



Leading and shaping change – focus on profitability

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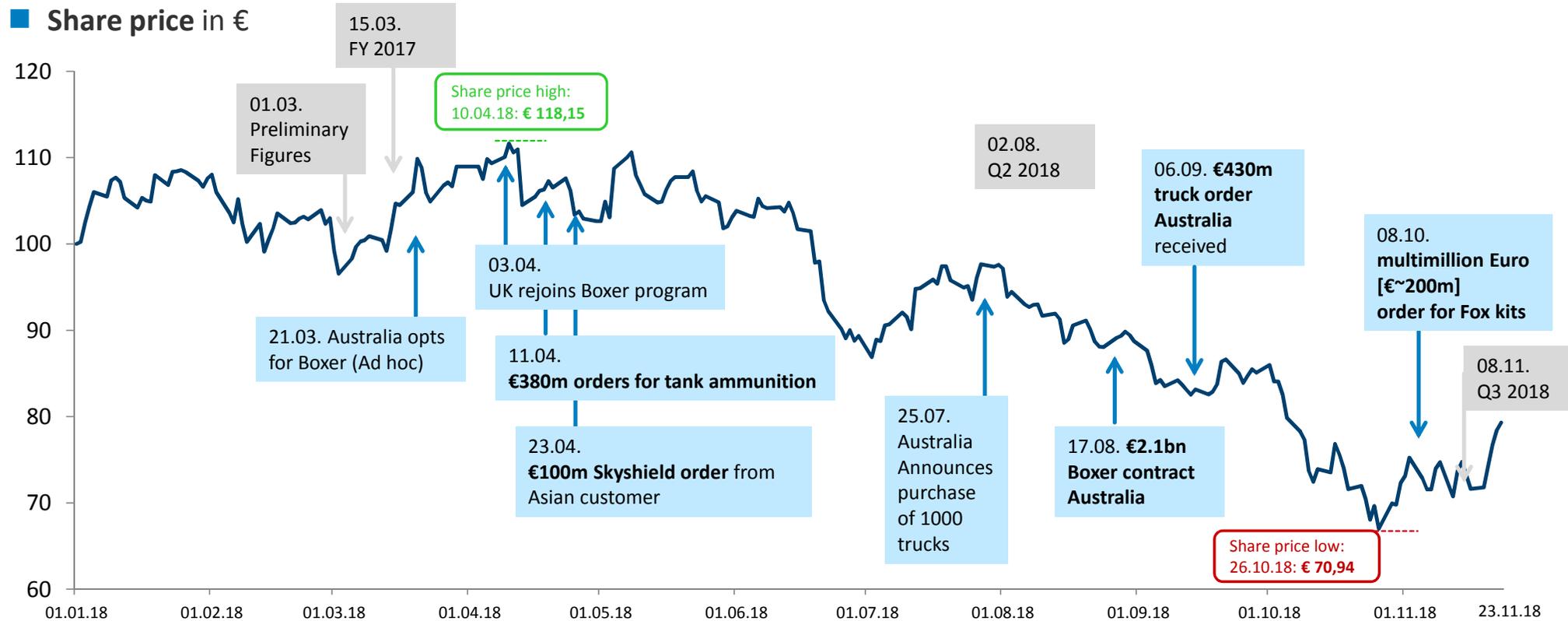
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MOBILITY. SECURITY. [PASSION.](#)



