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PRESENTATION

Operator

Ladies and gentlemen, welcome to the Drägerwerk Q1 2024 Earnings Call. I am George, the Chorus Call operator. (Operator Instructions) The conference is being recorded. (Operator Instructions) The conference must not be recorded for publication or broadcast. 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*

Yes. Good afternoon, and thank you for joining our conference call on our financial results for the first quarter of 2024. 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 with the 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. Before I jump into the business figures, please keep in mind that the first quarter is traditionally our weakest in the fiscal year. Moreover, we have to consider 2 base effects when we look at the past quarter. First and foremost, we benefited from strong catch-up effects in Q1 '23 as our delivery capability improved noticeably back then. In addition, the surge in demand for ventilators in China after the sudden end of the lockdown policy gave us a boost.

In Q1 '24, both effects did not repeat. That said, we delivered a solid business performance in the past quarter. Our order intake was slightly above the high prior year level, thanks to the good demand in our safety division. This means that demand for our technology for life remains high and that our markets are intact.

Net sales and earnings were below the prior year figure due to the base effect. With around EUR 15 million, we still achieved a positive operating result. At the same time, we saw a significant improvement in operating cash flow by almost EUR 38 million. Gert-Hartwig will comment on this later. Net sales decreased by roughly 3% around to -- to around EUR 736 million as a result of the soft development in the medical division. The safety division, on the other hand, delivered a strong performance. In the Asia Pacific region, net sales decreased significantly due to the missing China effects in particular. But next to this missing tailwind the order dynamic in general in the APAC region is currently rather weak. In the Americas region, net sales were only slightly below the prior year level. The other regions Germany as well as Europe, Middle East and Africa recorded solid growth.

As you may notice, we have recognized -- reorganized our regional structure. The Germany region was separated from the Europe region as a new independent region. The Middle East and Africa subregion was spun off from the Africa, Asia and Australia region, and merged with the Europe region to form the new Europe, Middle East and Africa region. The remaining part of the AAA region was combined to form the Asia Pacific APAC region. Our Americas region remains unchanged. With this reorganization, we focus our sales activities even more strongly and specifically on our customers within one time zone. In order to ensure proper comparability and full transparency, we have restated our original order intake and net sales figures since the fiscal year 2020 on a yearly and quarterly basis. The figures are available for download on our IR website.

As I said, the decline in net sales and earnings in the past quarter has been no surprise. Thanks to the positive results, we are confident that we will achieve our full year guidance. After our successful return to growth and profitability in '23, we will now focus on our midterm corporate objectives. This leads me to our Annual Shareholders' Meeting. In the -- the meeting will take place on May 8 in Lübeck. In addition, there is a significant dividend increase in our new dividend policy. Our corporate objectives will be one of the major topics at the event. Each division will explain what the corporate objectives mean for their business and how already today, our activities and innovations are supporting their implementation: increase midterm profitability, strengthen our innovation leadership and enhancing our competencies in interoperability and system business. For those of you who cannot attend, there will be a recording available on our website after the AGM.

With that, I turn over to Gert-Hartwig for a review of the financials before I will come back with the 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 also would like to welcome everybody to our conference call for our results for the first quarter.

Please turn to Page 7 for a view on the Drager Group. As usual, I will be stating currency-adjusted figures whenever referring to growth rates. As Stefan said, demand for our Technology for Life remained high in Q1. Overall, order intake rose slightly by about 2% to EUR 811 million. All regions contributed to growth except APAC, where the missing China effect and a subdued market environment led to a significant decline. At around EUR 736 million, net sales were slightly below the prior year level. Again, this was no surprise after the extraordinary improvement in Q1 '23, and we had benefited from a noticeable improvement from delivery capability.

Our gross profit margin, on the other hand, saw a slight improvement from 45.0% to 45.3%. This improvement is due to the good margin development in the safety division. Good price performance and higher production utilization contributed to this in particular. Functional expenses were roughly 2% above the prior year level. Due to the mentioned reasons, our EBIT amounted to EUR 15.1 million compared to EUR 29.1 million in Q1 '23. The rolling month -- the rolling 12-month DVA was also positive with a significant increase of roughly EUR 146 million to EUR 10.9 million.

Let us now take a closer look at the development of the 2 divisions, starting with the medical division on Page 8. In the first quarter, order intake was slightly below the high prior year level at around EUR 454 million, particularly due to the normalized ventilator demand in China as well as decreased demand for hospital infrastructure, consumables and services. On the other hand, orders for thermoregulation, patient monitoring and anesthesia devices increased. As a result of the Q1 '23 base effect, net sales in the medical division were significantly below the prior year level and decreased by roughly 10% to about EUR 417 million.

