

Rheinmetall AG
Investor Relations
Conference Call FY 2017
Transcript



Publication: 10:00 CET
Conference Call: 15 March 2018, 13:00 – 14:04 CET



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Rheinmetall AG Conference Call

00:00:01 Operator

Good afternoon ladies and gentlemen, and welcome to the Rheinmetall AG Conference Call regarding the financial year 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. Armin Papperger.

00:00:22 Armin Papperger

Thank you very much. Good afternoon everybody. My colleague Helmut Merch and I welcome you to our fiscal year 2017 analysts' conference call. After the press conference this morning, we are now pleased to review our 2017 results and to present to you our outlook for 2018. Before we begin, I would like to inform you that during this call, we will give forward-looking statements, which involve risks and uncertainties as detailed in our disclaimer.

Let's begin with the highlights on page number four. 2017 was a very successful year for Rheinmetall. Given the solid demand in both segments, group sales rose by 5.2% to €5.9 billion and operating result achieved an improvement of 13.3% to €400 million. Cash flow was up by more than 70% to €276 million and the cash conversion rate rose from 46% in 2016 to 69% in 2017.

Bottom line, improved performance and reduced interest payments brought earnings per share up to €5.24. The dividend proposal reflects an increase of €25 cents to €1.7 and if accepted by the AGM, would lead to a payout ratio of 32%. These strong group financials underscore our strategy and performance going forward.

Moving now to page five. With regard to sales, we started last year with a growth forecast of 4% to 5% and lifted this target in August to around 6%. While Automotive exceeded the sales target range of 6% to 7% with exactly 7.7%, the Defence business came in with a growth rate below the target range. We will come back to the reasons in a minute.

Profitability-wise, however we are happy to report that all targets were fully achieved. Defence made good progress on its way to the guided range of 6% to 7%, and Automotive clearly exceeded the target of around 8.4%. Let me continue with the Automotive highlights on slide 6.

In 2017, Automotive sales grew by 7.7% or currency-adjusted by 7.9% to €2.9 billion. In contrast to that, global light vehicle production rose by 2.1%.

Due to the ongoing high demand for products which contribute to the reduction of emissions and increase fuel efficiency, once more our Mechatronics business turned out to be the main driver of this growth.

As the operating result of €249 million grew stronger than sales, the operating margin was up from 8.4% to 8.7%. Last year we made an important step in our cost optimization efforts by announcing the closure of the pistons plant in Thionville in France.

In line with the growing demand for electro-mobility, we were able to win further orders and our Automotive group now benefits from an order backlog of €500 million for products directly related to electric and hybrid engines.

On page 7, I would like to highlight some more achievements of the Automotive segment in 2017. We were able to present to the market new products for internal combustion engines like the variable valve train, as a prominent example among a number of products.

The trend of light-weight gave further tailwind to our Castings business and we are now able to manufacture structural parts like the suspension sub-frame as well as E-housings and battery casings for electric engines.

A further highlight was the presentation of our electric vehicle demonstrator kit at the International Automotive Fair in Frankfurt, which is an excellent example to showcase our in-house capabilities and the cooperation between Defence and Automotive, because the kit's battery management and the protection components were designed in our Defence operations.

Moving on to the Defence Highlights on page 8. Sales growth came in at 3.1% or 2.9% FX-adjusted. As mentioned, this is lower than our original expectation for the year.

Here we saw shifts within some air defense contracts and delayed order intakes that other business areas could not fully compensate. Additionally, the delayed formation of the German government had an adverse effect. However, we can report a satisfactory development on the profitability line: the operating result went up from €147 million to €174 million, lifting the margin from 5.0% to 5.7%. Furthermore, operating free cash flow more than doubled to now €238 million.

In addition to that, we continued our internationalization strategy and signed partnership agreements with renowned international suppliers of defense goods such as Rohde und Schwarz, Raytheon and Lockheed Martin.

Please turn now to page number 9. Especially for the Vehicle Systems business, we can report a strong increase in demand for our product portfolio. Some of those tenders are approaching their final stage, for

example Australia; some have only been announced recently, like Hungary. So there is potential to be captured out there.

We achieved further success in the perception of Rheinmetall as a systems provider, which will become more important for some very large future projects, like MoTaKo, the Bundeswehr's giant program for mobile communication. And finally we enlarged the scope of our capabilities entering into partnerships with renowned corporations, as mentioned.

Moving now to page 10. The nomination of Rheinmetall Defence as the preferred bidder for the Australian Land 400 program represents a new milestone in our company's history. The Boxer as the vehicle of choice in the Land 400 Phase 2 has successfully demonstrated it is a technologically very advanced vehicle and proven to be an economically viable solution for Australia. We are now entering the next phase and expect to be able to finalize the contract negotiations with Australia very soon.

