REFINITIV STREETEVENTS

EDITED TRANSCRIPT

DRWG.DE - Q4 2023 Draegerwerk AG & Co KGaA Earnings Call

EVENT DATE/TIME: MARCH 07, 2024 / 2:00PM GMT

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

CORPORATE PARTICIPANTS

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

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

CONFERENCE CALL PARTICIPANTS

Alexander Galitsa *Hauck Aufhäuser Investment Banking - Equity Analyst*

Christian Ehmann *Warburg Research GmbH - Analyst*

Jean-Marc Mueller *JMS Invest - Co-Founder*

Oliver Reinberg *Kepler Cheuvreux, Research Division - Head of Med Tech Equipment & Services Research*

PRESENTATION

Operator

Ladies and gentlemen, welcome to the Dragerwerk Full Year 2023 Earnings Call. I'm Walt, the Chorus Call operator.

(Operator Instructions) At this time, it's my pleasure to hand over to Stefan Drager, CEO. Please go ahead, sir.

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

Good afternoon, and thank you for joining our conference call on our financial results for the fiscal year 2023. I have with me today Gert-Hartwig Lescow, CFO; as well as Tom Fischler and Nikolaus Hammerschmidt, both Investor Relations.

We would like to take you through the results of the fiscal year 2023 with a presentation that we made available on our web page this morning. Following the presentation, we will open the floor to your questions.

Let's get started on Page 5 with the business highlights. One year ago, we promised to return to growth and profitability in 2023. To achieve this goal, we announced the focus on the following 5 main topics: leveraging intact market growth; improving our supply capabilities; increasing our prices; optimizing our free cash flow; and last but not least, strengthening our cost awareness. One year later, we confirm that we kept our promise and even exceeded our own expectations.

With a currency-adjusted increase of more than 2%, our order intake in 2023 was slightly above the high prior year level. This demonstrates that demand for our Technology for Life remains high and our markets remain intact.

After the easing of the supply chain constraints, our net sales development -- developed very well in 2023. In nominal terms, increased by 11%, net of currency effects by more than 13%. This was particularly due to the improved delivery capability and the continued good demand for our products and services, but also because of the surge in demand for ventilators at the beginning of the year. In addition to this development, we countered rising costs through, on average, a 7% price increase.

Both the good demand and the effective sales price management paved the way for a significant improvement in earnings and a remarkable optimization of our cash flow. Together with the reduction in inventories, the positive results generated a strong improvement of free cash flow.

Last but not least, we reduced our functional expenses by almost 3%, thanks also to a consistent cost discipline in all areas. Hence, we delivered on our promise to strengthen cost awareness.

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Now we move on to Page 6. Overall, we saw a strong business performance in 2023 with a successful return to growth and profitability. Net sales totaled at around EUR 3.4 billion, and our EBIT improved significantly by EUR 255 million to EUR 166 million. The EBIT margin consequently rose by around 8 percent points to almost 5%.

While the normalization of our delivery capacity, the continued good demand and our successful expense management were clearly the main drivers for our strong business performance. There were also highlights in other areas, which brings me to the same important product approvals and the status of the FDA warning letter.

While the warning letter has not yet been lifted, we received FDA clearance for several key products in 2023, such as the new Atlan anesthesia devices; the Babylog ventilators; the Babyroo open care warmer; and the Evita ventilators, the V600 and V800; as well as VentStar Helix.

In October, we also received important clearances in regard to our Infinity Central Station, ICS, and our portable M300 devices. These releases come with cybersecurity enhancements and improvements that are directly associated with our warning letter and are a key milestone for us to close out the remaining commitments.

So we remain focused on all related topics in the warning letter for which the FDA will conduct a reinspection for final closure at their discretion.

Another highlight in 2023 was our share performance. With an increase of more than 20%, both our common and preferred shares developed very well and even outperformed the German SDAX.

However, while the share price performance in '23 was good, we cannot be satisfied with the current valuation of our company. In this regard, it is good that we are becoming more attractive when it comes to our dividend policy. I will come back to this issue later in this presentation.

Moving to Page 7. Ladies and gentlemen, we have successfully returned to growth and profitability in 2023. I would now like to share with you our 3 midterm corporate objectives. Corporate objective number one is profitability first, which means that we will focus more strongly on earnings growth in the future even at the expense of net sales growth in selected cases.

With corporate objective number two, innovation leadership we want to revitalize our innovation, deploy this strength successfully to our markets and become the first choice for our customers.

