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DRWG.DE - Half Year 2021 Draegerwerk AG & Co KGaA Earnings Call

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## CORPORATE PARTICIPANTS

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**Stefan A. Dräger** *Drägerwerk AG & Co. KGaA - Chairman of the Executive Board - Drägerwerk Verwaltungs AG*

## PRESENTATION

**Stefan A. Dräger** - *Drägerwerk AG & Co. KGaA - Chairman of the Executive Board - Drägerwerk Verwaltungs AG*

Good afternoon, and a warm welcome to everyone joining us today on our 6-months financial results. Today, I have with me Gert-Hartwig Lescow, CFO; Thomas Fischler, Investor Relations; and Peter Mueller, Financial Communication. We would like to take the total presentation on the half year results and that we have made available on our website.

I'm pleased to start right away with an overview of some business highlights and the demand trends before Gert-Hartwig will go into the financial details of the quarter, 6-month period. I will close the presentation of this summary in our website and our revised outlook. (Operator Instructions) Out of respect to everybody's time, we will end this conference in 1 hour. As you are aware, we published the preliminary figures back in mid-July. In the final set of figures published this morning, there are no significant deviations from the pre-release.

Starting on Page 3, we will now look at the business highlights of the first 6 months of 2021. For more than 1 year now we all have been living and working under the regime of the coronavirus pandemic. The pandemic and its impact continue to dominate the headlines and concern people, government organizations and businesses worldwide. Protective measures and rules have helped to manage the pandemic situation in most regions. In some countries, in Asia, Africa and Latin America, the pandemic situation remains challenging. Going forward, testing and tracking as well as the vaccinations will help us to advance and live with COVID-19. We will all have to get used to that.

In this environment for Dräger the dominant topic remains supporting our customers in the fight against the COVID pandemic. We continue to do as much as we can to serve our mission: to protect, support and save lives. We started the new business year with a record order backlog. And the demand for products to treat patients suffering from COVID-19 has persisted longer than anticipated. Order intake remained at a high level in both the first and second quarter. We have received some pandemic-related larger orders from customers in some emerging markets where the pandemic situation is still very challenging. As a result, business development has so far been stronger than originally expected. All of this affects our expectations for fiscal 2021. Following the record year 2020, we had originally expected a roughly double-digit decline in net sales. Following the high order intake in the Q1 and Q2, we have raised our guidance and now only anticipated decline of between 2% and 6%.

Due to the improved expected sales performance, we have also raised our earnings forecast and now expect an EBIT margin of between 8% and 11%. However in many regions, we are starting to see pandemic driven demand to come down again. This normalization of demand will continue throughout the remaining months of the year. We expect a lower order entry development in H2, and do not anticipate comparable demand in the coming year.

What else has happened in the last couple of months? We brought our antigen test, the Dräger SARS-CoV-2 Antigen Test to market maturity and approval. In the first step, CE conformity was obtained for professional use in April. I had elaborated on this already over our last call. In the second step, now in July, we have received the additional approval for use by nonprofessionals (inaudible) Our test can now be used by professionals and end users alike and both groups benefit from the most user-friendly tests available on the market. While obviously, corona self-tests are standard meanwhile, the Dräger self-test its unmatched ease of use as a clear USP over all competitive test-kits on the market. We will market it with an optional service to get a test certificate online, which is recognized by all major airlines and IATA. Even though this warrants the premium price of our self-test, it will have to be seen how receptive the market will be going forward for this new Dräger product. Furthermore, our work on the implementation of measures to remedy the deficiencies identified by the FDA remain a top priority. Our activities remain to be on track and we will hopefully resolve all issues by the end of the year.

We concluded some M&A activities during the last quarter. As already announced in our last call, we finalized our acquisition of the majority share of the Swiss medical start-up STIMIT beginning of the second quarter. With STIMIT, now our portfolio, we are further expanding, our expertise in the field of lung-protective ventilation. STIMIT is working on innovations targeted at stimulation of respiratory muscles of intensive care patients

by stimulating the diaphragm by noninvasive means of electromagnetic fields. I'm very excited about this collaboration since it has potential to bring significant value to our customers.