I will present our outlook going forward in a little while. Allow me now to pass over to our CFO, Helmut Merch, who will walk you through our Financials.

00:08:48 Helmut Merch

Thank you very much, and also a warm welcome from my side.

As you can see on page number 12, we made a great step forward in our efforts to strengthen our balance sheet. We grew our net cash position by €211 million to now €230 million. We increased our equity ratio from 29% to almost 32%. And last September we received an upgrade to positive outlook for our Moody's rating for Ba1. I will continue with details on our cash flow development on page 13.

Operating free cash flow increased by 71% from €161 million to €276 million in 2017. The single most important contributor was the higher net income, benefiting from better operational profitability from both segments and lower interest expenses.

D&A increased slightly, mainly on unscheduled D&A for our restructuring in Thionville, France. Conversely, cash outflows for our pension liabilities increased by €30 million. The single main factor were increased contributions to our CTA in Germany. The position of working capital and others contributed €82 million from changes in various positions, mostly on net working capital changes of around €30 million related to customer payments and the build-up of provisions of around €60 million, also for example for our restructuring measures of around €24 million.

All in all, Defence was the driving force behind the improvement of our operating free cash flow. And now moving on to page number 14.

The reported EBIT gained €32 million to now €385 million, despite a net negative effect from special items in the amount of €15 million. Net income rose further on the back of improved net interest result and a slightly lower tax rate in 2017 compared to 2016.

The average capital employed of €2.9 billion remained almost unchanged. We were able to expand our return on capital employed by 110 basis points to now 13.4% and have thus earned our cost of capital and created additional value.

Please turn now to page number 15. Already at the end of 2016, our net-financial debt swung into positive territory and amounted to a €19 million net cash position. In 2017, we were able to further expand our net cash position to €230 million.

This has, of course, a positive impact on our interest result. Net interest is expected to remain flat in 2018 on the level of roughly €39 million, as lower interest income will be fully compensated by the benefit of the lower average financing rate after the redemption of our €500 million bond in August 2017.

Now, I would like to present the financial details of our segments, and please let me start with Automotive on page 17. Q4 was a strong quarter. Sales grew by 7.2% and all divisions contributed. The operating result increased by €3 million to €63 million, with Mechatronics taking the lead role in this performance.

While operating free cash flow remained stable at €106 million in the full year, the quarter saw a decline, which was mainly linked to the net working capital development. Additional effects resulted from lower customer grants and slightly higher investments compared to Q4 2016.

On page 18, I will present the divisional breakdown of the Automotive segment:

Mechatronics' sales went up by €27 million to €407 million in the fourth quarter, as a result of the strong demand for our high tech products addressing emissions and fuel efficiency. Since these products generate high margins, operating results were up by 31% and achieved €46 million, lifting the Q4 margin to a new record level of 11.3%.

Sales in Hardparts grew by €14 million to €236 million. Especially, demand for large bore pistons reported a solid recovery compared to 2016. However, this development did not continue in the operating result due to the following reasons. A, we had a release of provision of a low single digit million amount in Q4 2016. B, we have still some ramp-up issues with structural parts in our German casting joint venture in Neckarsulm and C,

the applicability of the Renewable Energies Act (EEG) discontinued and negatively impacted our casting business.

The division Aftermarket improved operating results by 33% to €8 million on the back of improved sales, especially due to healthy demand in Eastern Europe and further reduced ramp-up cost in the Czech Republic.

On page number 19, the left diagram displays the regional LV production growth. Year on year, 2 million more light vehicles were produced in 2017. The light vehicle business of Rheinmetall Automotive grew by 5.5% which means, we repeated the market outperformance of global LV production growth in 2017 on a like-for-like basis.

Sales in our non-LV business jumped by 12.7% or €106 million to now roughly €950 million. And this was due to the following main growth drivers. A, a recovery in some regional markets, for instance Brazil and Eastern Europe, a good growth for our truck business, the recovery as already mentioned with our large bore pistons business, and a strong growth with our continuous casting products.

On the right hand side on page number 20, we compare our consolidated regional sales performance with IHS global LV production volume development. With two thirds of our sales, Europe remained our main market. As mentioned, growth with 7.7% substantially exceeded global LV production. And we think it is worth mentioning that this outperformance was achieved in every single region and to a high degree by strong growth rates out of Europe.