And last but not least, we strive to enhance the level of competence on interoperability and systems business in order to achieve our corporate objective number three.

Through working on these objectives, we want to improve our DVA with a positive DVA in 2024 and also in all subsequent years.

On Page 8, details of the corporate objectives. Let me first go in the objective number one, profitability first. Profitability is the prerequisite for our successful longevity. Our aim is, therefore, to increase our profitability, our EBIT margin by an average of 1 percent point per year over the coming years. The environment for this is good because the global market for medical and safety technology offer an excellent growth environment for our Technology for Life.

In order to sustainably increase profitability, we will focus on supporting our margins through selling price enforcement and careful cost and expense management, aligning our activities even more closely with our customers and consistently pushing ahead with our own initiatives.

This might also mean that we will exit certain markets. Just a few weeks ago, we announced that Drager will discontinue the business activities of the MSI in Hagen at the end of the current year 2024. Drager's MSI product portfolio is designed for the analysis of flue gas from fossil fuels. Customers are the HVAC markets and chimney sweepers. But due to the impending energy transition and the changes in air-conditioning technology, this business segment does not offer any prospect of sufficient long-term profitability. Drager is therefore exiting the fossil fuel flue gas analysis business.

Just like in this example, we will continue to restructure or discontinue businesses that are not sufficiently profitable.

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Moving on to corporate objective number two, innovation leadership. Technology for Life is our guiding philosophy. Technology stands for inventiveness, technology push and engineering excellence, which are deeply ingrained in our DNA. The company history started with a patent, and each year, we file about 100 new ones. In 2023, for example, 278 patents are granted for Drager.

We have many products that are considered particularly innovative and markets that we are leading in certain aspects. But there are also areas we still need to improve. We need strong partners and passionate experts to keep up the pace. This means we have become more open to working with third parties and no longer develop everything ourselves.

We have already taken the first steps in this direction. In areas where we cannot bring our own developments to market maturity quickly enough, we will also enter into targeted development for this purpose. Already today, we offer OEM products in the areas of patient monitoring and transport (inaudible) and will continue to do so in the future.

Our target portfolio is also about reducing hardware variance and increasing scalability through software functionality. At the same time, we invest in commercial innovation to develop business models that meet the requirements of our existing and future customers.

Ultimately, of course, we are interested in how innovative our customers perceive us to be. In the end, this perception is decisive for how much money customers are willing to pay for our products and services, how much we can sell and how well we can defend our prices and not how much money we ourselves have spent on our innovation.

However, as this customer perception itself is not easily measurable, we have decided that we will rather be measuring our progress with the innovation share, the share of new products launched in the last 3 years in proportion of total product sales.

To conclude my explanation, let's look at corporate objective number three, competence in interoperability and systems business. Interoperability is the ability of machines, devices, sensors and people to connect with each other and communicate. This approach supports our customers' decision-making process through greater transparency by linking up data and providing recommendations.

As an example, for our medical business, we are developing a digital ecosystem based on the IEEE SDC communication standard to offer our customers these valuable functionalities. This will allow secure interoperability of medical equipment and clinical information systems at workstation. By combining and analyzing data from different systems, we develop new digital applications to assist clinical decisions, improve workflows, and ultimately, automate care wherever feasible.

To support this corporate objective, we will be focusing on training large parts of our sales and service employees in interoperability and system topic.

So much for this short overview on our objectives now to the coming years. Before I hand over to Gert-Hartwig Lescow for the review of our financials, I would like to highlight our activities on sustainability on Page 9. In 2023, we started to further expand our sustainability organization. This will ensure that we can track the achievement of our sustainability growth even more effectively. We are also taking account of the increased regulatory and communication requirements on this topic. In addition, we began implementing comprehensive measures as part of our strategic areas of action in 2023.

With that, we are taking sustainability at Drager to the next level. Many of our measures in the 3 core areas of environment, social and governance have already been successful. For example, we have so far reduced our CO2 emissions by 31% compared to our base year 2015. We are, therefore, still on track to reduce our CO2 emissions by 1/3 in the period from 2015 to '25. Our goal remains climate neutrality by 2045.

In 2023, we received good ratings for sustainability again. For example, the EcoVadis institute, the world's largest provider of sustainability ratings for companies, awarded us Gold status for the third time in a row. This puts us in the top 5% of companies rated by the EcoVadis.

In addition, we were rated A by MSCI and we defended our Prime status with the ISS ESG rating.