The gross margin decreased by 1.3 percentage points, mainly due to a less profitable product mix and lower production utilization. Expense management continued to be affected with a decline of more than 3%, functional expenses were below the prior year level. As a result of the lower net sales and lower gross margin, our EBIT in the medical division was at around minus EUR 11 million after plus EUR 10 million in Q1 '23. Our EBIT margin in the division came to minus 2.7% after 2.2% in the prior year quarter. The rolling 12-month DVA improved significantly, and increased by roughly EUR 50 million to minus EUR 65.2 million.

I will now turn to our safety division, which recorded a strong performance in Q1. We're now on Page 9. Our safety business continues to grow. In the first quarter, order entry in the safety division increased by more than 6% to around EUR 357 million. This was driven by Occupational Health and Safety equipment, respiratory and personal protection products as well as alcohol and drug testing devices. Looking at our regions, EMEA and Germany were the key growth drivers. The overall good demand also contributed to higher net sales, which rose significantly by 10% to around EUR 318 million. The gross margin also went up by 2.2 percentage points, particularly as a result of the high production utilization and good price enforcement.

Functional expenses increased by more than 10%, mainly due to an increase in our sales-related capacities as we have increased, in particular, the customer-facing head count in our regions. Supported by the good net sales development and the high gross margin, our EBIT in the safety division rose significantly by almost 40% to EUR 26.3 million. The EBIT margin consequently increased from 6.5% to 8.3%. The rolling 12 months DVA also improved significantly by around EUR 96 million to around EUR 76 million coming from minus EUR 20.2 million in the prior year quarter. All in all, a very positive development in our safety business in Q4 '24.

Move on to some key ratios on Page 10. And first comes the cash flow, which increased significantly despite the lower EBIT. Effective working capital management was the main contributor to the better cash flow. Especially the better development of trade payables and receivables contributed. Operating cash flow amounted to roughly EUR 33.5 million, coming from around minus EUR 4.2 million in the prior year quarter. At roughly EUR 23 million, total investments were also below the prior year.

Free cash flow continued to develop favorably. It is now roughly EUR 40 million above the prior year period. We're confident that we can maintain a high level of cash conversion for the full year. Net financial debt has improved significantly over the year. As a reminder, in January '23, we took out a 5-year loan of EUR 100 million to strengthen our operating liquidity after the repayment of the remaining participation certificates.

Net financial debt-to-EBITDA has improved over the course of the last year. Now due to the improved profitability, our leverage of 0.6% is back to a much lower level. The significant improvement in the operating result over the past 12 months and the slight decrease in capital employed as at the reporting date also led to an improved 12-month return on capital employed of 10% compared to minus 1.6% in the same period of the previous year. The positive business development has also resulted in a further increase in the group's equity position. As of March 31, the equity ratio was more than 47%.

Now I hand back to Stefan Drager for the outlook on Page 12.

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

Ladies and gentlemen, considering the extraordinary improvement in the prior year quarter, we had a solid start into the new year in Q1 '24. Although the first quarter is traditionally the weakest in our fiscal year, we achieved a positive result.

Despite currently soft demand in the APAC region and ongoing discussions about a cool down of the economy in many geographies, we remain confident that we will achieve our forecast for the year. We continue to expect an increase of net sales of 1% to 5% net currency effects and an EBIT margin of 2.5% to 5.5%.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Oliver Reinberg with Kepler.

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

Three questions from my side. First one would just be on the kind of midterm outlook for sales growth, let's say, over the next 3 to 5 years. And can you just talk to the areas of themes where you see the biggest sales growth potential and probably also 2 or 3 areas where we believe that the kind of environment may continue to be challenging? That would be question number one. .

Secondly, can you just provide some kind of color on the ventilator market? The question is excluding China. China is clear that there is currently a lack of demand. But in the rest of the world, where do you see currently demand trends? Are they normalized with this pre-pandemic level? And in particular, given that Medtronic and also Philips partly pulled out of the market, to what extent is this the kind of opportunity for you?

And then thirdly, just on profitability. I mean, this is apparently kind of a new focus or accelerated focus for Drägerwerk going forward. So can you just talk a bit about the kind of process that you implemented, the incentives that local management teams have and how you want to safeguard that really medical is returned to kind of a sustainable adequate margin level?

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

Well, thank you, Mr. Reinberg, for your questions. This is Stefan Drager speaking. I'll start with the first the midterm outlook on sales. So in general, the good news is that our markets are intact. The technology for life is much needed and has a great outlook into the future in pretty much all markets that we serve. So that's overall. In more detail, I would say some markets where we had already seen good development like fire gas detection systems continue to grow and also services in general and consumables business and all the different businesses just to name some.

