysts call in March and they are still the basis for our outlook which we confirm today.

With this, I would like to thank you very much for joining our call and now I am ready to take your questions.

00:14:43 Operator

Ladies and gentlemen, if you would like to ask a question, please press 9 * on your telephone keypad. In case you wish to cancel your question, press 9 * again. So
please press 9 * now to state your question. First question comes from Sven Weier from UBS. Please go ahead.

Operator: Sven Weier, UBS.

Sven Weier

Yes, good afternoon, Mr. Merch.

Helmut Merch

Good afternoon.

Sven Weier

A couple of questions from my side, please. The first one is on the free cash flow where you already showed quite an improvement year-on-year. I was just curious if you also see further improvements on that line in the coming nine months?

The second question was on the defense order pipeline where you shared with us at the Capital Markets Day quite a number of projects in your presentation slide. I was just wondering, now with the cooperations you’ve announced and half a year has gone by, if you would say that this pipeline has filled up further and with some larger projects since then? If you could share any details with us on this.

Then just two smaller issues. I was just wondering if you could quantify for the Automotive business what the impact of the working days was, the additional working days on the quarter? And if because of that you would expect a rather negative sales development in the second quarter?

The last question is on the underlying in the Automotive business, minus €5 million was quite an increase over last year. I was just wondering if you booked any potential restructuring charges in the other division in Q1? Thank you.

Helmut Merch

Okay. Thank you for your question, Mr. Weier. So for your first question regarding free cash flow, yes, we expect further improvement in the upcoming quarters also for this year we have the target to generate a positive free cash flow.

Number two, I think our cooperations or our MoUs being signed in Q1 are still quite fresh in use. So therefore we have not especially new projects in size coming from this joint venture. As we already explained, we formed a cooperation with Steyr Mannlicher in order to be able bidding for the new rifle in Germany. This tender is still ... is open for bids up to end of May, so we will be a participant for this tender. And I think the announced cooperation agreement with Rohde & Schwarz is especially covering the upcoming tender for MoTaKo.
Besides this, our order pipeline is still intact, and especially the German orders being decided before summer break will give a positive impact at the latest for the Q3 order intake.

For Automotive questions, yes, you are right. We have I think three different elements. A, the low base effect which already explained by me last year. Then a tremendous tailwind from the market, especially from Europe, and also the effect from three additional working days compared to last year.

And yes, now looking to April, we are missing three working days due to Easter and therefore we already see a lower growth compared to the first quarter. I think especially if we look once again to the IHS prognosis, we clearly see a deceleration of growth in part in the second half of this year. But anyhow, we are quite happy to show the performance of the first quarter.

Last question from you was the €5 million. Here we had to do some provision for an environmental risk in one of our former sites. This is covering roughly €2 million and we have restructured to some extent our Chinese activities. We established a new Chinese holding company, and here we had to invest some money.

Sven Weier

Thank you. Maybe two quick follow-up questions. When I spoke about the pipeline I was not just meaning these cooperations but maybe also outside. So because we’re hearing the German Army seems to want to have more howitzers also in the future again. I guess, I think last quarter Mr. Papperger mentioned there was a pipeline of €2 billion for the next 12 months for Germany alone. So I was just wondering if you could confirm that figure today?

Helmut Merch

Okay, sorry. Then I missed you to some extent, yes. I think yes, we are still looking for the German pipeline. I will not exclude that we need instead of 12 months also 18 months. So it is always a matter of timing. But in the short term periods especially three projects will be decided by the budget commission. This is first of all the frame contract for the first lot for trucks. And this frame contract is roughly covering €700 million, thereof a first batch of roughly €170 to €180 million will be a firm fixed order.

Second, there is a second lot of infantry soldier system, Gladius. This will be a project amounting up to €300 million, and then our participation in the Leopard upgrade which is led by the prime KMW. Also here we expect a lower three-digit million number and then also the additional equipment for the Puma will be around €100 million.

So these are the largest ones and I think especially the negotiations around the frame agreement to restock the ammunition depots could also last for some
months more. It is always not easy to close these kinds of frame agreement, but we are full of confidence that the next 12 to 18 months, we expect around this number Mr. Papperger has mentioned.

There are no further news coming from the international tenders. As you know, we are among the last bidders in Australia and also in England. Australia is so far a long story because they need at least 12 up to 15 months of trials. But what we have heard in the meantime that the trials are running well, so there are no bad news. But I think that it's also a decision of high political importance. So I suggest we ultimately have to wait for the final decisions which we expect during mid of next year.