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

With that, I turn over to Gert-Hartwig for a review of the financials before I will come back with a summary and the outlook later. Gert-Hartwig, please.

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

Thank you, Stefan. I would also like to welcome everybody to our conference call for our results for 2023. Please turn to Page 11 for a view on the Drager Group. As usual, I will be stating currency-adjusted figures whenever referring to growth rates.

Stefan said demand for our technology remained high in 2023. Overall, order intake in '23 rose by more than 2% to [some] EUR 3.3 billion. After the first 3 quarters had contributed roughly EUR 800 million order entry each, Q4 contributed another EUR 860 million.

When looking at the regional trends, both Europe and the Americas contributed to growth over the full year while orders in AAA declined.

Year-over-year growth in net sales surpassed growth in order entry clearly. EUR 3.4 billion corresponds to a plus of around 13% against the prior year.

In the fourth quarter, net sales growth came down considerably since the comparable prior year figure, which was much more challenging. In Q4 2022, our supply chain had already started to improve.

Our gross profit margin also improved in Q4, leading to an improvement of 2.6 percentage points, and thus, to 43.3% for the year as a whole. The improvement was especially due to a higher production and service utilization as well as more effective price management.

Cost control was and remains the top priority throughout the organization. In spite of higher personnel costs for German employees, functional costs fell by around 3% in the fourth quarter and by around 1% for the year. Obviously, declining cost base cannot be maintained in an inflationary environment, so do expect a rising cost base in the current year.

As a result of the significant increase in sales and gross margin and effective price management, earnings improved massively.

After 3 profitable quarters, the fourth quarter was as is typical, the strongest quarter of the year with an EBIT of EUR 90 million. For the year as a whole, EBIT improved by EUR 255 million and reached EUR 166 million. Because of the strong earnings development, our Drager value added return to positive territory in the fiscal year.

Let us now take a closer look at the development of the 2 divisions, starting with the medical division on Page 12. In the fourth quarter, order intake in the medical division remained nearly stable compared with the same period in the previous year. In the Africa, Asia, Australia region, demand fell sharply after having risen significantly in the same quarter of the previous year due to the surge in demand for ventilators in China. Hence, this is mainly basis effect. In Europe, on the other hand, order intake increased significantly.

Looking at the full year, order entry was around 1% lower than in the prior year. This was due to lower demand for ventilators and anesthesia machines as well as patient monitoring.

On the other hand, there was noticeable growth in the service business and in the area of hospital infrastructure. Net sales in Q4 were just under 1% higher than the previous year with an increase in Europe and the Americas regions and a decline in AAA.

In the full year, net sales increased by more than 10% and driven by significant growth in all regions, which was due, in particular, to the noticeable improvement in delivery capability. Another reason for positive development was the significant increase in demand for ventilators in China at the beginning of the year, which resulted in a very significant boost to net sales of AAA during the first quarter.

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Overall, and in addition to ventilators, hospital infrastructure, thermoregulation, anesthesia devices as well as consumables were the main growth drivers in '23. And on top of that, our service business performed well.

The gross margin increased in the full year by 1.7 percentage points due to the improved production and service utilization as well as the effective price management.

Higher net sales and increased gross margin and lower expenses led to an improved profitability compared to the prior year period.

In the fourth quarter, our EBIT in the medical division came to more than EUR 39 million. Our full year EBIT went from an operational loss of more than EUR 90 million to a clearly positive result of around EUR 37 million. Our EBIT margin in the medical division increased to 1.9% at the full year.

Coming to our safety division that recorded a very strong performance in 2023, we're on Page 13 now. In the fourth quarter, business development in the safety division continued to be favorable.

Order intake increased by roughly 13%, thanks to growth in all regions. Product-wise, demand was mainly driven by gas detection devices and our service business. After 12 months, order entry was up by over 7% due to the same reasons like in Q4, but primarily because of our gas detection business, which has been increasingly affected by supply chain problems during the previous year, and therefore, benefited in 2023 from pent-up demand.

Net sales increased by roughly 12% in the fourth quarter and by around 17% in the full year with all regions contributing during both reporting periods. In addition to the noticeable improvement in delivery capability, this was also due to the positive order trend.

The gross margin went up significantly due to higher production and service utilization as well as effective price enforcement. For the 12 months, the improvement was 3.8 percentage points.

Functional expenses remained roughly at the prior year level in 2023.

Higher net sales and increased gross margin and slightly lower expenses supported the strong EBIT improvement in the safety division. In Q4, the EBIT amounted to just over EUR 50 million coming from around EUR 33 million in the prior year quarter. For the full year, the improvement is even more pronounced.