On slide 21, we have highlighted the business activities of our joint ventures and our 100% subsidiaries in China. While the Chinese market for LV production grew by 2.2%, we were able to outperform this growth and reached sales of almost a billion Euros. FX-effects, however, cushioned our sales growth, which was 4.1% in Euro-terms vs 7.8% FX-adjusted.

EBIT increased by 8.4% from €71 million to €77 million, whereby adverse FX effects accounted for €3 million. The joint venture margin expanded to 7.7% after 7.5% last year and the margin of our 100% subsidiaries grew even stronger from 8.2% to 8.9%.

We continue with our strategic move to increase the share of local Chinese OEMs in our customer portfolio.

With this, I would like to move now to our Defence segment starting on page 23. In the fourth quarter of 2017, order intake and sales developed a bit slower than expected, as already mentioned by our CEO.

While order intake saw some effects from the delayed formation of the German government, sales were influenced by deliveries shifting into 2018. Operating margin gained 20 basis points to 11.3% in the fourth quarter. The

highlight of the quarter and in particular the entire year 2017 was the improvement of the operating free cash flow. It increased by almost 24% in Q4 and more than doubled in the full year, lifting cash flow to sales ratio for the full year strongly to 7.8%. Let us now have a look at the divisional development on slide 24.

Weapon and Ammunition increased sales by around 10% to €431 million and increased its operating margin from 16.1% to 17.9% on the back of a higher share of profitable ammunition sales coming from our international operations and a favorable product mix.

While sales in Electronic Solutions were basically flat, the operating result declined by 24%. Q4 2016 included a profitable R&D contract and Q4 '17 was burdened by cost for the preparation of some strategic projects for air defense and also for instance, for MoTaKo.

The high order intake for the division in 2017 will push top line growth in 2018.

Vehicle Systems Q4 reflect different delivery volumes for a number of projects, however it was still the best quarter in 2017 sales and profit-wise. We anticipate in 2018 a continuing growth of the division with higher results going forward.

Page 24 shows our regional development in Defence. Order intake development was clearly dominated by the strong increase in German orders in Q2 and Q3 reflecting the positive trend in the German defence budget and the intention to return to 100% equipment level. German order intake had a net value of €1.6 billion, exceeding slightly our guidance of around €1.5 billion. The order backlog slightly declined per year end. We had here an FX impact of roughly €120 million coming from the Australian Dollar and Swiss Franc. Germany and Asia each represent now nearly 40% of the current order backlog. The region "Rest of the world" reported a good order execution which explains the main backlog development. Please turn now to page number 26 for the implications of the order backlog on future sales.

While Weapon and Ammunition as well as Vehicle Systems saw some declining backlogs in 2017, Electronic Solutions increased the order backlog by over €330 million, driven especially by orders for air defense products and Mission Equipment to almost €2 billion.

As per end of last year, we reported an order backlog of already €2.8 billion for 2018 and this makes us confident to be able to achieve our targeted sales growth in 2018. And for the outlook, I will now hand back to our CEO. Thank you for your attention.

00:21:29 Armin Papperger

Let me start the outlook chapter with Automotive on page 28.

Automotive is generally enjoying a positive market environment. IHS is forecasting a base growth rate of 2% for the foreseeable future and most of this will still be combustion engines related. Please remember, e-mobility still comprises a very small share of the market.

Our ambition is to maintain our market outperformance and profitability level. So more specific, first, we want to increase our content per car. Higher complexity under the hood, for example for the hybrids, and demand for cleaner, more efficient cars are supportive trends. Second, steadily we want to develop more powertrain neutrality to accommodate the market trend towards pure e-mobility. Third, with our expertise and know-how, we want to develop our portfolio further by entering into new markets. Fourth, China is the single biggest market and we want to grow our position with Chinese OEMs. And fifth, last but not least, we target a share of 50% electrified products by the end of 2020. And here we are already well on track.

Moving on to page 29 for the Defence mid-term outlook.

The current market outlook makes me very confident. We see growing military spend in many countries around the world and especially in Germany. Second, a number of vehicle projects are currently being tendered, where our products have a good chance of meeting the requirements. And we have seen the last decision now also in Australia that we are successful. Third, since Eastern Europe in particular is driving this tender pipeline, we will continue with our JV strategy and team up with local partners, for example in Romania and Poland.

We are progressing in our efforts in improved earnings quality, legacy contracts are fading out, and the margin of our order book is increasing. Preparation talks for next generation weapon systems have started and we are positioning ourselves to form part of this to be a strong part of this in this discussion. The future main battle tank and the indirect fire systems offer big potential for Rheinmetall. The table on slide 30, it summarizes our 2018 guidance. Please note that all our forward-looking statements are in euro terms and before any exceptional items.