We currently also see on a global scale, our neonatal business is developing quite well. And so some good development we expect geographically, so I suggest for the years to come, for instance, in India. So a little bit more cautious, I would be about China that in general, for that I expect to be somewhat muted in the market for let's say, what you said midterm, you mentioned 3 to 5 years, probably not that long. But more than just this year, I expect that will be slow. And say in business in China, which is an important country for -- in general, not only for Drager, but for us as well.

Your second question on the ventilation market. I would still say that there are no situation effect. So however, our overall ventilator sales are currently so not quite at the pre-pandemic level, whereas that may be partially due to a temporary lack of innovation that we had in the field that we now have the approvals for the most important ventilator families for the FDA and for the U.S. market. And there is more innovation to come that we will catch up to the market leaders and gain back our leading position we had for several times I could almost say, as we invented the mechanical ventilator in Dräger. So there were ups and downs.

So that currently is not the best period because of the weakness of a little bit in the portfolio, but it's coming. And of course, like you mentioned, that the fact that Philips and Medtronic both withdraw from the market is an opportunity for us where all the remaining participants in the market will gain from that, not so much on the shorter term. But certainly will towards the end of this year. I expect that we can already see it. And the companies, I would say, that are not controlled by private equity and such can probably gain overproportionally. When I see this from what happens from a customer perspective, I would assume that the companies that pursue a long-term strategy like we do have an opportunity to benefit more than the average, but everybody will.

So your third question...

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

Was about the key measures, maybe I start and then you can continue, include several measures as I was referring to what do we do for the process incentives for improving profitability. I'll focus on some of the measures that we have already implemented. One of the anchor points are our go-to-market strategies that focus on the potential in the individual country markets. We've developed them -- we've started to develop them a few years back, and they also identified potential where we perhaps need to restructure or even close businesses.

That includes the Interlock business that we closed a few years back in the U.S. It includes the discontinuation of the MSI GmbH, a German small manufacturing company that we will close down or sell. Some of the -- so it means pruning the portfolio of activities from a country point of view. It includes the measures that we have instigated about 2 years back with improving pricing excellence, a key driver that has supported us to improve profitability already in '23 and the improvement in pricing excellence are also a key driver for the better results on the safety side in '24.

And last, certainly not least, is the general cost awareness which has supported us in driving down overall cost in '23 against '22. That's supported also by including our profitability targets in our variable compensation for the leadership teams on a global level as well as in the countries.

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

Yes, that brings it to the point. I sum it up to 4 points. So strengthen our strengths to what the market place, eliminate weaknesses to pruning the portfolio from not so profitable businesses. Number three is price defense and number four, cost awareness and expense frugality.

Operator

Our next question comes from Alexander Galitsa with Hauck.

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

Yes, I have one on medical gross profit margin, which in Q1 was down 1.3 percentage points year-on-year. I'm just wondering whether you could provide us with the sort of more like-for-like development of the gross profit margin. If you were to strip out the China effect from last year? That would be the first one. And the second one also regarding the gross profit margin. If historically, if one looks at the quarterly developments, Q1 partly or largely get due to seasonality reasons has been not necessarily the highest quarter. So it's hardly ever that you generated full year gross profit margin below Q1. I'm just wondering whether this year, are there any reasons why that should be any different?

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

Okay, your first question, so I would say it's hard to quantify in greater detail. In general, the margin difference, I think, can be attributed fully to the non-repeat of the China regulation tailwind that we had 1 year ago because that is a high-margin business. So -- and for the outlook for the remainder of the year, I think should be normal, no significant other mix effects expected. In general, when the U.S. market picks up, now we have the necessary approvals. That's also, in general, a slightly higher margin than in other areas of the world what it could be, say, I mean, not really wise to predict an increase from that. It gives us some, let's say, the confidence to assume that it remains stable for the rest of the year. The -- say, how the different quarters will look like versus a standard, say, behavior of (inaudible) profitability throughout the year. I see no meaningful reasons why it should be any different than normal for this year.

Operator

Our next question comes from Virendra Chauhan with AlphaValue.

Virendra Singh Chauhan - *AlphaValue SA - Analyst*

And just coming back to the previous question that you spoke about margins through the year. During your commentary, you also mentioned that Q1 is typically the weakest quarter from a performance perspective. So do you expect revenues to move up sequentially through the year? That would be my first question. And then secondly, on margins, since you implemented wage increases in H2 of last year, should we expect higher margins in H2 as we lap that effect beyond June. So this will be my question.

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

Could you please repeat the second question again. It didn't come through too clearly?

Virendra Singh Chauhan - *AlphaValue SA - Analyst*

Okay. The second question is on margins. Since you've implemented wage increases in H2 of last year, would we expect higher margins in H2 as we lapse that effect beyond June and higher margins in the terms of the step up that we see in the margins -- from last year to this year.

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

Yes. There is an effect, but I would -- that of course, the wage increases affect the German personnel first and foremost. So I wouldn't over estimate it. We have some other overlying effects. But overall, I think the assessment is quite clear that there is there is also expected cost increases. So it's not driving necessarily the margin. What is more important driver also in the first quarter is the volume development and what has affected our margin, medical versus safety is also the different volume effect. The high net sales is beneficial to the capacity utilization on the safety side, the lower volume on the medical side is conversely negative on the capacity utilization. So to the degree that you're coming from the margin development, the net sales development overall will be a more relevant driver for the margin development of the different divisions and product groups.

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

Yes. And that effect I think may be greater on the capacity utilization than the wage increases. As given our structure, most of the salaries that we pay to our staff in Germany and as the German legislation does not go to a blue collar staff that's in the production, it goes into the COGS and the margins. But in expenses for people that work for higher salaries in, for instance, in R&D department. So that will go in the expenses.

Operator

(Operator Instructions) We have a follow-up question from Oliver Reinberg with Kepler.

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

Sorry, three quick follow-up, if I may. In your prepared remarks, you called out the kind of weakness in Asia Pacific also outside China. So can you just discuss what is behind that? And I think you also pointed to a softness in consumer and service revenues, which is a bit of a surprise. So any kind of color on what is driving that would be helpful. And secondly, any kind of news on FDA discussion on Warning Letter, I guess not, you just have to wait for the inspection just checking is there any kind of new developments? And finally, because you called out the Annual General Meeting and that there will be kind of recording, is that indicating that there would be any kind of relevant news to be disclosed as part of the AGM?

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

To start from the reverse from the AGM. So the -- let's say, (inaudible) from today's point of view, I would not expect any big surprises. So the -- on the FDA, we didn't particularly mention it today, that's correct because there is no significant news that we are preparing for the -- to eliminate all the points that have been addressed by the warning letter. And we believe that the -- there is a chance that during the course of the year, we can finalize all the necessary work and invite the FDA for a reinspection, and they can come and do it, and the warning letter can be lifted.

However, we are not in full control of all elements in that sequence. So it might take into the next year. But it's progressing and there is no effect on the business that we have to give us some management attention until it's fully closed. So at least same importance has -- the fact that we have achieved during the course of last year, a number of quite relevant FDA approvals for products that we had in the portfolio, and that we can now market itself in the U.S. That does have an effect on the business. It will be shown due to the course of this year. Your fourth...

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

One question on the weakness in Asia Pacific, and that's quite right. Let me start out by emphasizing that China is the largest country in the region. So that's really dominating it. We just wanted to be fully transparent that, among others, the business in Korea is negatively affected by the strike in the healthcare system and also in countries like Thailand, in Milan, Vietnam, there are delays in the elections, and that has a negative consequence for the development of our growth as well as the growth in some of the Middle East countries.

We see positive developments in some countries, including India, but that positive development will not be sufficient to offset the negative trend that we currently see in particular as far as it comes from China. And I think there was a sub question in there, relating to the softness in consumables. That, of course, also has a regional dimension to it. And I would say that is really driven by the soft demand in the region. There is overall slight pullback in our order entry in our consumables on the medical side, but that's really coming from Asia Pacific as well. If Asia Pacific were -- had been at least neutral, we would have seen growth in our consumable business. So in other markets, like in Germany, in Europe overall, we do see growth in our consumable business.

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

Okay. That's very helpful. And if I may just follow up. I mean, so far, thought on FDA, you're just waiting for the reinspection. So it sounds like there's still some kind of remediation work to be done. Can you just talk to the nature of this?

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

These are more or less formal things in the process that is being worked on. As I said, it has no effect on the business, not to mention any safety aspects for our customers, is just Fleissarbeit.

Operator

Ladies and gentlemen, this was our last question.

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

Okay. Very good. And I thank all of you for being with us today and for the -- and actually look forward to hearing from you again. And we're hoping to see you. Feel invited for the Annual General Meeting of the shareholders and have a pleasant afternoon. Thank you, and good bye.

Operator

Ladies and gentlemen, the conference is now over. Thank you for choosing Chorus Call, and thank you for participating in the conference. You may now disconnect your lines. Goodbye.