While the EBIT amounted to around EUR 129 million after roughly EUR 2 million in the prior year, the EBIT margin also made a big leap by 9.1 percentage points to 9.2 percentage points.

All in all, a very good development in our safety division.

Let's move on to some key ratios on Page 14, starting with cash flow, which was one of our focus topics throughout the year. The improvement in profitability drove a substantially higher cash flow generation with operating cash flow increasing by more than EUR 334 million to roughly EUR 190 million. The positive effect on cash flow from the higher earnings was further supported by good working capital development. The reduction in inventory contributed to cash generation. Investments were on the planned level, mainly for replacement investments.

At around EUR 122 million, free cash flow was clearly positive for the full year.

The key event for our cash flow from financing activities was the cash outflow for the repayment of the remaining profit participation in the amount of around EUR 209 million. This was partially financed by a new loan of EUR 100 million. Both transactions took place in the first quarter. This is the main reason why in spite of the earnings improvement, our liquidity position at the end of the year was lower.

For the current year, we expect to generate sufficient free cash flow to compensate for the higher dividend payment and be able to increase our cash position.

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Drager's balance sheet is in good shape. Net financial debt-to-EBITDA has improved quarter-over-quarter. With a leverage of 0.6 at the end of the year, the company is back to healthy leverage levels. The significantly improved operating profit and a slight increase in capital employed resulted in a return on capital employed of 10.9%. The equity ratio has improved as well and climbed by roughly 3 percentage points to around 46% in 2023.

As Stefan said in his opening remarks, this will trigger a higher payout ratio to shareholders for the past fiscal year.

Moving to Page 15. 2023 was the year we completed the simplification of our capital structure with the cancellation of the participation certificates in early 2020. And the redemption of the PCs over the following 3 years, we have concentrated Drager's market cap from 5 to only 2 listed securities. In total, the payment for the redemption of all participation certificates amounted to approximately EUR 470 million and was partially financed with a capital increase in the amount of some in 2020.

From this year on, the profit goes entirely to our shareholders. This will be directly apparent in higher earnings per share.

Moving to Page 16. On the next page -- on this page, we have illustrated the effect from the earnings concentration on the remaining 2 Drager securities, the preferred shares and the common shares. If we calculate the 2023 EPS on a pro forma basis with the legacy capital structure prior to the cancellation of the PCs in 2020, then the EPS today is some 27% higher than it would have been, including the former 3 series of the participation certificates. This also takes into account the dilution effect from the capital increase to partially finance the transaction.

The capital structure today is much more favorable to our shareholders.

Handing over to you, Stefan.

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

Yes. Thank you, Gert-Hartwig. And to build on your remarks on the capital structure, the concentration of the distributable earnings to Drager shareholders is a journey that started much earlier than 2020. The cancellation of the remaining participating certificates is actually only the last step.

When I took office of the Chairman in 2005, 35% of Drager Medical and the respective earnings were owned by Siemens. At that time, Drager shareholders overall were only entitled to some 35% of the earnings next to the JV partner and the PCs. At that time, there were more than 1.4 million PCs outstanding.

In a first and second step, in 2006 to 2010, we acquired the shares of the JV partner reducing its portion from 35% to 25% and later from 25% to 0. The untangling of the JV cost around EUR 360 million at that time and required a capital increase in preferred shares and the listing of the common shares to raise the money for that buyback of the Siemens share.

Two years later in 2012, we made a buyback of participation certificates worth roughly EUR 120 million. Again, Drager shareholders contributed this time with a low dividend. While this buyback lifted the portion of earnings attributable to the shareholders to some 70%, still roughly 30% of earnings belonged to the remaining participation certificate holder. Due to the corona time, in spring 2020, we used the boost in the business to cancel all the remaining PCs. That step cost around EUR 470 million and required another small capital increase in preferred shares.

Finally, today, with the completed redemption of the last PCs, the entire earnings are attributable to the Drager shareholders. This was the final step in simplifying the capital structure and concentrating all earnings to Drager shareholders. It took almost 20 years to complete. But as I have said many times before, at Drager, we take a long-term perspective. For a long time, Drager shareholders have contributed with reduced dividend and with dilution.

However, starting now in the year 2024, Drager shareholders can enjoy the benefit of this long-term effort and of the contribution they made over the long period.