In May, we also made a smaller acquisition for our hospital consumables business. We acquired a majority stake in the Swedish Company, ULAX. The company manufactures foams for heat and moisture exchangers and breathing system filters that ensure that the inhaled air is humidified securing mechanical ventilation and cross-infections are minimized. ULAX operates in a very concentrated segment inherited and has been an important (inaudible) supplier to Dräger in the past. With this acquisition, we are safeguarding our access to these important consumables products. And finally, regarding the sales of our interlock business in the U.S. and Canada, we divested parts of our nonstrategic portfolio. The "Ignition Interlock Offender" business is a service business that installs and leases breath-controlled immobilizers into vehicles of offenders that have been convicted of driving under the influence of alcohol or drugs. It aims to prevent driving under influence and to ensure regular reporting to the responsible authorities. For the past few years, there have been many changes in the US market that involves around combating drunk driving. These changes will require significant investments in our part in order to be competitive. After careful consideration, we decided to look for a strong partner who will fully concentrate on the market dynamics of the U.S. and Canadian markets and thus create a basis for a successful future for the business. Please note that this transaction only concerns the direct rental of the Interlock devices to end customers. We will continue to supply Interlock devices to appropriate providers for this service and, of course, continue to supply the police with alcohol measuring devices. For all other markets, Dräger remains fully committed to the development, production and marketing of Ignition Interlock products and all other impairment check devices.

Now let's look into business development of the group. With that, I would like here to hand over to Gert-Hartwig Lescow, please.

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**Gert-Hartwig Lescow** - *Drägerwerk AG & Co. KGaA - CFO, Executive Board Member for IT & Vice Chairman of Executive Board - Drägerwerk Verwaltungs AG*

Thanks, Stefan. I would also like to welcome you all to our conference call for the results of the first 6 months. Before starting with the financial development of the group, I would like to clarify that whenever we refer to growth rates, I will give values in constant currencies, unless otherwise stated.

Let's start with the business development of the Dräger Group on Page 4. In the second quarter of this year, order entries remained on an elevated level with just under EUR 788 million. Order entry in Q2 was on the level of the first quarter mainly driven by strong order development in May. That means during the quarter, we still have a good portion of pandemic-related order entry versus 2019, the year not affected by the pandemic, order entry is up by nearly 10%. The conclusion is that while current demand was lower than the very high levels we experienced during 2020, it was not yet at normalized levels. Mentioned by Stefan at the beginning of the year, we had expected to see a quicker normalization of demand. Currently, especially towards seen Q2, we now do see a lower level of corona-related orders coming in and the lower final level for the rest of the year. Hence going forward, we expect to see the normalization of demand that was to speed up in the second half of the year.

Net sales in the second quarter amounted to EUR 841 million, exceeding the high level of the first quarter and well above the previous figures as well. Last year, pandemic driven net sales has started to pick up the second quarter consequently as a base effect quarterly or year-over-year growth rates starting to come down now. But compared to the pre-pandemic levels, net sales are obviously much higher, more than 30% over the 2019 second quarter.

Gross profit was roughly on the level of the prior year's quarter. The group's gross profit margin is 46.3%. Among other things, higher quality costs in medical and negative exchange rate tax led to a reduction of about 3 percentage points in the gross profit margin. Especially in the medical division, we have seen a pronounced decline of the gross profit margin compared to the first quarter margin. I'll get to that in a minute. While functional costs in the first quarter were at the level of the previous year, obviously not normal run rate, they were roughly 9 percent higher in the second quarter compared to the second quarter of 2020. This increase is mainly the result of our higher personnel expenses due to the increase in the number of employees, including higher provisions for variable compensation considering the revised guidance and higher expenses for project-related third-party services. With some easing of pandemic-related constraints sales and marketing expenses are also rising again slightly year-on-year. As a result of the afore mentioned, despite the higher net sales volume, EBIT came now below the level of the previous year and around EUR 80 million in the second quarter.