And also England is a special story here. We have also to look what will be the discussions around Brexit. There are rumors that there could be some postponement regarding defense spending. We have not the final information, but I think we are in a very complex situation and therefore we will inform you immediately if we have a corresponding news flow.

Sven Weier

Did I understand you correctly that despite the working day issue you would not expect negative sales growth actually in Q2 for autos?

Helmut Merch

No, but I think the view we have actually, we will have not a downturn compared to last year, but growth will clearly different from the Q1 growth path. So I think we will see a quite normal figure but still on the growth level.

Sven Weier

Understood. Thank you very much indeed.

Helmut Merch

Thank you, Mr. Weier.

Operator

The next question comes from Alexander Hauenstein from DZ Bank.

Alexander Hauenstein

Yes, hello. Alex Hauenstein, DZ Bank. I have three major questions.

First of all, could you please elaborate a bit about the potential timeline when we might actually see some earnings out of the Raytheon corporation? I know it’s pretty far down the road, I guess? But maybe some light here. I was curious to hear which of the five mentioned areas, which of them could be with the first
outcome, which of them the last? Maybe a bit of color here about the plans here and the potential, please.

The second question is with regard to Automotive. Could you elaborate a bit about the mentioned further necessary optimization of cost and size, particularly in Hardparts? What are the plans here and how far has this progressed with the examination?

Last question on Defence. In Q1 you saw losses at Rheinmetall International Engineering GmbH and Rheinmetall International. That was on page 14. Maybe I missed it, maybe you could remind me please what kind of activities these are and what caused these losses, how should we look at it going forward? Thanks.

Helmut Merch

Yes, okay. Starting with the first question regarding the potential outcome out of the Raytheon cooperation. I beg for your understanding, Mr. Hauenstein, that it’s too fresh, too early. We just signed the cooperation agreement and what we have firstly in mind, to have a closer cooperation, especially on the air defense or in the air defense business.

As you know, Raytheon is a very strong and competitive missile producer and we are one of the leaders in especially short-range air defense. And here are some customers out in the field who wish to combine different scenarios and to have one supplier for both areas and to combine also certain radar capabilities.

Therefore I could imagine that air defense will be one of the first fields, [where] a cooperation could show some results. But it is much too early to discuss about concrete tenders of projects. What is in our mind, that is a project in Germany. Here, as you probably know, also Germany is thinking of a modernization of their air defense capabilities, including missiles, and this could be a first proof of this cooperation.

Second situation, or second question, the question regarding optimization of the cost structure. I think, as you know, our Hardparts division is a very labor-intensive business field. Therefore it is a regular task to focus on cost management and also to improve the competitiveness and profitability of our locations.

And in the last couple of years we continuously have optimized our cost structures. I’ll give you two examples. We shifted our production for light vehicle aluminum pistons from Germany to the Czech Republic and also, for instance, from our US facilities to our production site in Celaya in Mexico. And especially our Hardparts sites in Europe, in Western Europe, are now under review. We have not yet finalized our reviews, but I think during H2 of this year we could have some ideas about this.
Third question regarding Rheinmetall International Engineering. This Company was founded end of 2013 and started its business early 2014. This is a 50-50 joint venture with the company Ferrostaal and the original intention was to bundle activities and international project management for oil and gas and also for defense infrastructure. But for the time being we have to admit that this business concept is not developing to our contentment. Therefore we have shown already last year some losses and also in the first quarter of this year.

**Alexander Hauenstein**

Okay, thank you, maybe a quick follow on, a follow-up?

**Helmut Merch**

Yes, sure.

**Alexander Hauenstein**

Is this going to continue here with the losses over the next two or three quarters or should we take this as a kind of a one-time losses?

**Helmut Merch**

I think we have to look probably also for some improvement of the business structure. Also here we are presently in the phase of discussing with the second shareholder how we proceed and what we shall do in order to stabilize the situation, or also possibly quit the situation.

**Alexander Hauenstein**

Okay. Thank you very much.

**Helmut Merch**

Welcome.

**Operator**

Next question comes from Sash Tusa from Agency Partners, London.

**Sash Tusa**

Thank you very much indeed. Good afternoon. I’d just like to follow up on the Ferrostaal situation. Should we see the level of losses that you do in Q1 as being an ongoing rate for the next three quarters or so? Or was there an element of one-off costs in the first quarter? And then the other questions I’ve got, you made a payment into the CTA in Q1. I assume that was another €30 million?

**Helmut Merch**

Yes.
**Sash Tusa**

Is there likely to be any more such payments in the rest of the year? Or will you just have a practice of making these payments every Q1?

**Helmut Merch**

Not really. But I think having in mind that we made a link of the funding of the CTA with our ability to generate free cash flow. As you’ll know, that last year we have produced some nice positive cash flow, therefore we decided to fund in Q1 additionally our CTA. For the time being we have no idea and no target to give additional funding during this year. But dependent on our ability to generate free cash flow, we said that minimum per year should be €30 million. If the free cash flow situation is probably better than expected, then we could imagine to give some more million during next year to the CTA. But we would or want to feed the CTA on a continuous level.

Second question regarding Ferrostaal. What I just explained to Mr. Hauenstein, after suffering under a loss of roughly €10 million last year, we have to review the business model. I would not see for the time being a continuous loss-producing entity in the next couple of quarters. So we have to fix this situation and therefore we will do our homework and probably during the next Q2 calls I give you some updates concerning this special situation.

**Sash Tusa**

Lovely, thank you. And then final question, I wondered how you’re progressing with reducing the losses and hopefully eventually returning to profit at Simrad in Norway?

**Helmut Merch**

Yes. Here I have to admit that we have not a fundamental change in the situation. Also Q1 saw an operational loss in the entity of roughly €3 million, so if you may deduct the €3 million from the €4 million, then the whole other area of the division is more or less breakeven. So we have ongoing cash drain because of the fact that we have to deliver on bad contracts. I do hope that we see some slight improvement, i.e. some reduction of the operating losses during this year, but a real change we do not expect before 2018, as already mentioned, I guess, during our Capital Markets Day.

**Sash Tusa**

Great. Thank you very much indeed.

**Helmut Merch**

Thank you, Sash.
Operator

Next question comes from Christian Cohrs from Warburg AG.

Christian Cohrs

Yes, good afternoon, thanks for taking my question. Maybe first related to Automotive, you grew 13% top line and you strongly outperformed the relevant market. Now you mentioned that even in April was ... or even in Q2 with lower working days growth will still be positive. And I’m fully aware that market dynamic is going to be much more muted in the second half. But actually your 3% to 4% revenue guidance for the automotive division implies hardly any topline growth for the remainder of the year. So do I miss something or are you just being conservative for this time of the year?

Similar question related to Defence. You started with plus 16% topline growth. Your full-year guidance is unchanged at 5% to 6%. Is this more to a phasing issue we should pencil in for the quarters to come? Or do you see any headwinds you might want to share with us?

Then secondly there was a news report out lately, on a ... I quote the German word on the potential “Heeresstrukturreform” and “Fähigkeitsprofil” of the German Army. Do you see any potential or would ... do these reforms, would these imply additional business possibilities for Rheinmetall and what is the corresponding timeline?

Helmut Merch

Yes. Starting with your last question, Mr. Cohrs, yes, we do see a positive implication of this “Heeresstrukturreform” but as you also being aware of the article in the Frankfurter, this is a long-term issue covering the next 20 years. And I think what we could expect, and this was also mentioned to some extent by Mr. Papperger in March, that there could be in the next 18 to 24 months, there could be a positive decision for a second lot of Puma, for instance.

I’m not aware for the time being of decisions already being made regarding howitzer and so on. But every modernization, every additional equipment regarding the army, I think should and will affect positively our medium- and long-term business model, because we have the products. We have a very large installed basis in the army. And therefore if they come up, the German Bundeswehr and the politicians with ideas regarding this Heeresstrukturreform then also Rheinmetall should be one of the participants in this game.

Second questions regarding Defence growth. Yes, we show some very strong growth with 16% in the first quarter. But I think also the Defence situation is not only regarding order intake but also the sales side is a little bit volatile. It is clearly an issue of phasing some contracts. And therefore we will still have the back-end
loaded structure of producing sales, so there is still a strong H2. But we do not have any sign that we will be above our expert guidance.

A different story regarding Automotive. No, you didn’t miss anything. I think with a strong Q1 and also with the short-term perspective of being able to produce also some growth in Q2, I think we clearly will face the situation on carefully looking to the guidance of the full year. But this we will do, I think, within our Q2 call in the beginning of August this year.

Christian Cohrs

Okay, understood. Maybe just one short follow-up. In your guidance you also mentioned I think a double-digit amount, expenses for new technologies.

Helmut Merch

Yes.

Christian Cohrs

Could you maybe now ... I think four months have passed already in 2017. Can you maybe quantify the potential amount and also, what have you spent in Q1?