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

So moving to Page 19, the dividend proposal. The finally simplified capital structure, and more importantly, the sound financials and earnings open up the possibility to incorporate an attractive payout policy going forward. Provided an equity ratio greater than 40%, we will be paying out at least 30% of net profit.

For 2023, this increases the dividend from the minimum level of EUR 0.13 to EUR 1.74 for the common and from EUR 0.19 to EUR 1.80 for the preferred share.

Now last but not least, the outlook on Page 20. Ladies and gentlemen, '23 was a successful year. We have successfully returned to growth and profitability in '23, double-digit top line growth and a major year-over-year swing in earnings of more than EUR 250 million.

But to be fair, assessment belongs to recognize that this development has benefited from some tailwind, a strong order backlog from '22 and some corona-related orders from China at the beginning of the year '23 had a positive impact on net sales and earnings. These 2 effects will be absent in the current fiscal year.

Despite missing tailwinds we expect to remain on a growth trajectory. We expect an increase in net sales of 1% to 5% net of currency effects. As a result, we are planning an EBIT margin of 2.5% to 5.5%.

As I said, when talking about our midterm corporate objectives, we are targeting a further improvement in profitability in the following years. While due to the normal fluctuations of the business, not every given year will show a steady margin expansion. But over a several year horizon, we will improve the EBIT margin by 1 percent point per year on average.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And the first question comes from Oliver Reinberg from Kepler Cheuvreux.

Oliver Reinberg - *Kepler Cheuvreux, Research Division - Head of Med Tech Equipment & Services Research*

Three if I may, the first one will be on the kind of midterm guidance. I guess it's quite encouraging to see that you're putting profitability more into focus. But I guess, what would be even more helpful is to have a kind of specific margin commitment for a specific year.

So first question would be just, is it something that you still consider to provide at some stage going forward when certain milestones have been met?

Second question also related to the midterm guidance. Can you just provide any kind of color how you think about the phasing of this 1 percentage point margin improvement? Is it more back end-loaded? And also what kind of sales growth assumption have you embedded to reach this kind of profitability improvement goal?

And thirdly, can you just provide an update on China, what you see in general in terms of market environment? What kind of impact do you see from the anticorruption campaign and also the discussion about changes in the procurement systems?

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

Okay. Profitability growth, as I said, Mr. Reinberg, we expect and plan for 1 percent point per year on average. So that is start in the year '23. '23, I mentioned we had a tailwind. So subtracting the tailwind from the particularly high ventilator orders due to corona at the beginning of 23 in China and the backlog that we had and then the return of our ability to deliver from that backlog, subtracting these two, the adjusted margin on EBIT would be around 3% for '23.

So then you see from the guidance for '24 we give, the midpoint is in around 4%. So naturally, then in '25, it should be 5%. And that, I would expect from our planning assumptions, should continue for a few years and it's neither back nor front loaded. It should be steady, 1 percent point per year.

However, not exactly, that's not -- would not be fair and possible to be exact by the point. But on average, 1 percent point per year for the next, say, up to 5 years to come.

We plan to, say, come out and share true midterm guidance at a later point in time so it's -- when we have further improved our visibility, in particularly in the medical division. There, we have been working on some issues. I don't mean the warning letter, I mean on the portfolio issues and monitoring. That's -- so looking quite promising quite now from my perspective, but please bear with us a couple more months at least. So then we have a better visibility and then we can tell when we have a midterm -- a true midterm plan for you.

So then left open point is China. As I mentioned, as part of the tailwind from last year as much of a headwind for this year and maybe also next year, as you exactly stated, the anticorruption, which is, by the way, not only in the medical field, but particularly strong in the medical field. And the general -- I would probably already say, crisis of China were several aspects like real estate and other things, let's say, putting a burden on the growth and financing. So there is some aspect that the government actions are partially -- have objective to reduce the spending just because there's no money available.

So my expectation is that would stay for the remainder of this year, China will be quite difficult and more in the red compared to the expectations we had ourselves 1 year ago. And though in maybe 2 years, it will come back. So that's not so likely that will be completely closed or cut off.

However, strategically, it's becoming more challenging, in particular, for medical technology. It seems to be the field where the government focus is the most and even more than electric cars or rail transportation was in the past -- has -- the focus has shifted after corona towards becoming independent and self-contained in medical technology. So that makes the life for all, let's say, global players more challenging in China.

But there are opportunities. We continue to invest and to grow be still higher. We recently received the certificate for a particularly innovative company in China that gives us some tax breaks. So it's definitely worthwhile pursuing, however, not so going as fast as it used to in the past 3 to 5 years.