In Automotive, we expect sales to grow in the range of 3% to 4% above prior year's level. As guided in the past, we maintain our target to outperform the market by 100 to 200 basis points. However, in Defence, our sales expectations range between 12% and 14% growth, significantly higher than last year's rate given our existing backlog. For the Group, this means total sales are expected to grow between 8% and 9% in 2018, a marked step-up versus last year. Earnings-wise, our operating margin for

Automotive is expected to come in at around 8.5% and between 6 and 6.5% for Defence.

All in all, the 2018 Group operating margin is expected to be around 7%. This includes holding expenses of approximately €30 million and an underlying Group tax rate of below 30%.

Ladies and gentlemen, thank you for your attention.

00:26:05 Operator

Ladies and gentlemen, if you would like to ask a question please press 9 followed by the star key on your telephone keypad. If you wish to withdraw your question, please press 9 followed by the star key again. Please press 9 star now to state your questions.

And so we have a couple of questions here. The first one comes from Florian Treisch who's calling from MainFirst.

00:26:36 Florian Treisch

Yes hello gentlemen, thanks for taking my question. I have two actually. One of around the Automotive margin guidance. It means that the margin is expected to be down year over year slightly. The question is why is it? Is it whatever only driven by commodity, FX headwinds, a cautiousness going into the year? Or are you expecting for example higher R&D expenditure, etc.?

And one partly related question is you mentioned that you only broke even in the German Automotive joint venture in '17: Is that something we can also expect for '18? Or will that turn more profitable again?

And the second question is around cash flow. You mentioned that the very strong cash flow was supported by customer pre-payments in Defence. The question is can you quantify that a bid and give us a feeling for '18 if that will also support in the current year '18 as well? Thank you.

00:27:31 Helmut Merch

Thank you Mr. Treisch for your questions. Coming with the last question regarding cash flow, as you can remember our strategic guidance for our cash flow ratio is between 2% and 4% for both segments. That can include that in some years we are slightly above, in some years slightly below. We got this year a higher ratio of 4.7% on group level and this makes us also happy. The impact of the higher pre-payments was in the amount of roughly €60 to €70 million and I think if we were lucky to acquire some bigger projects there, we can also imagine a positive impact. But we explicitly do not want to guide concrete numbers for the cash flow. But this range of 2% up to 4% is okay.

The margin of Automotive we are guiding is exactly what we have explained in our midterm guidance. I think it makes no sense to guide 10 or 20 basis points. I think we have shown a great deal with 8.7% last year. 8.5% is the midterm guidance and if throughout the next couple of quarters, we will see some tailwind from the market, then we are also able to make some minor adjustments.

Regarding the joint venture in Germany, I think we still have some ramp-up issues with some structural parts. We are heavily doing our best to improve the situation and especially in H2 we saw some improvement regarding the comparison to H1. But we will still have some operational issue during 2018. But I think the impact will be lower compared to 2017.

00:30:08 Florian Treisch

Perfect. Thank you very much.

00:30:12 Operator

Thank you and the next question comes from Sash Tusa, he's calling from Agency Partners.

00:30:18 Sash Tusa

Good afternoon. I've got a couple questions about Land 400. I think the first issue I'd just like to understand is how you see the contract progressing in terms of development of Boxer CRV and then production? And how do you intend to mitigate risk? Because clearly this is an extremely advanced vehicle compared to what you sold to Australia before. Australia is an incredibly demanding customer and my worry would be if there were development risks here, that you weren't able to assess and mitigate at a relatively early stage. So I wondered if you could just talk about that.

00:31:00 Armin Papperger

So first of all let's go to the progress on the Land 400. As you know if the Prime Minister makes a decision, you usually need in Australia, around one to two months to get the final contract. In this final contract are the numbers of vehicles that you have seen in the press releases. If this is the full amount of vehicles they need, ... there is a discussion that maybe need more. The second point is, in this contract is not included the maintenance and spare parts contracts which will be added later on.

Second point is about the risks. I think we have a very good situation because the turret is the Lance turret which is in good condition and we see not a big risk on the turret side. And on the vehicle side, we see absolutely no risk because we are in serial production in Germany. This is for one point from our side.

The second point is that we bring the Australian workers who have to build to make the final assembly then in Australia, we educate them here in Germany because we produce the first vehicles in Germany, educate people, bring them back to Australia, and start then our factory in Australia. So we do risk reduction programs in that way.

The third point is that we are in a good situation that it seems to be that the German government wants to buy the same configuration that we have now under contract in Australia for Germany. And this is, there are about 70 vehicles where we are looking for and so it's a program that we do between Australia and Germany together which is also reducing the risks in different areas, because we get also as you know, support from different institutes from Germany. So at the end of the day, I see not a very high risk in this program.