Looking at the 6-months period, this adds up to a very strong net sales development, 17% higher than the comparable figure 1 year ago. While net sales growth was strongest in regions of Americas and AAA, net sales increased also in Europe, mainly due to high net sales volume and the gross profit contribution was high up by close to EUR 131 million to EUR 802 million. All 3 regions contributed to this growth. Overall, the gross margin of 49.1% was 2 percentage points above the level of the previous year. The positive country and product base, which especially in Q1 supported a higher margin overcompensated for higher quality costs and slightly higher negative exchange rate effects. With fading pandemic tailwind, we expect the lower gross profit margin in the coming quarters.

For the full year, the gross profit margin should come out roughly on the level of pricing. With functional expenses at 6%, EBIT amounts to EUR 209 million, which is significantly above the prior year level. In the 6-month period overall, currencies had no meaningful impact on the EBIT margin. And should exchange rates remain on current levels, they wouldn't burden profitability for the full year either. Despite some expected full year FX headwinds on the top line. Our Dräger value added increased by more than EUR 320 million to around total of EUR 403 million.

Moving on to the medical division on Page 5. In the second quarter 2021, we recorded a year-over-year decline demand of just under 20%. But compared to the second quarter of 2019, order entry is still nearly no higher. Looking at 2021, quarter-over-quarter, Q2 order entry was even above the Q1 level, showing that the second quarter still benefited from pandemic-driven demand. However, as I said, we have seen the normalization of order entry in recent weeks to pre-corona pandemic levels, and we are seeing continuing normalization also during the current quarter.

Despite lower order entry, year-over-year, net sales increased slightly by 1.6% versus the same quarter last year. The increase of the region AAA as well as Americas was offset by decline in Europe, especially in Germany. The gross profit margin was disappointing, in the second quarter gross profit decreased by 10% and gross margin decreased by roughly 4.5 percentage points. Higher expenses for quality measures and weaker positive effects from the product mix compared to the first quarter of 2021 are responsible for this decline. Higher field corrective actions triggered provisions of about EUR 10 million to EUR 15 million towards the end of the quarter. Q2 EBIT was just below EUR 48 million corresponding to an EBIT margin of 9.1%.

For the 6-month period, order entry of around EUR 463 million is 14% the half year figure in 2019 in nominal terms. But as expected, it is lower than the order entry 1 year ago. Net sales during the first 6 months increased in all regions by a total of 15%. As a result, gross profit rose by more than 18% and the margin increased by 2.8 percentage points. The very good gross profit from the first quarter compensated for a decline in the second quarter. As a reminder, in Q1, we had a very strong gross profit margin in the Medical division, mainly due to higher capacity utilization, better pricing and improved product mix. EBIT of the first half of the year improved to EUR 145 million contributing to a strong improvement of the DVA which is up to EUR 275 million to just above EUR 335 million.

Let us now look at the development of the Safety division on Page 6, starting with the development in the second quarter. As we have just noted that for the Medical division, also the Sales division, order entry is above to pre-corona levels. Compared to the record level 1 year ago, Safety division's order entry declined slightly by 9% in the second quarter. This means that order entry is currently no longer benefiting from pandemic-related demand. Following the strong increase in demand for light respiratory protection last year that's the business with FFP or N95 masks we currently see order entry normalizing. Particularly in Europe and the region of Americas as the pandemic-related large orders were not repeated this year. On the other hand, we currently see a solid demand in the Service business as well as the business with respiratory and personal protection and with our alcohol testing equipment.

Net sales in the second quarter increased by roughly 25%. All regions contributed to this growth, with the Americas region contributing strongest with an increase of some 40%, in line with the increased sales volume gross profit improved significantly by 23% in Q2 and gross profit margin remained stable at the level of the second quarter of 2020. Q2 EBIT nearly doubled to a total amount of EUR 32.5 million, lifting the EBIT margin to 10.3%.

Looking at this 6-month period, net sales increased at nearly 22%. The gross profit margin increased by close to 1 percentage point. Positive product and country mix effects were partly compensated for by start-up costs for the new mask productions sites. EBIT of the first half of the year reached nearly EUR 64 million, corresponding to an EBIT margin of 10.7%. Due to the higher earnings, DVA improved and increased to just below EUR 68 million.

Turning now to some other key figures of Dräger Group on Page 7. With more than EUR 172 million, cash flow from operating activities for the first 6 months is considerably higher than in the previous year. Main factor for the strong development is the higher profitability. Besides that, also the strong collection of trade receivables and the lower buildup of inventories contributed. By contrast, operating cash flow was negatively impacted by a reduction in trade payables and other prepaid items accumulated purchase options for ventilators last year. In addition, we had a cash inflow from investing activities of some EUR 33 million, whereas in the same period of the previous year, there was a cash outflow of rounded minus EUR 49 million. The cash inflow is explained by the divestment of money markets funds. And that amount of nearly EUR 90 million. Main cash outflows are for replacement and extension investments -- and some investments into our new mask production facilities.

Free cash flow is substantially above the prior year's level at roughly EUR 206 million. As you might be aware, we have taken steps to optimize capital structure, something we had discussed in detail during our last conference. As a result, these activities, the cash outflow from financing activities in the amount of EUR 251 million can be attributed to the cancellation and partial buyback program of participation certificates. Payment of the termination value for remaining series D participation certificates in the amount of rounded, EUR 209 million, will be made as scheduled in January 2023 from current (inaudible).

Moving on to net financial debt. The first half 2020 net financial debt has increased and the equity ratio had declined significantly due to the cancellation of the participation certificates. As of end of June this year, net financial debt was EUR 148 million is back at a lower level. Also, the equity ratio has increased to 38.2%, 8.2 percentage points more compared to the end of June last year. The improvement in the equity ratio by almost EUR 177 million is mainly attributable to the significant increase in earning. In addition to the adjustment of the accounting parameters for German pension accruals decreased. The net amount of this adjustment of around EUR 35 million after tax adjustments increased contained earnings in equity without affecting profit or loss. Also the issuance of the new long-term ESG-linked note loan to the amount of EUR 100 million and the early partially repurchase of the participation certificates Series D in the amount of EUR 100 million contributed to this.

Thanks so much. I'd like to hand over to you Stefan. Thanks.

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**Stefan A. Dräger** - *Drägerwerk AG & Co. KGaA - Chairman of the Executive Board - Drägerwerk Verwaltungs AG*

Thank you, Gert-Hartwig Lescow. Let me close to summary or few financials for the outlook for the current fiscal. We had a very strong start into the year with considerable tailwinds supporting our Q1 net sales, net earnings. In the second quarter order remained above our expectation on a high level of the first quarter. Following the strong demand development above our previous expectations we raised our full year guidance at the end of June. We now anticipate a decline of only between 2% and 6% return adjusted net sales compared to the record level last year. And due to the higher expected volume, the associated scale effects and the expected product mix, the earnings guidance was also raised. THE EBIT margin is now expected to reach between 8% and 11%. This guidance implies a lower top line and bottom line for the second half of the year. This is based on the fact that we have started to see pandemic-driven demand coming down, which is in line with what we had said before pandemic-related demand will normalize during the current year and we do not anticipate comparable demand in 2022. Of course, due to the pandemic, the guidance remains subject to higher uncertainty than usual.

With this, I would like to end the presentation and hand over to the operator to open the floor for your questions, please.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) It appears we have no questions in queue at this time.

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**Stefan A. Dräger** - *Drägerwerk AG & Co. KGaA - Chairman of the Executive Board - Drägerwerk Verwaltungs AG*

Give a little bit more time. If there are questions coming, we would like to answer questions.

Last chance, if there are any questions, you can ask now?

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**Operator**

No questions in queue.

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**Stefan A. Dräger** - *Drägerwerk AG & Co. KGaA - Chairman of the Executive Board - Drägerwerk Verwaltungs AG*

If there are no questions, thank you for your participation and for being with us and listening to us. And we look forward to hear from you and hopefully meet you some time in the not-so-distant future. Thank you very much and a good afternoon and summer. Bye-bye.

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