Oliver Reinberg - *Kepler Cheuvreux, Research Division - Head of Med Tech Equipment & Services Research*

Perfect. That's very helpful. And can I just follow up on what kind of sales growth assumption have you embedded into your midterm guidance to achieve this 1 percentage point of margin improvement?

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

That's part of more detailed guidance for the midterm other than taking like a look at the last few years, but we'll provide more specificity, as Stefan Drager has said, once we have more clarity on some of the open issues on the medical side.

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Operator

And the next question comes from Christian Ehmann from Warburg Research.

Christian Ehmann - *Warburg Research GmbH - Analyst*

I was just wondering how we should look at the phasing of the, let's say, divestments of certain business units, as you're trying talking about, especially what should we think about the time lines for these kind of divestments? .

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

There is the -- compared to the overall size of Drager and the great diversity that we have in Drager within many businesses and markets that we serve, all these are, say, relatively small. The opportunity is in the detail -- on a detailed level of product or country or business.

For a specific product and a specific country, we will find ways to improve, that can mean a divestment we already have, at this point 3, so maybe has not been so much received attention that already a while ago we discontinued our own Interlock business in the United States and sold this to a partner. We're still making the devices and the business in some other countries, but no longer in the U.S.

So then later during the course of the recent past, we divested the business of the fire detection systems in the Netherlands. This is a nontypical Drager business for the office and administration and industrial buildings, has not much to do with the gas detection systems that are for offshore oil rigs, and let's say, [unaccounted] mines and more demanding environment.

And so -- and most recently closed the business of -- that I mentioned in my speech in MSI in Hagen that's to measure gases -- flue gas in the exhaust of fossil fuel furnace for oil and gas. And there may other opportunities come in the past, but they need to be discussed in detail that people that are affected, and we do not publish a plan looking far ahead.

And these -- from the overall perspective, these are smaller steps that do not affect the nature of Drager. However, [our head] together to pursue corporate objective number one, to improve profitability by strengthening our strengths and so eliminating weaknesses that we have identified.

Operator

And the next question comes from (inaudible) from AlphaValue.

Unidentified Analyst

First is regarding your midterm EBIT margin ambition that you just highlighted? So what is your benchmark or ambition, let's say, in the longer term? Like the reason why I ask is, who are you benchmarking against to try and understand what kind of a runway we have to expand margins? So that would be the first question.

Secondly, on dividend policy, do you intend it to be at least 30% payout ratio or relatively progressive. By progressive as in the future years, do you intend to at least match the previous year's dividend or will it be just 30% payout every year and it could move up and down over the years? That is on the dividend policy.

And thirdly, in terms of your order intake-to-sales ratio, when do you expect it to be more of a normalized level? And by normalized, I mean greater than 1. Your order book as -- order intake being higher than sales, do you have a time line to that or some sense of when we could be at that level because most growth businesses ideally would be at more than 1 book-to-bill ratio.

So these will be three, I have one more which I will probably ask you once we run through these 3 questions.

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

Okay. I'll start, Stefan Drager speaking. I'll start with your first question, what are the benchmarks?

Unidentified Analyst

Yes, yes, that's right.

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

Overall, there is no company directly comparable to all of Drager with that similar diversity. However, we do have benchmarks for medical and for safety divisions -- for the safety division, for instance, you can use Honeywell or MSA as a benchmark or 3M.

And for the medical division, there is -- typically the medical technology companies such as Getinge is publicly listed from Sweden or the Philips or Siemens Healthineers. However, these are a little bit different because medical imaging has a little bit different mechanics than we have.

And from that level that these are, there is no particular reason on the longer term whereby we should not be on the same level. So that's to your question number one, benchmark.

On the dividend, you observed that correctly that the policy is a payout ratio of 30% of the earnings to the shareholders as dividend. So that is the goal. It can go up and down with the earnings. So depending on this develops and so there is, let's say -- so that is the general policy.

And the last point, the book-to-bill ratio in '23. That was the tailwind that I described was that we came when we started January 1 into '23. We had a far too large order book because it was larger definitely than we wanted because we could not deliver because we could not build the product because we were short of components because of supply chain issues. That had already started actually in the mid-'21 after the corona times, as you all remember. So that was the starting point.

So as you can see in 2023, our sales rose by 13% and orders only grew by 2%, which is good. I think that it came down because we should go back to normal delivery times to our customers to satisfy their expectation and also to remain competitive to other market companions who have short delivery times. And there are quite many cases there, whether you want it in order or not depends whether you can deliver quickly and on time.