00:33:16 Sash Tusa

Right. Thank you very much.

00:33:21 Operator

And our next question comes from Alexander Hauenstein calling from DZ Bank.

00:33:28 Alexander Hauenstein

Hello gentlemen. Thanks for taking my questions.

First of all, with regard to Defence and looking at the Sikorsky strategic teaming agreement, could you please elaborate a bit more about the timelines here for the potential contract signing and the potential delivery schedule related to it?

And additionally, I would like to get some more color if possible on the specific workshare you're looking for and eventually some margin indication here.

On Defence, the next question would be do you expect to see more similar and cross-Atlantic corporations for other weapon systems over the coming years similar to the one potentially coming up here with Sikorsky?

And also on Defence, what kind of changes do you expect to get from the newly formed German government compared to the last years?

And lastly, with regard to your outlook, you spoke about low double-digit expenses for realizing and marketing of technologies. Could you please specify this a bit more and tell us which divisions and which quarters we should probably model them and maybe give us a certain hint here? Or is that completely included in the €30 million holding costs which you pointed out on one of your slides? Thank you.

00:34:50 Armin Papperger

Starting with the Sikorsky deal, so it's one year ago Lockheed Martin came to us and said there is an opportunity in Germany. As you know Rheinmetall is strong in simulations, in producing high-tech documents for helicopters. We do that for a lot of customers, also for the German government, in program management and in different other things also to build some technologies and subsystems also for the air forces.

So Sikorsky and Lockheed came and said okay, it seems to be a good idea that Rheinmetall and Sikorsky create a partnership for the German business. As you know there are only two bidders, this is Sikorsky and this is Boeing. Boeing is doing a lot of this work from the United Kingdom. The whole amount is on the procurement side at the moment between 45 and 60 heavy-lift helicopters. It's a budget of about €5.5 billion and there is another budget for maintenance and spare parts and program management. So we will have a very small part and this package for maintenance for the first 10 years is around, let me say around €2 billion.

The first part of the purchasing the €5.5 billion will be mostly in the hands of Sikorsky and Sikorsky will guide that step. We help them on the program management side. And the second point on the maintenance and spare parts side, Rheinmetall will be the leading company and will take over the lead.

So this second point is, are there other opportunities. Yes, there are a lot of other opportunities and we are at the moment in discussions with different American but also with European companies to create cooperations. And then on the Transatlantic side there is a very special with Raytheon and Lockheed, the discussion for other programs. At the moment we discussed between 10 and 15 different programs where we can be partner.

Your question about the new government, we are very happy that we have a new government because over the last five months as you know, there was not really a decision about the big programs. We think that we, and we do this always, we are very near to the government and speak weekly with them about the strategies they have and also about the export stuff. The most important thing for the next four years I think is really to find a way for the European export permissions and we started that discussion, and hopefully we are together successful.

00:37:59 Helmut Merch

Coming to your last question regarding new products or expenses for new products, normally the expenses for new products are incorporated in the guidance of both segments. Only some parts of a new ideas which are in a very early seeding phase are covered within the holding. Coming to your

question, all is covered in the existing guidance including the €30 million on holding level.

00:38:34 Alexander Hauenstein

Okay thank you.

00:38:38 Operator

The next question comes from Christoph Laskawi calling from Deutsche Bank.

00:38:44 Christoph Laskawi

Hi. Christoph Laskawi, Deutsche Bank. Thank you for taking my question. I want to have a follow-up on the Land 400 program. Are there any upfront investments that you need to take and when do you expect to see them? And could you quantify them just roughly? And give us probably an indication about the profitability of the project since you basically expect that you are selling to other customers as well? I would assume the margin doesn't look too bad.

And then on Autos, you commented on the items that affected Hardparts in Q4. Aside from the ramp-up that was likely also going into 2018, are the other sectors basically one-offs to be seen in Q4? Or should we expect them to continue at least in the first half of the year? And could you comment on the current trading in Autos since Q1 last year is a very high comp base? Do you feel comfortable and see production as actually a tailwind? Or are you a bit worried that you have a very tough comp base in Q1 last year? Thank you.

00:39:56 Armin Papperger

First of all for Land 400, we have not very big upfront investments. The first small investments will start 2020. And the reason for that is that the government of Queensland will build up the factory. We will rent the factory and we have a very convenient contract with them. This was one of the deals that we did with the Australian government. So no big upfront investments for new factories and other things. The profitability is fine. It's in the range that we had over the last year in profitability, but we don't go into details about our customers where the profitability is. But it's okay for us.

00:40:49 Helmut Merch

Coming to your last question regarding Q4 in Hardparts, I would try to explain that we had some positive base effect in Q4 2016 which gives us a slight difference regarding the EBIT development in Q4'17. And also we have some burden in coming from the ramp up issues from the German casting JV. Here I tried to explain that we are heavily working on this issue to reduce the negative impact and we are actually on a good way.

But I think we will still have not the profitability in 2018 compared to '15 and '16. And regarding our expectations for further growth, I think you have some flavor about the LV production, the first two months. We have seen once again heavy growth in January, lower growth in February, but overall a nice growth. And I think we will also be able to follow this growth path.

00:42:12 Christoph Laskawi

Understood. Thanks a lot.

00:42:17 Operator

Next up we have Sven Weier calling from UBS.

00:42:22 Sven Weier

Yes good afternoon. First question, please, is on what you said on the Auto backlog that you have around €500 million for e-mobility which compares against the total order backlog of €520 million. So can you just help me understand those two numbers I guess that your Auto backlog that you report does only include the short-term projects probably? That's the first question.

00:42:51 Helmut Merch

Yes I think as you know, Mr. Weier, this €500 million represents the nomination letters we got. That is not a firm and fixed order backlog, and therefore we have this difference between the €520 and €500 order backlog. But what we want to explain that we got nomination orders for e-mobility applications and these have to be executed along the road in the next couple of years.

00:43:28 Sven Weier

That's understood. The second question is on Land 400, I was just wondering first of all how much follow-up business you see as maintenance that is not included in the €2 billion and how it does improve over your position on phase three as well as the UK Boxer contracts?

00:43:51 Armin Papperger

Yes the expectation is that for maintenance of spare parts there is a potential of another €500 million, so half a billion euro. And on the phase 3, we see a good chance because the discussion at the moment also with the government that there is a good chance for example that we have the same turret on the tracked vehicles and on the wheeled vehicles. So if that happens there is a good chance for the Lynx vehicle to go forward. But the decision of that contract is later. They wanted to combine that two years ago to say okay maybe we can combine it, but our expectation is that we get a decision about the next phase maybe in two years.

00:44:47 Sven Weier

And from the UK?

00:44:50 Armin Papperger

I think in UK we will get the decision very soon.

00:44:57 Sven Weier

Okay.

00:44:58 Armin Papperger

Very soon.

00:45:00 Sven Weier

Okay. And the last question is just on your Defence revenue guidance. I was just wondering if you could tell us out of the three divisions which one will grow below the guidance average and which one will be above and so on.

00:45:17 Helmut Merch

Yeah I think what we tried to explain when we elaborate on our order backlog covering our sales expectation, that we expect a huge growth, positive growth impact from Electronic Solutions. As you know we had seen now for five to four years, a flat sales development. And due to some nice orders getting in in 2017, we built up the order backlog of roughly €2 billion and now that will be executed and Electronic Solutions will show the highest growth development in 2018 followed by Vehicle Systems and we expect a more or less flat development for Weapon and Ammunition. This will only be a temporary development from 2019; we expect also Weapon and Ammunition to start a growing phase again.

00:46:21 Sven Weier

Thank you.

00:46:27 Operator

At the moment there seem to be no further questions. So I will repeat once again that if you would like to ask a question, please press 9 followed by the star key on your telephone keypad. Please press 9 star now to state your questions. We have a couple more questions on the line now. The first one comes from Florian Treisch again calling from MainFirst.

00:46:56 Florian Treisch

Yes thanks for taking another question. Just a very quick one. You mentioned €230 million net cash. Any fantasy around that? Or will you simply stockpile your cash for now? Thank you.

00:47:11 Helmut Merch

I think we will build up more cash. That is our vision and our target. And I think in case we have some nice usage for this cash, we will spend it.

00:47:29 Armin Papperger

We will need it for the European consolidation for sure and something will happen.

00:47:35 Florian Treisch

Okay thank you.

00:47:38 Operator

The next question comes from Christian Cohrs. He's calling from Warburg Research.

00:47:44 Christian Cohrs

Yes good afternoon. That was actually also my question. Now after the improvement of the balance sheet and also the improved capital performance, last year I remember you were explicitly guiding for organic sales increase in Defence which I think was supposed to give you a gear that you could reenter the M&A territory again.

So is this something which we should have in mind also, or especially then also in this year? And does this just relate to Defence or are you also willing to go for acquisitions in your Automotive business?

And then secondly in your presentation, Mr. Merch, you mentioned the net interest result which I think was €39 million. You said it's going to be flatish in 2018. I was surprised, I was positively surprised actually by the Q4 results, the Q4 financial results which was down sequentially. Now you took me by surprise with your statement about a flatish development in 2018 given that the relief from the bond side I think kicked in in September 2017. So I expected there is more to go or was Q4 '17 simply influenced by some positive one-off effects. Could you maybe shed some more light on this issue?

00:49:20 Armin Papperger

Let's start with M&A. On the M&A side we are looking in both areas in Defence and Automotive to find companies which really fit to us. There's nothing changed there. By the way, nothing changed that we have the strategy to have two pillars, Security and Mobility. And on the other side we think that the very, very big programs in Europe will be a driver for cooperation and consolidation in Defence.

00:49:50 Christian Cohrs

Okay. And on the M&A, for you, just follow-up in Defence. Do you have an eye on a certain subdivision you want to strengthen? Or are you completely agnostic and you take whatever makes sense?

00:50:05 Armin Papperger

We take what makes sense and we take what makes our customers in Europe happy. So this is I think very important and as you know, this is a very, very political game. And Europe has to invest a lot of money over the next 10 years to be a big player. If you go to the Munich security conference, it's the first time that the European ministers told that Europe must be stronger and must be a counterpart also to the United States of America. This is only possible if we have a governmental strategy and then industrial strategy. And both of them are on the way.

00:50:42 Christian Cohrs

Okay, understood. Thank you.

00:50:44 Helmut Merch

Coming back to your question around interest results, as you mentioned we have some nice increase in the interest income compared to 2016. We jumped on a level of €9 million here and this was the right assumption. We have an extra income of roughly €6 million which is more or less a one-time effect, and will not occur in 2018. This €6 million extra income came from a long lasting tax case in the US which we have finally won and therefore, we got some positive impact on tax rate and also on the interest side. And therefore this €6 million will not occur in 2018.

So we will go back to a normal level of roughly €3 million of interest income, but on the other hand, if I now say that we want to have the same level of interest result of roughly €39 million, we do expect for sure a positive impact from the redemption of the bond and therefore the interest expenses will go down from €48 million last year to roughly €41, €42 million next year. And we have also some reverse effects because we have to pay some interest for our Schuldscheindarlehen and also from our loan with the European Investment Bank. So if you compare it, we will see some relief on the interest side. But on the other hand we will not have the same positive effect as explained from this historical tax case.

00:52:46 Christian Cohrs

Okay that's clear. Thank you.

00:52:52 Operator

And the next question comes from Richard Schramm calling from HSBC.

00:52:59 Richard Schramm

Yes, good afternoon gentlemen. On the minority position which rose significantly in 2017, is it correct to assume that this relates mainly to the progress in profitability in the joint venture on the vehicle side? And should we expect that this trend will go on in the years ahead so that you'll have to share more of the profit with minorities here.

Second point, the special items should we expect anything here in 2018 or is there nothing on the agenda? And also the topic digitalization, where you said this would afford some investments and also some start-up losses here in this area of about I think €20 million was the figure given last year. So what about this issue?

And finally just a remark on your M&A strategy, so you're right it's a highly political thing in Defence and to be quite open I'm not sure if it's then, really it's always in your advantage or aren't you running the risk that you might be pushed into a deal which is not so favorable in the end because at the moment do you really need M&A because you have such a strong organic growth to handle. So M&A I think would be more risk than a chance at the moment, right? Thanks.

00:54:48 Armin Papperger

Starting with the M&A, Mr. Schramm, we don't want to be driven in such a deal. We only do such a deal if it makes sense for us. And you are totally right, we must not do a deal because the growth rate that we have is good enough. But on the other side, if it makes sense, yes for sure we want to do it. But we are not under pressure. You are definitely right.

00:55:16 Helmut Merch

Coming back to your question regarding minorities, to both questions a 100% yes from my side. The increase of minorities is 100% driven by the recovery of the EBIT performance in our joint venture with MAN, and as you know with future contracts which we are actually acquiring, the story of growth and further EBIT performance will go further in the Vehicle System. So actually we expect further increase of minorities, and also we had some nice development in our South African joint venture where we also have the lead with 51%.

Regarding special, or one time effects, here I can say that actually we have no major restructuring issues on the table. But on the other hand, you never know if something happens we have to react. But compared to the French case of last year, we have no similar issues. But we cannot exclude that we have to spend the one or the other million to fix some problems. But in case we will report during our quarterly calls.

00:56:49 Richard Schramm

Thank you much.

00:56:54 Helmut Merch

Anything missed?

00:56:52 Richard Schramm

No, thanks. That was it.

00:56:57 Operator

The next question comes from Alexander Hauenstein calling from DZ Bank.

00:57:04 Alexander Hauenstein

Hello again. I have two quick follow-up ones. First of all in Defence coming back to the upfront cost for new projects that occurred in Q4 2017 for MoTaKo and air defense, could you give us an indication how much that was roughly and what is still to come here potentially in Q1 and Q2?

And the second question is: as you announced the Land 400 deal more or less being the preferred bidder, I wonder whether this could have any impact in the one or the other direction with regard to the much bigger potentially coming up contract for €15 billion with regard to tanks. Any ideas here? Or has this deal somewhat strengthened your position? Or is it maybe the opposite that the government then decides in favor of someone else after having picked you as the preferred bidder? Thank you.

00:58:08 Armin Papperger

Yes, so you should know that if the government speaks about the €15 billion, they speak about 20/25 years. This is the €15 billion and we speak about 15 billion Aussie dollars, not Euros. This is number one. The second point is, there is a discussion that they want to have same turret and the same turret is only from Rheinmetall, so I think the chance is very, very high that we have a very good opportunity to win also the other deal.

The pure Vehicle deal of Land 400 in the next phase is about between €4 and €4.5 billion, but if you count up now everything, yes you think there are things, missing stuff, and the missing stuff is maintenance, is maybe new vehicles, maybe new technologies, new equipment that they need, and so on. So I see the chance very high that we have the opportunity to win. The cost that we spend it for digitalization of the Bundeswehr, German Bundeswehr, is between €1 and €2 million last year.

And it will be the same amount, about the same amount this year, because we have the program management team and before we go into bigger investments, we usually get a contract from the government.

00:59:40 Alexander Hauenstein

Okay thank you very much.

00:59:44 Operator

And our final question for today comes from Michael Raab, he's calling from Kepler Cheuvreux.

00:59:51 Michael Raab

Hi gentlemen. I'm Mike Raab of Kepler Cheuvreux. I'd like to get back to your earlier comment about the German army also potentially looking to ordering the same version of the Boxer as the Aussies just did. I mean essentially when you look at the version you sold to the Aussies, it's more or less an infantry fighting vehicle.

So the question is, if it was the same version for Germany, A, would you think that 70 units only would be the end of the road? Secondly, which specific branch of the army do you see it using? Would it be sort of a let's say escort vehicle? Or would it really be an infantry fighting vehicle for let's say the armored infantry?

01:00:35 Armin Papperger

The discussion we have at the moment and this is not out of the blue, this is a discussion that the German also had as the Aussies – in Germany we say Schwere Jägertruppe, they need the 70 vehicles. They need at the end of the day, it seems to be that they need more, but it would be politically also a very, very good sign if the Australian contract and the German contract could be combined.

There is also another opportunity which is coming up, maybe from the Netherlands, because the Netherlands also need for the Jägertruppe another 40 vehicles. So we try at the moment to combine different things and we want to produce components in our factories in countries, and to make the final assembly in Australia. This is a win-win situation to have a European-Australian governmental good relationship.

01:01:34 Michael Raab

Okay so let's say if the Jägertruppe or light infantry goes for 70 Boxers, it would mean the light infantry is getting more or less the same fire power as the armored infantry has with the Puma. If that's the case, do you see any threat of substitution in the sense that perhaps the armored infantry would also get that type of a Boxer version? Or is it simply that, let's say the off road capability that the Puma brings along is something the Boxer couldn't match, and hence the armored infantry couldn't use it?

01:02:10 Armin Papperger

No, it's still so that we speak about another 200 Pumas because as you know, they want that the Marder should be replaced over the next 10/15 years. And on the other side, there is a huge need on the Jäger troops

because as you know they want to build capacities up. And I don't see that the Boxer took over what the Puma usually should do. They are two different vehicles, but the fire power, you are right, is the same.

01:02:48 Michael Raab

Essentially, what you're saying is that Germany is more or less looking into substantial upgrading of the fire power for light infantry. So if I recall the old configuration of the light infantry, let's say in the days of the Cold War, essentially what we're still missing are mortar systems. That would be a logical knock on effect of what you just described. Are you seeing that too?

01:03:12 Armin Papperger

Not at the moment, but we are in discussions and they really miss a mortar with long distance. But I see this is a program for the next two or three years. Not for tomorrow.

01:03:23 Michael Raab

All right. Thanks.

01:03:33 Operator

There are no further questions at this time Mr. Papperger.

01:03:39 Armin Papperger

No other questions? No, okay thank you. So thank you for your attention and thank you for your time. It was a pleasure for us. Thanks a lot.