Rheinmetall shares 2018

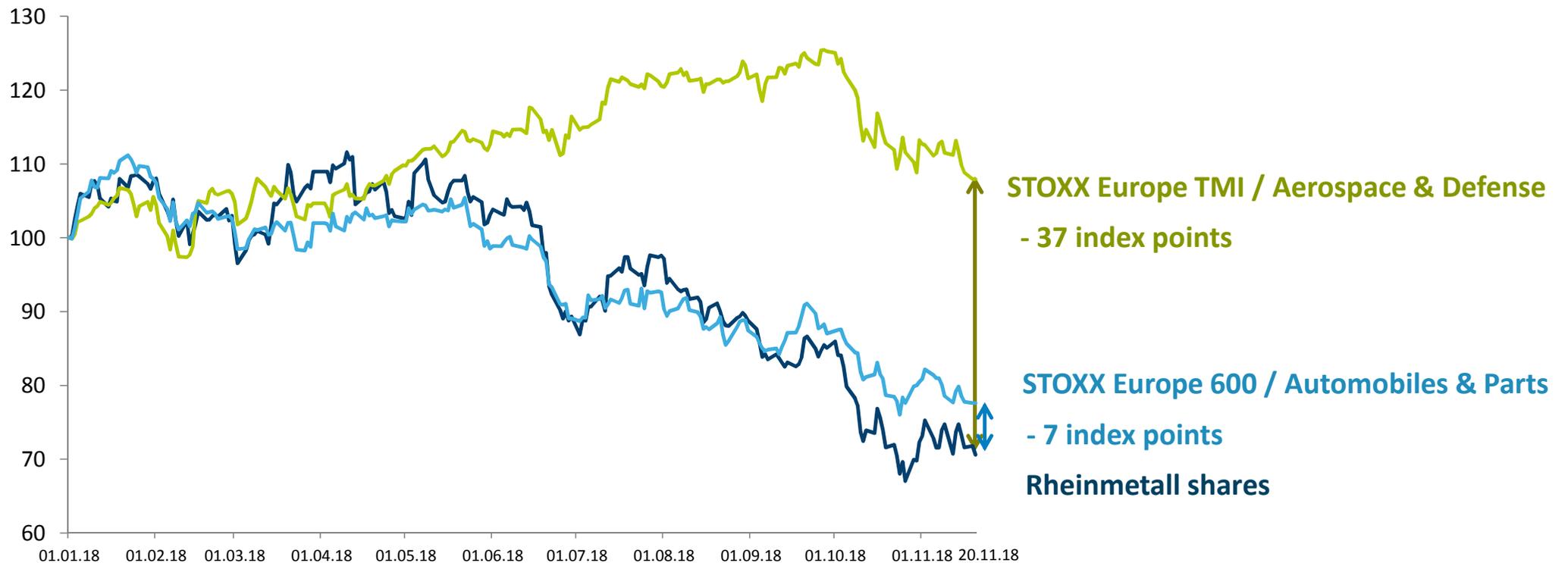
Downward movement in spite of solid performance and record order intake



Rheinmetall shares 2018

Share price reflects Automotive but not Defence indices – W H Y ?

■ Share price and indices



Rheinmetall valuation

Recent analyst's comments



Valuation anomaly: Auto at a 50% discount vs. peers

Since April, RHM's Implied Auto valuation de-rated from around 9.0x to c.3.5x on 2019 EV/EBIT, and trades at a 50% discount to EU Auto suppliers at 7.0x. Nothing fundamentally (clients, products or geographical exposure) justifies Rheinmetall's Auto business to trade at such a discount in our view. On the contrary RHM Auto business has shown resilience in both growth and profitability in Q3 which should reassure.



9 November 2018

least due to a 130bp margin expansion at Defence. As the order book at Defence has swelled to c.€9bn as of Q3 vs. 2018 sales of c.€3.2bn, and Automotive has navigated well through a very challenging 2018 (organic sales growth: 4%, stable EBIT margin y/y), 8x EV/EBIT 2019, i.e. only in line with Automotive peers, is too low as this ignores the credible and structural upside case in Defence. As both earnings and order momentum are favourable, the CMD in November may add to this. We reiterate Buy.



Why the shares have come off over the last months

Rheinmetall shares had come off sharply before the Q3 results due to 1) the auto-sector-related sell-off 2) concerns about a break-up of the German government, which would then cause potential delays to German defence spending 3) fears about weak Q3 defence numbers due to export approval delays and the South Africa ammunition site explosion. [The actual Q3 results](#) were very solid in autos and while defence sales were indeed soft, margins and orders were quite strong. We continue to believe that the pullback of the shares represents a further buying opportunity for investors looking beyond the near-term turmoil and for a [structural growth story in European defence](#).



Automotive a rare positive exception among suppliers

The raised 2018 margin target for the division looks very plausible to us and gives it an even more offensive appearance than before. So in our view this specific element of its Automotive operations distinguishes Rheinmetall in a positive fashion from other suppliers.



Rheinmetall trades at c.8.0x EV/EBIT 19e, well below EU defence peers (11x), despite its faster 2018–21e sales CAGR (6%). Our 2020 SOTP implies a re-rating to c.9.0x.



Rheinmetall

Buy the defence business and get auto for free



Mispriced Autos, mispriced Defence

Changing into an integrated technology group

Technology borders between Automotive and Defence will begin to fade

■ Sales in % of total sales



2008



2018e



Mid-/long-term

Robust and flexible business model of Automotive

Well prepared to maintain profitability in a changing environment

Markets

Light vehicles

- Private customers, global light vehicle market

Commercial vehicles

- Industrial customers, transport and shipping companies, bus operators

Aftermarket customers

- Repair shops, whole sellers

Challenges

Macro picture/Business cycles

- Global LV production
- Tariffs

Structural changes

- Decline of Diesel demand
- E-Mobility

Profitability

- Cost structure
- Pricing

Strengths

Balanced product portfolio

- Broad spectrum of pumps and valves
- Know how transfer to truck products

Innovations secure market leadership

- State of art technology
- Efficient CO2 and NOX reduction
- High value-added for customers

Resilient earnings generation

- Benefits from restructurings
- Flexible cost structure
- Price escalation clauses

Defence: Innovative products unfold their business potential

Staying on the path of growth and rising profitability

Markets

Germany

- Expanding size of German army with better equipment level
- From 2019 on preparing for VJTF leadership

Europe

- Rising demand for tactical vehicles (D/F, UK, Eastern Europe)

Global

- Potential in Australia, Asia, North America

Challenges

Managing “super cycle”

- Turning high order intake into profitable sales

Technology

- Transfer of know-how to local production sites
- Cooperation with international partners

Profitability

- Maintaining and improving price quality of order s
- Avoiding project risks

Strengths

Product management

- Roll-out phases of large-scale products with reduced risk profile
- Improved project management

Technology leadership

- Largest European supplier of military vehicles
- Globally leading market position in Weapon & Ammunition

Basis for earnings generation

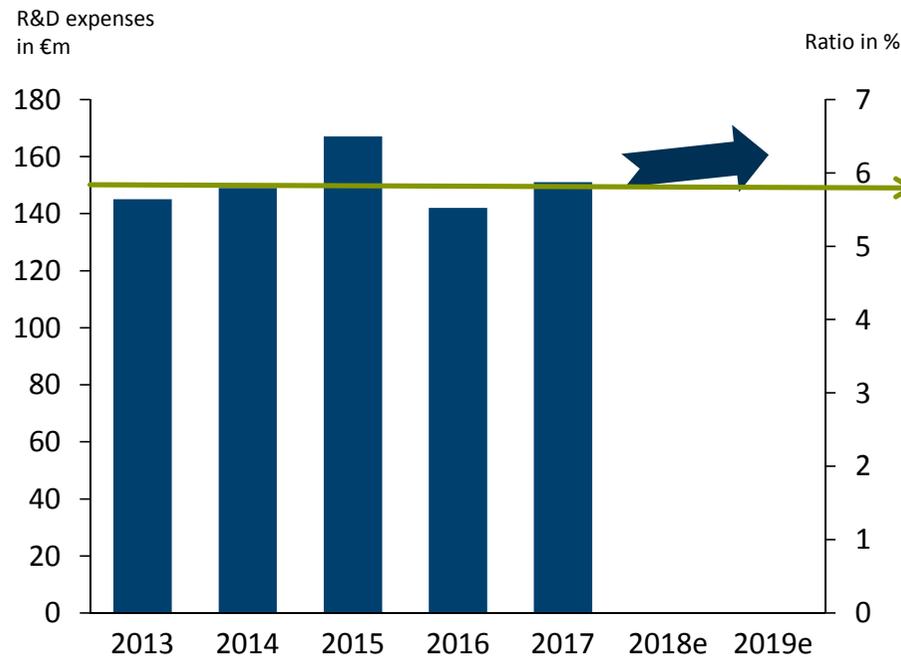
- Top-line growth
- Improving leverage
- Legacy contracts phasing-out

Research and development

Stable ratio and ...

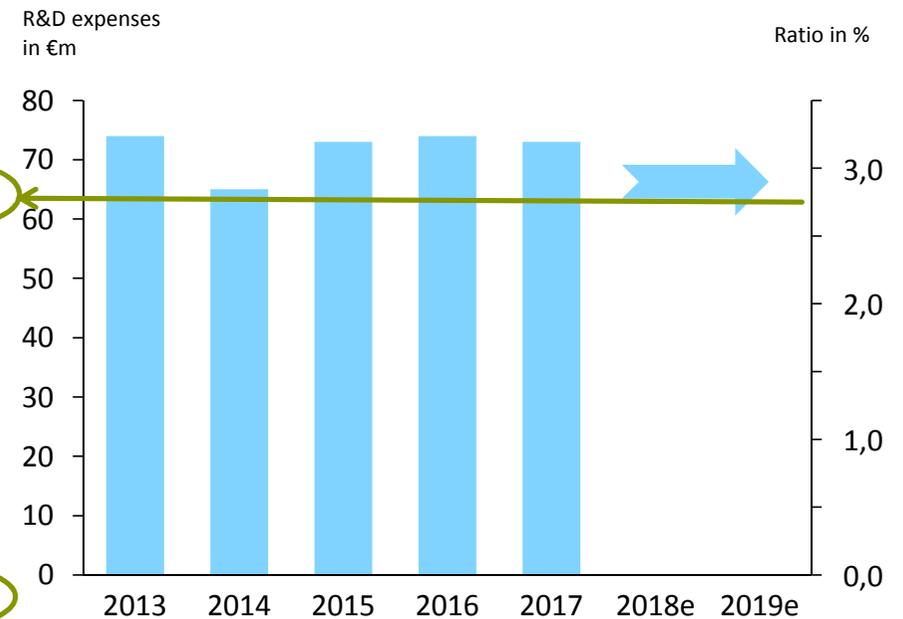
R & D Automotive

■ Research and development in €m/in % of sales



R & D Defence (without external funding)

■ Research and development in €m/in % of sales

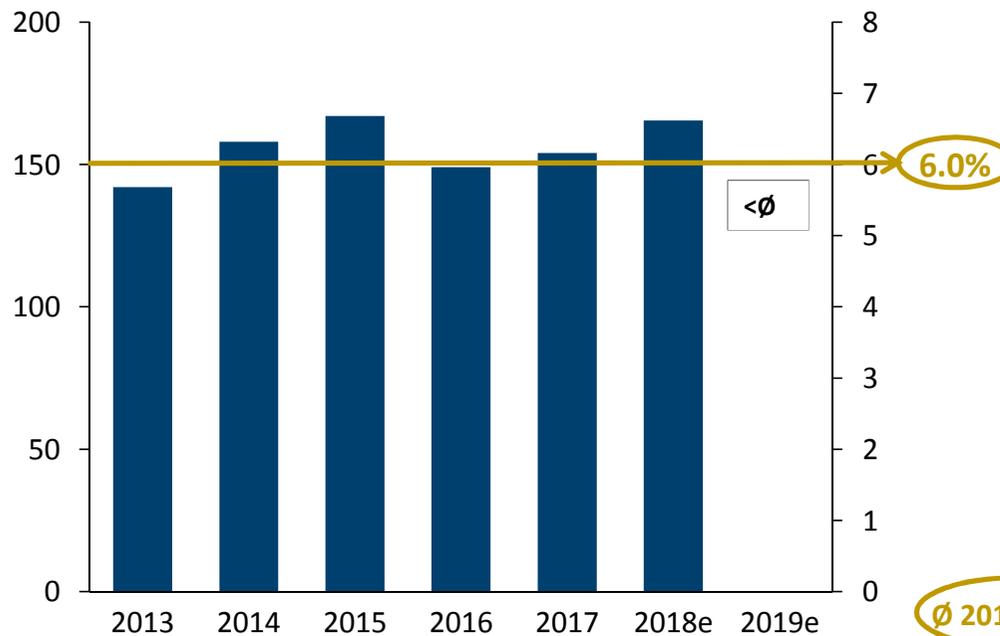


Capex

Slight increase of capital expenditure in 2019

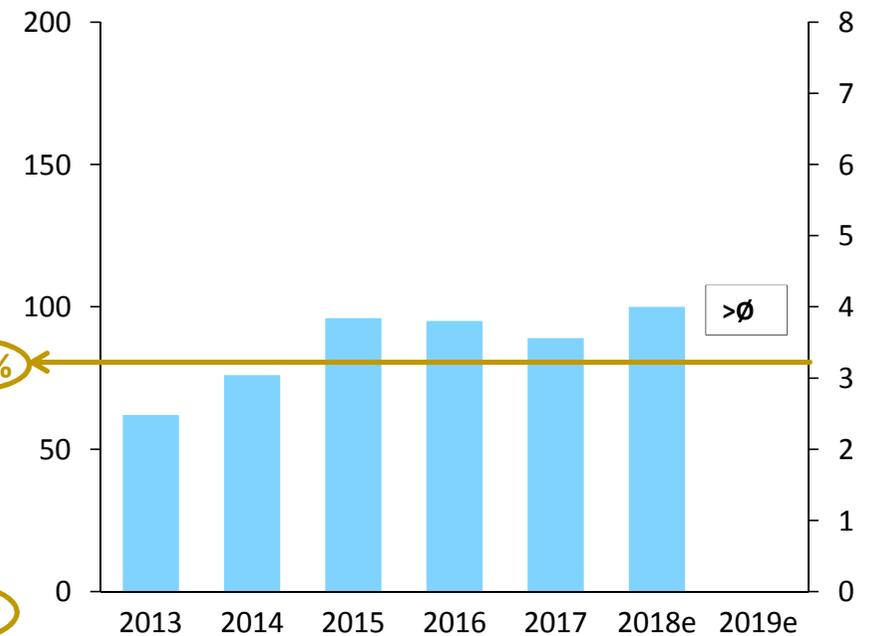
Capex Automotive

■ Capital expenditure in €m / in % of sales



Capex Defence

■ Capital expenditure in €m / in % of sales

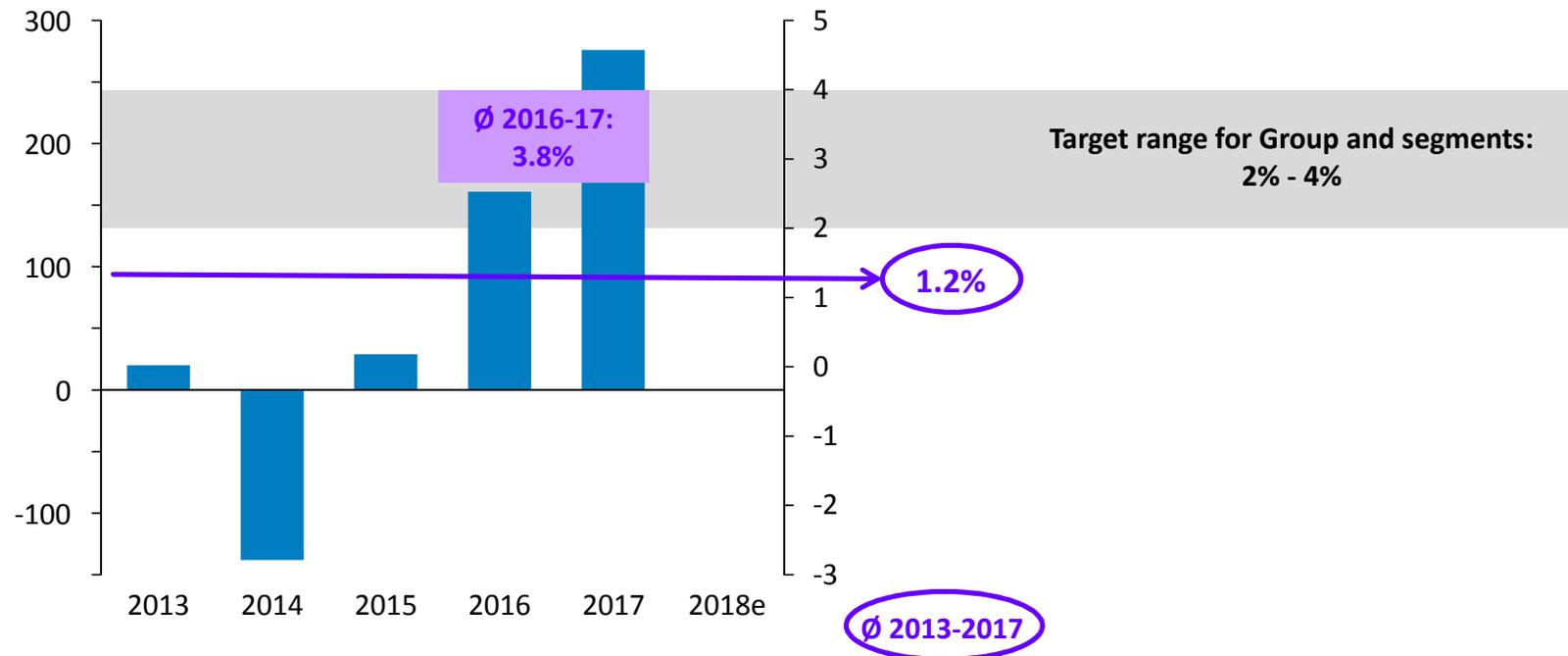


Free Cash Flow from Operations

Rheinmetall Group improves cash position

Free Cash Flow from Operations Group

■ FCFO in €m / in % of sales

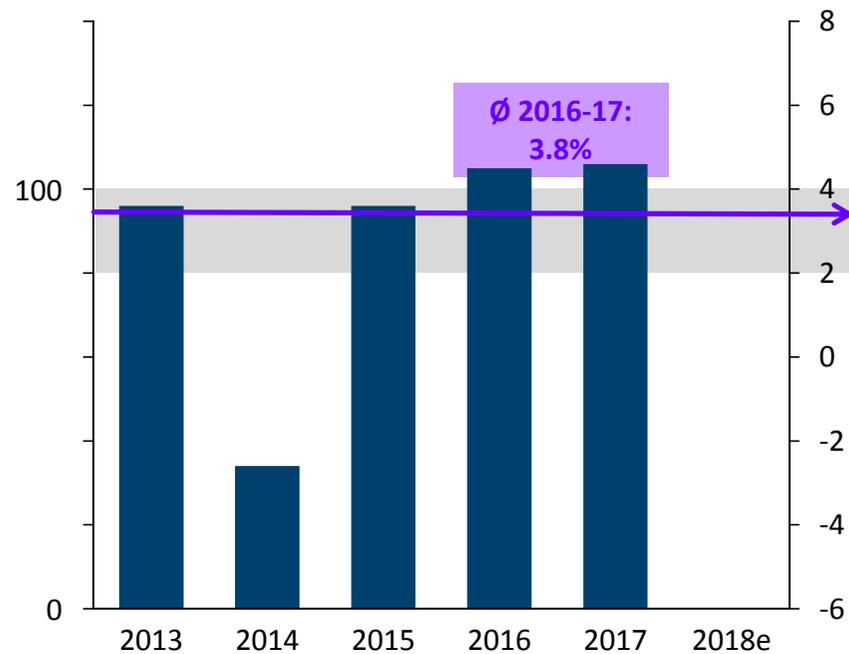


Free Cash Flow from Operations

Different business models create different cash profiles

Free Cash Flow from Operations Automotive

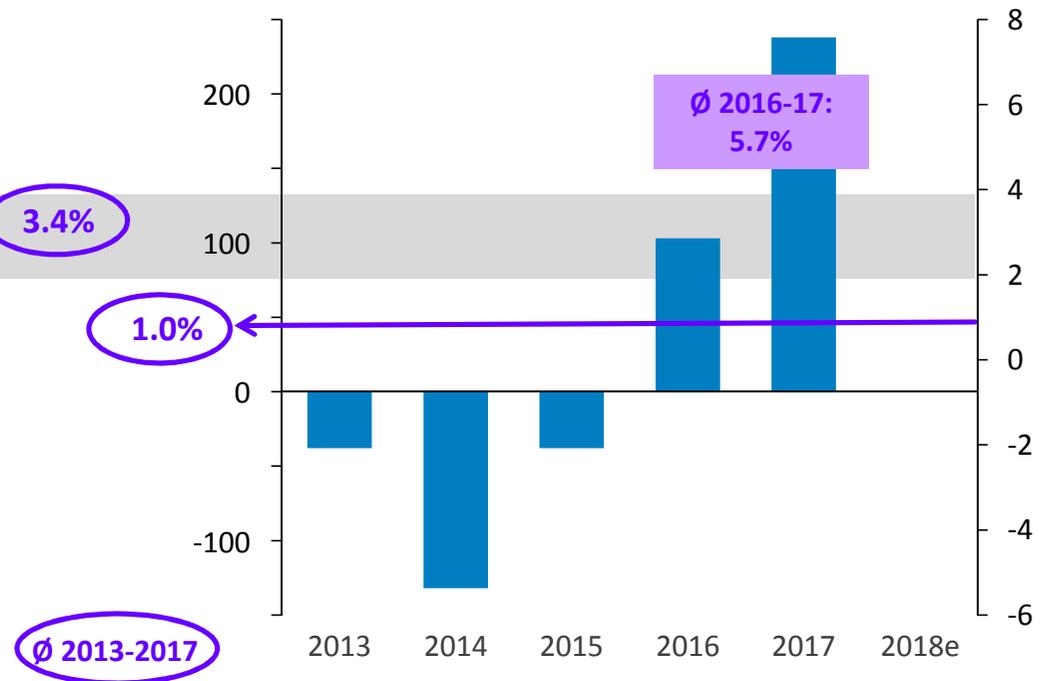
■ FCFO in €m / in % of sales



Steady Cash Flow ratio in Automotive

Free Cash Flow from Operations Defence

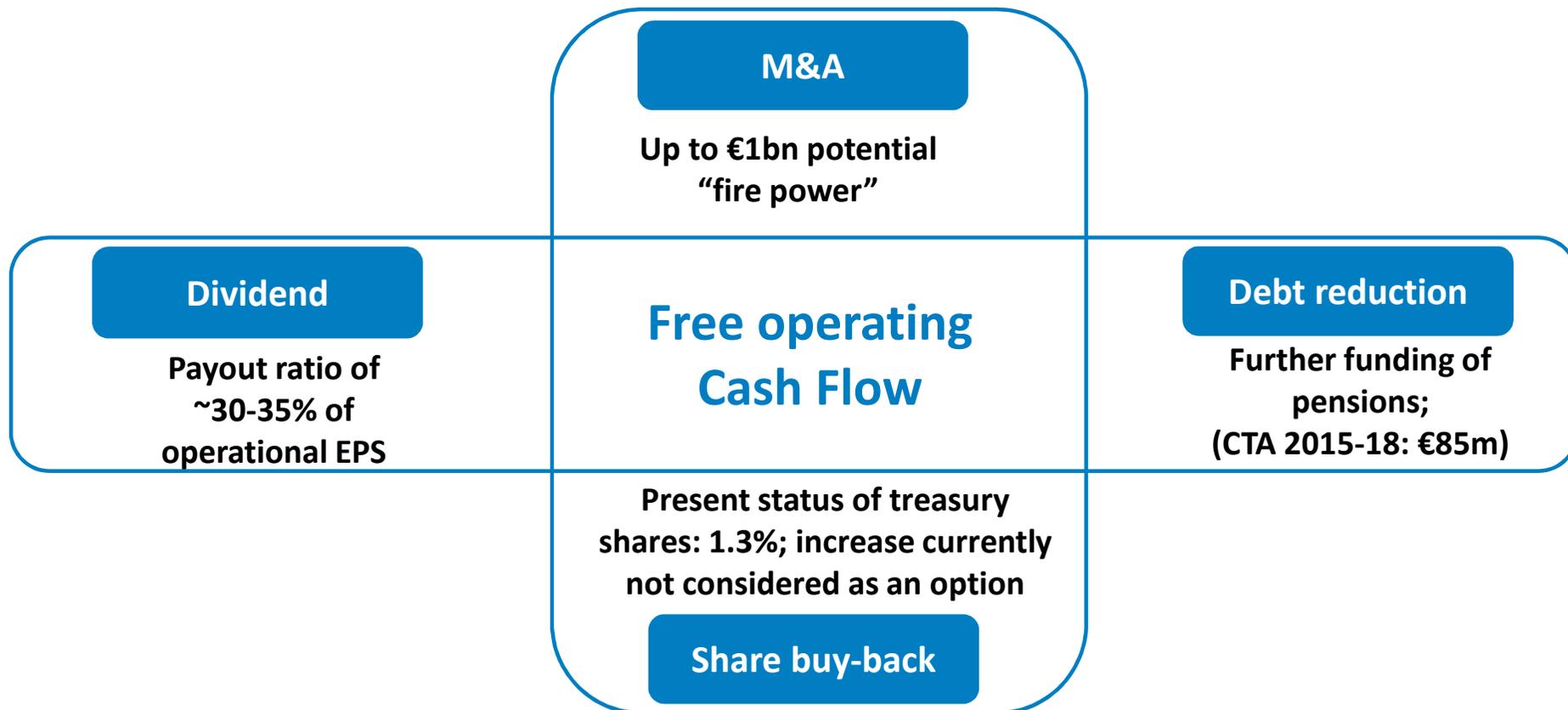
■ FCFO in €m / in % of sales



Volatility in Defence influenced by prepayments and milestones

Use of operating Free Cash Flow

Creating potential for growth and fair participation of shareholders

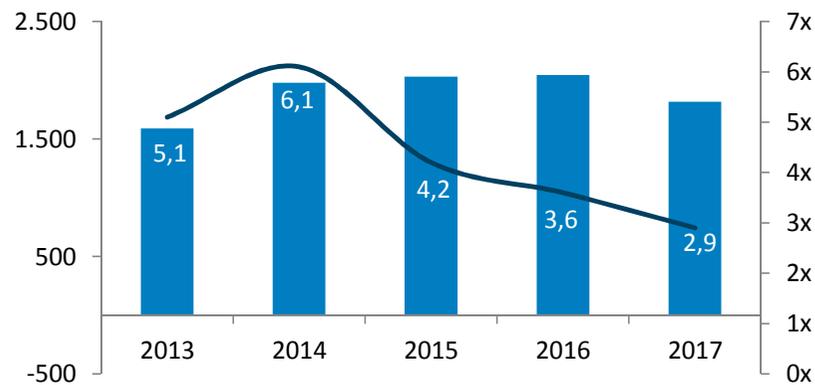


Rheinmetall moves on with strengthened and solid balance sheet

Return to investment grade on improved credit metrics in 2018

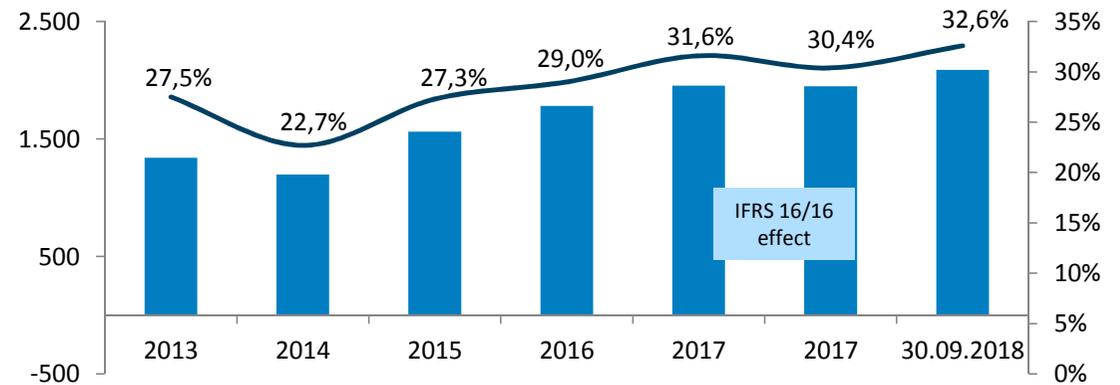
Credit metrics

■ Moody's total adjusted debt in €m / Debt/EBITDA



Equity

■ Equity in €m / Equity ratio in %



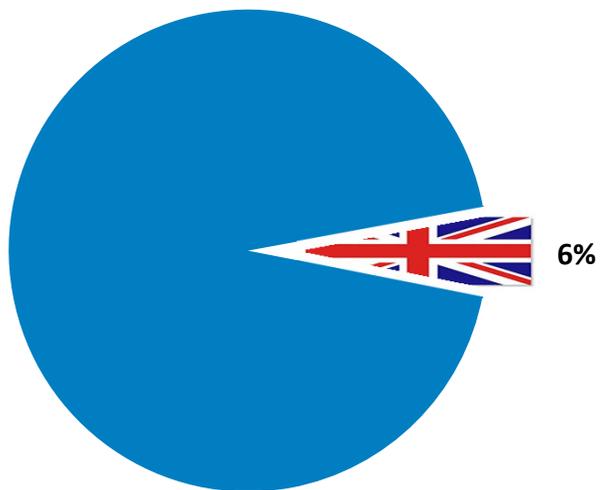
Moody's raised investment grade to Baa3 with stable outlook

- Improvement on operating performance and cash flow
- Conservative financial profile
- Leverage ratio 2.5x-3.0x (Moody's adjusted)

Brexit

Risks manageable due to limited UK exposure

■ 2018 Group sales share in%



- UK sales share ytd 2018 again around 6%
- No supply chain issue identified in Automotive and Defence
- Good growth opportunities by big defence projects for Boxer and Challenger upgrade in spite of Brexit

Outlook on Q4 2018 confirmed From today's point of view in line with expectations

Automotive

- Ramp-ups in line with our expectations
- Market uncertainties not yet disappeared: WLTP, Diesel, conflicts on tariffs, China
- Expected Q4 growth supporting adjusted growth guidance
- Cash improving, but likely to end on the lower end of the guidance

Defence

- Order entry FY 2018 expected \geq €5bn
- Truck export approvals blocked
- Profitability profile of executed orders in line
- Supply chain issue in Vehicle Systems solved
- Reduced inventory relieving working capital, but cash flow will remain clearly below last year's level

Mid-term guidance Update depending on future order profile

Operating Margin

Sales Growth



~8.0% to 8.5%
✓ confirmed

100-200bp above market
✓ confirmed



6-7%
✓ confirmed,
update in 2019

CAGR 2018-2020: ~ 10%
✓

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