So did I keep telling my production people that don't be too worried if in the afternoon, you have run out of work to do because all orders have been processed. That's actually a desirable condition. So on average, order intake on sales should be on par. But last year, luckily, we processed more orders than we received new orders.

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

Perhaps, in addition, for '24, it will be around 1 would expect '25 to be a year where, again, a net order entry would be slightly ahead of our net sales development.

Unidentified Analyst

Okay. Perfect. That's clear. So '24 around 1 and then in '25 slightly ahead, that's right?

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

Yes.

Unidentified Analyst

Okay. Just one last question that I have is so with the increasing focus on climate change and global warming in particular. And given the kind of news that we saw in the last few months of last year or so at least of more wildfires and stuff like that, do you see that as necessarily a longer-term tailwind for the safety business?

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

Yes, in 2 aspects. Well first, improving the traditional energy industries like the oil and gas industry is probably the biggest lever in all. If we can make a contribution to make these more climate friendly to like to control the methane emissions that it has been -- become a big topic in the United States, to measure and control methane emissions from, let's say, oil and gas installations. And there, we do have expertise and competence in this. Then this is a boost for our safety business plus the new energies like hydrogen and even a battery factory, we are very positive that will contribute to our business.

So the week before last, I was visiting Northvolt in (inaudible) in Sweden and met with Peter Carlsson to see what we can do together in his plans in other locations. So there is quite some potential in this rightfully so.

Operator

And the next question comes from Alexander Galitsa from Hauck Aufhauser Investment Banking.

Alexander Galitsa - *Hauck Aufhäuser Investment Banking - Equity Analyst*

The first one, I just -- I want to better understand the safety division profitability dynamics. I think during the course of 2023, the margin range of maybe 7%, 8%, 9% was sort of presented as a sustainable development, but now we learn that there were some windfalls related to the pent-up demand. What would you say is the sort of sustainable margin of this division if you strip out the benefits you received?

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

The windfall that we mentioned was not so attributable to safety because one part of it was the ventilator. The surge in demand for the change in corona policy in China at the end of '22, '23, that was medical. And so yes, we had some, say, order backlog, in particular, on the fire and gas detection systems, that's safety. So that had a particular nice growth in '23. Probably will continue to grow in the future, maybe not exactly at the same roaring speed anymore.

On the other hand, we had some, say, headwind on the safety margin because we had write-offs, onetime expenses for FFP mask production sites that we built in 2020 in corona times and they earned their money that was already worthwhile in the course of 2021 and then part of '22.

However, there -- it's a little bit unfair because the benefit was reaped already fast and then what paid for the investment. And there were some, say, final write-offs for 3 sites that we closed in 2023 were included. So that's a onetime effect downward that will not reoccur in '24.

So there is no reason to believe the margin would go down in the future for safety. So it still has the potential to contribute to the overall profitability growth of Drager.

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Alexander Galitsa - *Hauck Aufhäuser Investment Banking - Equity Analyst*

Understood. And then maybe another one. I noticed in the presentation, you talked about positive the Drager value-add in 2024. I believe, by your calculation to get there, you need at least the EBIT margin of 4% for the group. So can you confirm that? And are you basically positive that the midpoint, so to speak, of the margin target is sort of your confident base case scenario for 2024?

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

So firstly, yes, your calculation is accurate. And second is also that we don't have a preference for either side of the guidance.

I should also add that for the computation of the DVA, which is an internal non-IFRS metric, we have decided to increase the back to reflect the higher interest rate from 7% to 9%. So in '23, we have computed the DVA with 7% and for '24 onwards we will be using 9%.

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

So that makes it more challenging to reach that positive DVA.

Alexander Galitsa - *Hauck Aufhäuser Investment Banking - Equity Analyst*

Okay. But if you're talking about being rather confident then that should be your preferred or base case scenario.

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

Yes. And that's -- your computations is correct and that's based on the 9%.

Operator

And we do have a follow-up question from Oliver Reinberg from Kepler Cheuvreux.

Oliver Reinberg - *Kepler Cheuvreux, Research Division - Head of Med Tech Equipment & Services Research*

Probably 3, if I may. I mean, firstly, can you just say a word on current trading? I would assume that given the base effect from China, Q1 will be tough. So just to get it out there, is it reasonable to assume the kind of sales decline in Q1?