Helmut Merch

Yes, we have spent €1 million in Q1.

Christian Cohrs

Okay.

Helmut Merch

€1 million, yes. I think these are very, very new technologies we are looking at. And therefore at the very end it could be a little bit too high, our estimation for this year. But also this we will review during the next couple of months and then being able to give you an update in the second half of this year.

Christian Cohrs

Okay, great. Looking forward for it. Thank you.

Helmut Merch

Perfect. Thank you, Mr. Cohrs. Bye-bye.

Operator

And the next question comes from Florian Treisch, MainFirst Bank.
Florian Treisch

Yes, hello, also good afternoon from my side. We are questioning a lot the potential growth rate in Automotive. I would probably more question the potential growth rate in Defence in the second quarter. Are you optimistic to see positive growth rate? I would clearly question that in the second quarter bringing down defense growth rate to a more recent level. The question is ... well, basic question coming from first all can you remind us what you will see a kind of run rate for the Vehicle Systems business? You should have some visibility due to these large-scale contracts, Australia, Puma, Boxer. So can we expect like a flat quarter-on-quarter development, or what is your assumption here? On the downside, if you look at last year, you really have these very strong Weapon and Ammunition quarter. So that is probably meaningful downside here in the end of the second quarter. So more, what is probably your exact expectations for the second quarter in defense? That’s the first question.

Helmut Merch

Yes. So Mr Treisch, thank you, but I want to remind you that we are discussing the Q1 results. I do not want to discuss the possible Q2 figures. I think what we confirm that is the full-year guidance, and I differentiate a little bit between Defence and Auto. So defense, we have this 5% to 6% growth for the full year. We have a good start, so one can calculate that this cannot be the expected growth rate for the next couple of quarters. So we will see on a year-to-year comparison a normalization of sales in the coming three quarters. But at the final end, leading us to this expected growth of between 5% to 6%. And what also is important to have in mind, more than two-thirds of the absolute growth in 2017 compared to 2016 will come from the Vehicle Systems. The other divisions, especially Electronic Solutions, will be more or less and we have some slight growth in Weapon and Ammunition. So therefore growth for defense will be driven by Vehicle Systems and here especially by the series delivery for the truck contract in Australia.

Florian Treisch

Okay, perfect. The second one and this is relating to the first quarter, the Chinese joint ventures are only showing these around 2% year over year growth rate. Is there a specific reason for that? Or simply will it accelerate in the coming quarters again?

Helmut Merch

I think I explained the figures. When we look to the Chinese market in the first quarter, we have only a market growth of 3% in our joint ventures in Yuan and we have to compare on local currency. Here we have a growth rate of 4%. So we are
slightly above the volume growth. So we are not unsatisfied with this situation. We could imagine if the market will pick up slightly in the next couple of quarters that we have also a similar growth. But what is much more important actually is a clear and strong ramp-up of our 100% activities. I think this is an additional proof of our strategy to start, especially with Mechatronic products, not in JVs, but on our own. Especially we are delivering products for Chinese OEMs which are heavily needed Western products. Therefore this will be also one of the biggest issues in the next couple of quarters and therefore all in all we are quite satisfied with both activities, the JVs and also with our 100% entity.

**Florian Treisch**

Fair point, thank you very much.

**Helmut Merch**

Thank you, Mr Treisch.

**Operator**

The next question comes from Christoph Laskawi from Deutsche Bank.

**Christoph Laskawi**

Hi, Christoph Laskawi, Deutsche. Thank you for taking my question. Those will be on Autos. You’ve printed a very strong Q1 and actually we have seen quite weak data for April coming from the US where OEMs now show very high inventories and already comment on potential production adjustments in Q3 basically. I was just wondering if you have seen discussions with the US locals already in the US market or in NAFTA in general and if you could quantify your exposure to the OEMs in that region? And the same holds actually true for Chinese OEMs in the Chinese market. People are now worried about the inventories. Do you see any discussions with them? Is it already reflected in order intake? Or is everything basically running smoothly in both markets and you wouldn’t be too worried?

The second one would be on Q2 actually although we are discussing this in a Q1 call. General production was down in April 18%. So the question is, do you see the order momentum offsetting this fairly well in May and June? Or is there still a way to go to offset this strong decrease, which is obviously due to the Easter impact and some working days? Thank you.

**Helmut Merch**

So first I think we are not the master of the crystal ball. We look as you know for the next two, three months and therefore actually we have no signals, no discussions with our OEM partners, neither in US nor in China, which could give us early bird indicators for an adjustment in production. It is a fair point to ask the question, but actually we have no single sign referring to this. What we have to
underpin, that despite a more or less flat market in Q1 in the US we were able to
grow by roughly 20% in North America. And this is that we have booked some
business in the last 18 months. Now we see the cars being sold and especially with
our tandem pump we have some strong products in the market, and especially
regarding April. This was also our concern in preparing this call.

We have looked at our April figures. We do not see there’s a similar growth, no
doubt about compared to Q1. But we see is still some normal growth to the extent
what we have guided for the full year. And also for the next months, especially in
May, June, we do not see any shortage of demand. Therefore we are still
confident that in Q2 we should be able to show some slight growth compared to a
strong figure of Q2 last year. I think this we should have to have in mind and this is
also the rationale behind the expectation of IHS in Q3. Up to Q4 last year we saw
some very strong production figures from which the OEMs but also the supplier
have strongly benefited. But on the other hand, we have some nice new SOPs also
having seen in Q1 and this clearly helps us also to be a little bit better than the
market.

Christoph Laskawi

Thank you, very helpful. Just a small follow-up in the US market and this time
related to trucks. We see very, very strong order intakes over the last couple of
months, and you said basically that the large-bore piston business for heavy
machinery and trucks recovered. Is that also related to the truck order intakes? Is,
for example, Cummins already ordering or other customers are ordering to supply
that demand?

Helmut Merch

Yes. We see also what I have explained under the line of our non-light vehicle
business. We also see beside a slight recovery in the large-bore piston segment.
And this large bore piston segment is more related to vessels and locomotives and
so on, not directly to trucks. But also in the truck business we see some positive
growth compared to last year. So yes, also we see this improvement in the truck
segment on a lower level, but yes, we also have this positive impact in our figures.

Christoph Laskawi

Very clear. Thanks a lot.

Helmut Merch

Thank you, Mr. Laskawi.

Operator

The next question comes from Thomas Swift from Creditsights.
Thomas Swift
Hi, good afternoon. I just have two quick questions, if I may. The first is, do you have any plans in returning to investment grade? And the second is, what are your thoughts in terms of refinancing the bond which matures in September? Thank you.

Helmut Merch
Okay. A, yes, our ultimate target and aim is to regain investment grade. But we are not alone in this arena. Moody’s, which is our rating agency, is accompanying us over the last couple of years and we are in close contact with them. We also got positive signs from them looking through our 2016 results. I think also the Q1 of this year will be another proof for them that we have a continuous track record of several quarters of improving our businesses, especially also our cash flow situation. So we got last year from Moody’s a small upgrade from negative to stable outlook. I think before we will expect an upgrade to investment grade, I think Moody’s will make up their minds whether they give us a positive outlook. I think for the time being we will have to deliver on our 2017 guidance. Then I think if we should see another good year, it could be a chance to be upgraded during 2018. But I think this is more or less also to some extent in the hands of Moody’s. But we will do our best to perform, especially on the metrics given by Moody’s. I think we are on a good way.

Second question regarding the refinancing of our bond: If you look at our net debt position end of last year and also the situation of our net liquidity this year, then we will be able to refinance our bond without bringing a new one to the market. I think what we also have announced last year, that we have closed a loan with a European Investment Bank, given the finance possibilities for R&D in Automotive. So for the time being I think we are well positioned in order to refinance our bond in end of September.

Thomas Swift
Okay. Thank you very much.

Helmut Merch
Welcome.

Operator
And the currently last question comes from Sebastian Growe from Commerzbank.

Sebastian Growe
Yes, good afternoon, gentlemen. Thanks for taking my questions. It’s two, or two areas at least for the questions. The first one is on the consolidation line in the defense business. After Sven asked for Automotive, I was stumbling over the €7 million in the consolidation line at Defence. Maybe you can just give us an indication what is behind that, because there was up to €5 million in here?

Then secondly, on the automotive business and here in particular on Mechatronics; obviously impressive growth in the first quarter which were due to the low comp and also the working day effect that we discussed before. Can you just give us a number for the underlying growth in this business and given your comment that is strong demand has been largely driven by emission or reaction product. I’m just questioning if this momentum shouldn’t continue going forward. And in this regard can you comment on the book to bill eventually for the Mechatronics business in particular?

Then last not least and on pumps, I just have one follow-up question. Can you just give us an indication if you are gaining market share as at least I think one German competitor of yours is struggling heavily these days? Any comment in this regard would be much appreciated. Thank you.

**Helmut Merch**

Yes. So first question regarding consolidation line in defense, €3 million losses came from Rheinmetall International Engineering and roughly another €3 million came from the costs for our international network which we have built up in the last 12 months. So this network is actually producing costs but gives the entrance for the operation businesses for future order intake and sales. And €1 million is a normal consolidation of intercompany businesses.

**Sebastian Growe**

If I just may quickly come in here, but you would say that these expenses are done, so anything that you had to do in terms of international network etc., that is all now set and done, yes?

**Helmut Merch**

No, no, this will be an ongoing spending in the course of the year. What we expect from hopefully next year on, that also this network is producing own order intake and own sales. So our ultimate goal is that every activity should at least cover its own costs and for the time being this is not the case in 2016 and will not be the case in 2017.

**Sebastian Growe**
Okay, so to put it differently it means that you would expect a doubling, roughly speaking, of the consultation expenses year-on-year, 2017 over 2016 so from the €50 million that you had incurred last year that you mentioned also?

Helmut Merch

Not a doubling. We have a special situation regarding Rheinmetall International Engineering which I already mentioned, and elaborated on. So therefore I think we should wait for Q2 in order to give you a more precise answer to the questions for H2.

Sebastian Growe

Yes, yes, okay.

Helmut Merch

Yes? So Mechatronics, regarding double-digit growth, yes, we have double-digit growth. If I would exclude the positive effect from three additional working days, we would still have a double-digit growth. This is mainly driven out of the European growth, especially from China, especially from the pump business being done in the US and also from India. As you know, we have also in India our own activities and having seen a more or less flat market in the recent years, we see now in India a progressing situation. So therefore we see this nice growth in Mechatronics. And your specific question regarding pumps and possible market share, yes, what we can see and what you must have a certain access to data, and we do not have all data which might be available. But yes, we have seen some market share gain in special pump segments.

Sebastian Growe

Okay, very good. And the other question I had on emission reduction products, that is a trend obviously that should continue very, very strongly also in the coming quarters, right?

Helmut Merch

Yes. That is what we expect for the full year, Mr Growe.

Sebastian Growe

Okay. Thank you very much.

Helmut Merch

Welcome.

Operator
Last question, the forelast comes from Sven Weier from UBS.

Sven Weier

Yes, one last question on the Automotive business. I was just wondering Delphi announced the carve out of the traditional powertrain business yesterday. I was just wondering if at somewhere down the road you would consider something similar, let’s say for the traditional pistons business and those activities who probably don’t definitely have a future in the fully electronic cars. If you would consider something similar or would you consider everything being really core to the auto business? Thank you.

Helmut Merch

Mr. Weier, this is more or less a very strategic question. I would give the following answer: Actually our pistons business, which clearly will have the largest exposure in the next, I guess, 15 years, is I think a business which is still valid in our portfolio. I think if we look to the actual discussion around diesel, we have no real Diesel business within our pistons except steel pistons. We are more or less to 100% in gasoline cars with our pistons so we do not have an additional exposure from the Diesel side.

I think it is a matter of different scenarios. If you look to very aggressive scenarios, these scenarios see the fully electrified cars gaining a share of up to 15% to 20% in 2025 or 2030, If you assume a steady growth only by 1% or 1.5% of global car market production then we will face 110 million or 115 million cars reducing up to 20% of fully electrified cars, then you will still have a number of roughly 90 million cars either with gasoline or diesel or plug-in hybrids. Therefore we are not as afraid to have this piston business in our portfolio.

But to make it very clear, we are not planning and we are not assuming strong growth in this business. We also are not in the phase of putting a lot of capex into this business. We have maintenance capex, no doubt about, but I think our growth path will be clearly along the Mechatronics road. Therefore we are not struggling actually with our pistons business. We will do some cost optimization as already explained and therefore we should have still some EBIT contribution from this business segment.

Sven Weier

But I think it’s fair to assume that if it was needed at some point, that from an organizational point of view, it would be relatively easy to carve it out or spin it out, whatever?

Helmut Merch
Yes, that is right, no doubt about it. We have three different divisions with more or less different size. We have some shared service companies or shared production companies that would be more difficult. But at the very end you are right, it is separate business. But to make it very clear, we are not thinking of any disposal.

Sven Weier

Yes, that’s understood. Thank you.

Helmut Merch


Operator

(Operator Instructions). There are no further questions.

Helmut Merch

So then I thank you very much for participating in our Q1 call. Have a nice day and see and hear you next call. Bye-bye.

01:07:11