Secondly, on the warning letter, how to think about it, it's basically you're now just waiting for the FDA to come back with the reinspection? Or is there still any kind of internal work related to the pending warning letter?

And then thirdly, on monitoring because you mentioned that the progress on monitoring is a requirement for setting this kind of formal midterm guidance. Can you just talk to the nature of the missing part you're still having in monitoring? And also, what gives you the confidence that now more focus is being made, given we had quite a few delays in the past?

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

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

Perhaps I start with current trading. Your observation is quite accurate. Obviously, on the medical side, we will be working with a somewhat lower momentum.

At the same time, as I said earlier, we still have a somewhat elevated order book, in particular, on the safety side. So -- and within every quarter, the last month typically is the most important one. So it's a bit too early to have a full judgment on the first quarter.

But to your question, we are working against somewhat of a headwind on the medical side when it comes to sales realization. But I'm not saying that we will necessarily be declining against the prior year quarter. It's too early to say that.

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

Well, your second follow-up question on the warning letter. So to my knowledge, all prerequisite that the FDA demand should be in place and all actions that needed to be completed are done.

However, it is, of course, at the discretion of the FDA and I wouldn't want to, let's say, put out any expectation when they find the time and the resources to act and then do a site inspection again, which is required for the closing of the warning letter.

So it is. Yes, it is still open. However, it does not have any adverse effect on the business. It's just a bit of -- we are taking up some resources and attention, so without having actual -- an adverse effect or a downward effect or limitations on the business.

On the monitoring, let's say, listen very carefully. There are some things that we are working on that, when finished, will allow us to have enough visibility to have a midterm guidance and to share it with you. These involve a different parts of the and also external partners. So to not, say, put this at risk, we unfortunately can't share that today with you.

Operator

And the next question comes from Jean-Marc Mueller from JMS Invest.

Jean-Marc Mueller - *JMS Invest - Co-Founder*

A couple of questions from my side, clarifications, mainly. Your EBIT in medical was EUR 37 million and I understand that this profited from one-off business in China, et cetera. I mean, you mentioned this a couple of times. You also said that on a group level, if you adjust for this one-off, the margins would have been around 3% instead of the 4.9%.

So if I do the computation, we can basically argue that roughly EUR 60 million EBIT or so was something, which had to do with the ventilator business in China. Am I correct in my calculation that medical would have been negative EBIT, medical would have been negative again in 2023 without this extra sales in the first half?

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

Not quite, not quite. Let me explain. Firstly, there is, of course, a different way on how you look at onetime effect. When we talk about a run rate, we're referring to a starting point for improving profitability and we are looking at the strong order book with which we started the year 2023. And we could look at it as a onetime attack because it's a consequence of the poor delivery performance in '22.

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Without that, that order book would not have moved into '23. Net sales would have been lower. That affects both divisions, medical and safety, and actually to a stronger degree -- to a stronger relative degree at the safety division with the gas detection systems business.

If we just focus on the China business, as you did in your question, and I wanted to make clear when we talk about onetime effects, there's more to that than that. One, the China business is, from an EBIT point of view, contributed less than the EUR 37 million. So even if we were to take that out, profitability would still be positive. And in addition to that, we would not be too granular in looking at the medical per se because I believe we can all agree a 1.9% EBIT margin for the medical division is not sufficient because from a DVA point of view it translates by itself already into a negative DVA.

Operator

So the next question comes from Alexander Galitsa from Hauck Aufhäuser Investment Banking.

Alexander Galitsa - *Hauck Aufhäuser Investment Banking - Equity Analyst*

I'd be happy also (inaudible). My question that I had remaining is on the innovations that you announced, that there will have -- or will be a significant number of updates, innovation released into the market. Just wondering how to think about it, whether this represents a meaningful tailwind for the medical division?

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

Oh, yes, of course, there is an important factor in the improvement that we go for in -- also in the growth and profitability for the medical division is the renewal of the portfolio, so that is a very natural point.

So with this, I think, as we already have exceeded our time limit, we have today, and particularly today, thank you to all of you for your vital interest in Drager. So we look forward to stay in touch with you and to receive more questions and give you more answers also on an individual basis.

Now I would like to end the call and thank everybody for being with us and your interest, and have a pleasant afternoon and evening.

Operator

Ladies and gentlemen, the conference has now concluded, and you may disconnect. Thank you for joining, and have a pleasant day. Goodbye.

DISCLAIMER

Refinitiv reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES REFINITIV OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2024, Refinitiv. All Rights Reserved.

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV