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Drägerwerk AG & Co. KGaA (DRW8.DE)

Q4 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, welcome to the Drägerwerk Full Year 2024 Earnings Conference Call. I'm Sandra, the Chorus Call operator. I would like to remind you that all participants have been in listen-only mode and the conference is being recorded. The presentation will be followed by a Q&A session. [Operator Instructions] The conference must not be recorded for publication or broadcast.

At this time, it's my pleasure to hand over to Stefan Dräger, CEO. Please go ahead, sir.

Stefan Dräger

Chairman-Executive Board & Chief Executive Officer, Drägerwerk AG & Co. KGaA

Yes. Good afternoon and thank you for joining our conference call on our financial results for the fiscal year 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 of the presentation that we made available on our web page this morning. Following the presentation, we will open the floor to your question.

Let's get started on page 5 for the business highlights. 2024 was a successful year for Dräger with a robust business performance and a significant improvement in profitability. While net sales were slightly below our expectations, we maintained a strong performance, achieving around €3.4 billion, matching the prior year figure. This is an outstanding achievement considering that we benefited from strong catch-up effects in 2023, driven by the improved delivery capabilities and a surge in demand for ventilators in China. And importantly, although business in China fell in 2024 by almost half to what it was in 2023, we successfully compensated its impact through substantial growth in the rest of the world, highlighting the resilience and adaptability of our business.

Our EBIT increased by €28 million to €194 million, thanks to our operating business and also supported by one-off effects totaling around €22 million. With earnings growing stronger than our peers, our EBIT margin increased from 4.9% to 5.8% in the full year, ending just above our expectations. Our order intake also developed positively and exceeded the high level of the prior year at around €3.4 billion. This underlines a sustained demand for our Technology for Life and gives us confidence for the future.

Following our dividend policy, we are going to distribute around 30% of group net profit to our shareholders, resulting in another dividend increase. I would come back to this topic at the end of our presentation.

Improving profitability remains our primary focus. In the medium term, we want to contribute to this by strengthening our innovative power and expanding our business model with expertise in the areas of interoperability and systems business. In the prior year, we promoted the implementation of these goals by introducing more innovations. These included important product improvements such as our new Vista patient monitoring system and our updated Babyleo TN500 open care warmer, among others. Moreover, we started with the implementation of our new site concept in Germany. I'll come at this in a few minutes.

Regarding our FDA warning letter, the expected FDA inspection in Andover has taken place in November, and it did not reveal any formal deficiencies, that's to say no FDA Form 483 was issued. And that means zero findings. We are awaiting the final list of the warning letter from FDA even if it is currently not foreseeable when this will take place. Due to the restructuring within the FDA, processing appears to be delayed.

In terms of sustainability, we achieved several milestones in 2024. On the one hand, an Executive Board Department for Sustainability and Quality has been created, which is headed by our new board member, Stefanie Hirsch, since July 24. On the other hand, we have defined key focus areas to implement our sustainability strategy. Let's take a closer look at this on the following pages.

So we come to page 6, Dräger's impact on people and environment. Ladies and gentlemen, for us, our guiding principle is Technology for Life. This means we take responsibility. It gives greater meaning to our work and creates a sustainable foundation for our business model. We are aware that we have a footprint, of course, we do. And we believe that the overall positive aspect of the footprint is larger than the negative footprint. And the result of our being, our existence in the world is overall positive.

On the one hand, we improve healthcare with our medical technology and help sick people heal with our devices and services. On the other hand, occupational safety all over the world to help with our safety technology. And the purpose, Technology for Life, gives our work greater meaning and makes us an attractive employer. And we reinforce this part, the S on the ESG, by offering employees fair pay, in addition to reliable and meaningful employment. We also make a positive contribution on the local and global gross domestic products, be it salaries, taxes, earnings that we pay out. Around 10% of our net sales is invested in research and development.

On the other hand here, the left side of the clock, we need resources for our products that are not yet returned to a complete material [indiscernible] (00:13:23). We also contribute to climate change as part of our business activities and our employees are exposed to risk of accident and [indiscernible] (00:13:33) unequal treatment. We also cannot rule out human rights and environmental risks completely. Without ignoring the negative effects on people and the environment, we therefore say, we left our footprint.

But what we ought to say is there is no sustainability without profitability and vice versa. Our focus therefore remains on our corporate objective number one, namely improving profitability. Our goals remain to increase the EBIT margin by an average of 1% point every year.

Now let's turn to the next, sustainability, page 7, the strategy. So the strategy of concentrating our efforts on focused topics in the areas of: environment and society; customer and products; and company and employees. And these three areas is our aim to improve along measurable targets. We are certain that no lasting economic progress can be achieved without social environmental sustainability in our supply chains and vice versa.

Our main goal in the field of environment and society is to reach CO2 neutrality by the year 2045. To this end, we are actively involved in reducing Scope 1, 2 and 3 emissions. Moreover, we are promoting environmentally friendly and socially responsible business practices by establishing sustainable supply chains.

In the field of customer and products, we want to develop new products according to the eco-design criteria and aim to lower that CO2 footprint. We approach the overarching principle of a closed circular economy through material reduction in the area of product and transport packaging, and through individual pilot studies and actions as part of product development. This enables us to consciously expand our portfolio of environmentally friendly products and services, offering sustainable solutions to our customers. Furthermore, we support the environmental and cost objectives, our customers, through innovative and efficient business.

When it comes to company and employees, one of our main goals is to get them that lost time incident rate below 4 points by implementing our Vision Zero program. Hence, this focus on securing employee [ph] loyalty (00:16:29) and commitment through greater workplace safety and the promotion of health. We also want to strengthen diversity, reaching a female share of 30% in management positions by 2035. We will continue to develop training programs in order to prepare our employees for any future challenges.

So please turn to page 8. Ladies and gentlemen, when I talk about profitability and sustainability, I also have to mention our location strategy in Germany, which aims to optimize resource utilization for domestic operation. Currently, we have 17 sales and service hubs nationwide, employing around 2,000 people. These facilities act as basis for our field service teams and serve as training facilities for our German customers. In addition, there are also so-called customer project locations. That's the same locations that result from individual contractual relationship with the customer.

In recent years, our space requirements have changed. Digital collaboration has grown due to the coronavirus pandemic and has integrated new forms of work into everybody's life. We are therefore examining the extent to which we can consolidate locations in order to use them more effectively and meet future requirements. We want to create an attractive future-proof working environment, taking into account the trend towards more mobile working. We are creating locations that are equipped for the future and those – and whose premises are adapted to working methods.

At the same time, we keep our focus on the customer. As part of the new concept, we closed eight locations out of the 17 by 2026 and make changes such as downsizing at 4 other locations, in addition. We are planning to do this for the existing workforce. Our aim is to improve services for our employees and customer. Of course, there will be some savings from rental and ancillary costs, which amount to around €1 million per year.

But our focus is on a qualitative benefit. This includes an improved performance for our customers through the expansion and modernization of our academy capacities and space, as well as the digitalization of the range of workshops and improve processing capacity management through centralization of the workshops. The full savings per year will become effective for the first time in 2027.

In addition, there are further indirect costs versus complexity reduction. This more needs-based use of our resources will also contribute to more sustainability at Dräger.

Ladies and gentlemen, before I hand over to Gert-Hartwig for the financials, I would like to elaborate on our strategic goals in the areas defense and security on page 9. The start of the Russian war against Ukraine has ushered in a new era and dramatically changed the security situation. Expenditure on modernizing our armed forces is, therefore, being significantly increased. This is a development that will also affect us.

Just as the German army is defending our national borders, we also have a mission. We protect those who protect us. We do this with our Technology for Life, in other words, products that protect, support and save people's lives. We already have trusting relationships with the important defense authorities, public clients, and, if they're a supplier, also the producers of military equipment.

Our aim is to systematically develop these relationships further and to position ourselves as a partner and solution provider in the context of strategic defense programs. In this way, we want to drive forward the strategic expansion of our market position. Unlike in the past, we now have considerable project inquiries and offers in the pipeline, although it's not always certain that these will actually materialize.

These deals also have very long lead times. Nevertheless, our prospects are very promising because we can use our unique expertise and skills, which have made us one of the world's leading manufacturer of safety technology.

As part of its 2024 national security and defense strategy, the German government has defined key technologies that we have been covering in our product portfolio for many years. These include, for example, breathing air monitoring and supply for military vehicle's sensor technology and space protection, as well as our personal NBC protection.

Our total net sales in the defense business are currently still below the €100 million threshold. However, due to the changed security situation, we expect a substantial increase in the coming years as we believe that our sales team in this area will be able to more than triple by 2028.

With that, I turn over to Gert-Hartwig who will explain our business development in more detail. I will then turn to the dividend and outlook. Gert-Hartwig, please.

Gert-Hartwig Lescow

Chief Financial Officer and Executive Board Member-IT & Vice Chairman-Executive Board, Drägerwerk AG & Co. KGaA

Thank you, Stefan. I would like to extend also a warm welcome to everyone joining this conference call for our results for the fiscal year 2024. Please turn to page 11 for our real view on the Dräger Group. As usual, I will be stating currency-adjusted figures whenever referring to growth rates.

As Stefan mentioned, demand for our Technology for Life remained strong. Overall orders increased by 3.4% to around €3.4 billion, with growth in both divisions. The APAC region demand declined due to the challenging market conditions in China impacting [ph] almost western medtech suppliers (00:23:20). However, growth in other regions allowed us to compensate for this downturn.

In Q4, order intake increased by 8.6%, supported by both divisions and across all regions. Net sales remained robust at around €3.4 billion, matching the level of the previous year, despite the non-base effects like higher order backlog in the prior year. Net of currency effects, net sales increased by 0.5%, thanks to the growth in the safety division, which compensated the decline in the medical division.

In nominal terms, net sales of the group were stable at around 0.1% below the prior year figure. In Q4, net sales increased by 2.6% to around €1.1 billion, driven by growth in both divisions and all regions, except EMEA. Benefiting from favorable pricing and reduced quality costs, among other factors, our group's gross profit margin rose by 1.6 percentage points to 44.9% at the end of the year. Functional expenses increased by 1.8% in 2024. This resulted, in particular, from the increase in personnel expense owing to high employee figures and remuneration. But also, the one-off effects had a positive effect on the expense development.

As Stefan mentioned, our earnings were positively affected by one-off effect of around €22 million. With around €15 million, the impact in our safety division was stronger than in our medical division with around €7 million. The total one-off effects consist of positive one-off effects totaling approximately €37 million, offset by negative one-off effects of around €50 million. The positive one-off effects largely included the sale of the local noncore division in the Netherlands and the sale of real estate in the US in the second quarter. The sales amounted to around €20 million in total.

In addition, the positive one-off effects included the sale of a building in Spain in the third quarter of around €10 million. Around €32 million of the one-off effects are included in the functional expenses. The adverse effect include the depreciation in connection with the valuation of an associate in Q4. This depreciation is included in the financial results before interest result. All details are included in the Annual Report in Note 40.

Including the €22 million from the one-off effect, our EBIT increased by around 17% to €194 million in 2024. Consequently, our EBIT margin rose from 4.9% to 5.8%. In the fourth quarter, our EBIT of around €114 million was also significantly higher than the prior year's figure of around €90 million. The EBIT margin rose by 2.1 percentage points to 10.6%.

The full year EBIT development is in line with our medium-term goal to increase the EBIT margin by 1 percentage point per annum, on average. Even when excluding the one-off effects of roughly €22 million, the underlying profitability in 2024 is roughly 5.1%, exceeding the prior year's margin that itself had substantial tailwinds from the China effect and the high order book.

We remain committed to our plan to improve the midterm profitability further. The guided 2025 EBIT margin includes an additional margin improvement on the higher end of the guidance range. Our DVA in 2024 was just below the prior year figure of around €54 million.

Let us now take a closer look at the development of the two divisions, starting with the medical division on page 12. Following a slight decline in the prior year, our order intake in the medical division rose by 1.2%. This was primarily due to higher demand for our services and warming therapy devices. The lower order value in the APAC and EMEA regions was more than offset by an increase in the Americas and Germany. Demand improved notably towards the year's end. In Q4, orders rose by around 10%, driven by all regions, as well as a high demand for ventilators and hospital infrastructure. So, a very positive momentum at the end of the year.

Net sales in the medical division fell by roughly 3% in 2024. This was due to the mentioned base effects and the challenging market environment in China, which broadened our overall development in the APAC region. In Q4, on the other hand, net sales rose by 2%, thanks to the significant growth in the Americas region. As a result of successful price enforcement and lower-quality expenses, our gross margin in the division increased by 1.1 percentage points in 2024. In Q4, it improved even stronger by an impressive 5 percentage points. This was due to the significant increase in gross profit, mainly because of significantly lower expenses for field actions.

Functional expenses increased by roughly 1% in 2024, which can be largely attributed to personnel costs. The EBIT on the medical division decreased by around 24% to around €28 million, while the EBIT margin was reduced by 0.4 percentage points to 1.5%. In Q4, on the other hand, the EBIT increased significantly from around €39 million to around €56 million, thanks to the good operating business. The EBIT margin was 9.2% after 6.5% in the prior year quarter. Our DVA in the medical division was significantly lower in 2024 at around minus €50 million, coming from around minus €23 million in 2023.

I'll now turn to our safety division, which delivered another good performance. We are now on page 13. Our safety business continues to grow, both in the full year and in Q4. Order intake rose by at least 6%. This was primarily due to a much higher demand for a respiratory and personal protection products and the positive development in all regions, especially in Germany.

Net sales increased by around 5% in the fiscal year, with all regions contributing to growth. In Q4, net sales increased by roughly 4%, driven by the Americas region, as well as Germany and APAC. As a result of our effective price enforcement, our gross margin in the division went up by 2.1 percentage points in 2024. In Q4, it increased by 3.3 percentage points. Functional expenses were around 4% higher than in the prior year, mainly due to higher R&D expenses and a higher sales cost in the region.

The EBIT of the safety division increased considerably in 2024 by around 28% to reach roughly €166 million. The EBIT margin amounted to 11.3% after 9.2% in 2023. In Q4, the EBIT stood at €57.5 million, coming from €50.1 million in the prior year period. The EBIT margin was 12.5% after 11.2% in the same period of 23. Our DVA in the safety division also improved significantly by around €21 million to €104 million coming from €83 million in the prior year. All in all, a very positive development in our safety business.

Let's move on to some key ratios on page 14. Despite lower operating cash flow, our free cash flow was slightly above the prior year figure at €124 million. Next to the higher earnings, the biggest driver for the development was the positive effect from the increase in trade payables, but also a lower investment cash flow due to the sale of the noncore fire and gas business in the Netherlands and the property in Spain contributed positively. Cash, cash equivalent amounted to around €231 million at the end of 2024, down around €41 million on the prior year figure.

Net financial debt significantly improved in 2024 and amounted to €165 million at the end of the year. Net financial debt-to-EBITDA improved as well with 0.5 leverage is on a healthy level. At the end of the first quarter, we secured an additional loan commitment from the European Investment Bank totaling €100 million. This enhances our financial flexibility, supplementing our existing unused credit facilities of €375 million. We have maturing debt totaling €100 million in Q3 of this year and Q1 of next year.

Capital employed increased by around 5% to around €1.6 billion. However, the improvement in EBIT resulted in an enhanced 12-month return on capital employed of 12.1%, up from 10.9% in the same period of the prior year. Net working capital was around 13% above the prior year levels at just over €740 million. The positive business development, among other factors, contributed to a further strengthening of the group's equity position, with an equity ratio nearing 50%.

Now, I hand back to Stefan Dräger for the outlook, starting with our dividend proposal on page 16.

Stefan Dräger

Chairman-Executive Board & Chief Executive Officer, Drägerwerk AG & Co. KGaA

In line with our dividend policy, we intend to distribute around 30% of our group net profit to our shareholders. Since our group net profit has increased significantly, we will increase the dividend significantly as well. We intend

to propose a dividend of €2.03 per preferred share and €1.97 per common share to our annual shareholders' meeting in May. Provided that the group's equity ratio remains at least [ph] 30% (00:34:29), we will continue to distribute 30% of our annual net profit in the coming years.

That said, let's move on to our outlook for the current year, 2025, on page 17. Ladies and gentlemen, with a good demand, robust net sales, and significantly improved earnings, we had a successful year 2024. Of course, our EBIT benefited from the mentioning one-off effects. But on the other hand, the positive effects from 2023 were missing.

For 2025, we expect a currency-adjusted increase in net sales of 1% to 5% and an EBIT margin between 3.5% and 6.5%. Both segments should contribute to net sales growth and a positive EBIT. Taking into account the nonoperating special items of the past two, years which have had a positive impact on earnings, the expected EBIT margin for 2025 is in line with our target of increasing the EBIT margin by 1 percentage point each year.

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

QUESTION AND ANSWER SECTION

Operator: Thank you, sir. We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from Oliver Reinberg from Kepler Cheuvreux. Please go ahead.

Oliver Reinberg

Analyst, Kepler Cheuvreux SA / Germany/



Oh, yeah, thanks so much for taking my questions and three, if I may. Firstly, starting off with tariffs. And I guess exposure through the year should not be too significant. I guess, we're talking 10%, 15% of group sales. But I was just curious, there was an article in the [indiscernible] (00:36:41) statement was made that if a 25% tariff would be implemented, that this could still impact the operating profit of the group by around a third, which appears quite meaningful. And I guess the kind of color was provided that you talked about kind of long-term contracts that are in place here. So first question would be if you can add some kind of more color to that.

Secondly, just on the defense, the opportunity that you're facing. I mean, can you just talk to us, is there any kind of [ph] benefit-only (00:37:10) that you anticipate this year and how tangible are these kind of talks that are ongoing? You talked about longer-term lead times, but I guess part of the offering could also be a shorter-term realized. And the kind of €300 million that you talked about, is it just pure in-house estimate or is it also backed up by any kind of potential plans already?

And then lastly, just on the outlook, can you provide a bit of more color on what you have in mind for the divisions, both in terms of sales growth and margin expansion. And also because Q1 is coming up, I guess, in the past, it was always volatile and sometimes we had negative EBIT in Q1. Is it something we should also assume this year after the kind of special support sectors have been phasing out? Just to make sure that expectation on the [indiscernible] (00:37:52). Thank you.

Stefan Dräger

Chairman-Executive Board & Chief Executive Officer, Drägerwerk AG & Co. KGaA



[indiscernible] (00:37:55)

Gert-Hartwig Lescow

Chief Financial Officer and Executive Board Member-IT & Vice Chairman-Executive Board, Drägerwerk AG & Co. KGaA

A

Yes. Let me start off with your question on the customs. So, the impact will, of course, depend on any customs raised and in the past, customs in many countries differentiate between medical and safety products. In a scenario where in the future this would not be the case anymore. And in a scenario where, let's say, a flat custom fee of 25% would be levied upon our products, mainly imported into the US, that could, based on the earnings, impact our EBIT by roughly a third to a quarter of the total figure we had this year.

Having said that, no such customs have been announced, and of course, we are all also looking on April 2 into the US how this will change. I believe, or my understanding is that the expectation that going forward, there will be a separation of medical and safety will remain in place, but that remains to be seen. So at this point, there is not a concrete impact, but going forward, we have obviously no confirmed plan in our hand what will happen. But we will see. But that is – the third that you quoted is correct, and that is roughly depending on the [ph] above (00:39:45). This we will, of course, work on to reduce. But given our portfolio and the way we operate, any reaction will not be easy and will take some time.

Stefan Dräger

Chairman-Executive Board & Chief Executive Officer, Drägerwerk AG & Co. KGaA

A

If I may expand, Mr. Reinberg, on this scenario, [indiscernible] (00:40:03) also quoted earlier today that it's unpredictable what happens in the Oval Office and in the economy. We already do have a scenario by now that there are tariffs imposed on products from China to the US. And the US, a competitor of us, has imposed a customs surcharge on the prices in the US dollar charged to US customers to compensate for the tariffs because this competitor has most of its products actually manufactured in China and is suffering from the customs.

We are not affected yet, but we use the opportunity and also implement custom surcharge to the same level that the other guy does. So, for us, this actually works out as a windfall benefit. So it's hard to predict the effect in details in the future. So we will see.

Oliver Reinberg

Analyst, Kepler Cheuvreux SA /Germany/

Q

[indiscernible] (00:41:26) mentioned that you can't pass that on because of the contract structure. So, I mean, I'm a bit surprised because most people believe that they can simply pass it on. Can you do that or not?

Stefan Dräger

Chairman-Executive Board & Chief Executive Officer, Drägerwerk AG & Co. KGaA

A

No – no and yes. We cannot pass it on the situation where we have it in the contract, like it's set in stone, it's hardcoded in the contract. What we can charge a surcharge. We cannot increase – change the price, but we can charge a surcharge. If we are the only one, it will probably not be possible. But if major as well US companies do it, then we can say in it the trailing orders and can do it as well that even if we do not have the extra cost.

Oliver Reinberg

Analyst, Kepler Cheuvreux SA /Germany/

Q

Okay. Thank you.

Stefan Dräger

Chairman-Executive Board & Chief Executive Officer, Drägerwerk AG & Co. KGaA

A

So that's – but you have more questions. So, yeah, feel free.

Gert-Hartwig Lescow

Chief Financial Officer and Executive Board Member-IT & Vice Chairman-Executive Board, Drägerwerk AG & Co. KGaA

A

So I think you're – I think there's at least one – your last question was, what's the outlook for the Q1? And as you pointed out, Q1 typically is the weakest quarter in every given year. Last year was, in fact, relatively strong, at least if one compares it to a pre-COVID average, about 1 percentage point more in net sales than we had on average in those five years. And so that would translate into net sales. In fact, if we were to return to a normal – a more normalized seasonality of about €30 million, €35 million, if I take last year's net sales as a guiding impact. And obviously, the quarter is not quite over, it's still close, of course, but actually, the last two days are the strongest net sales figures. But referring to your question on the seasonality, that's what we are currently working on. And I think...

Oliver Reinberg

Analyst, Kepler Cheuvreux SA /Germany/

Q

And can you...

Gert-Hartwig Lescow

Chief Financial Officer and Executive Board Member-IT & Vice Chairman-Executive Board, Drägerwerk AG & Co. KGaA

A

Sorry, go ahead.

Oliver Reinberg

Analyst, Kepler Cheuvreux SA /Germany/

Q

Yeah. And I think the other question was, if you can add a bit more color on the sales and margin profile for the divisions for the full year.

Gert-Hartwig Lescow

Chief Financial Officer and Executive Board Member-IT & Vice Chairman-Executive Board, Drägerwerk AG & Co. KGaA

A

Yeah. Yeah. And I think you had a question on the defense impact in-house.

Oliver Reinberg

Analyst, Kepler Cheuvreux SA /Germany/

Q

Yeah.

Gert-Hartwig Lescow

Chief Financial Officer and Executive Board Member-IT & Vice Chairman-Executive Board, Drägerwerk AG & Co. KGaA

A

For – perhaps on the outlook for the division, we do not, if you will, provide a specific guidance, but it is in our plans to see an improvement in both divisions. But the improvement on the medical will be, if you will, marginal improvement on the way to also improve – to improve our group margin. So, medical will be slightly above the current year but not in a stepwise jump. Net sales development will – or net sales growth we expect to come from both divisions as we have seen this year with the contribution of also, again, both divisions.

What is perhaps also a key input in there is our weaker net sales and order entry was as we had communicated previously due to the very weak development, in fact, decline in China. And we expect China to stabilize, and this stabilization was, in particular, be – will be more relevant for the medical division than for the safety division.

And your last, on the impact for the defense, this currently is not based on, if you will, confirmed contract, in which case, we would have also articulated it, I think, more forcefully than it's supported by inquiries into contracts. They have not been signed, though. So, to your question, those are based on our in-house estimates on to what degree certain tenders and project will materialize. And obviously, they will depend on funding also, especially from Germany or other countries. Debt funding, it appears, will increase, but it's not confirmed yet.

Oliver Reinberg

Analyst, Kepler Cheuvreux SA /Germany/

Q

Do you expect only the first benefit this year?

Gert-Hartwig Lescow

Chief Financial Officer and Executive Board Member-IT & Vice Chairman-Executive Board, Drägerwerk AG & Co. KGaA

A

Possibly in order entry, net sales with these projects are typically long term in nature, and net sales will be more at the back end of the horizon.

Oliver Reinberg

Analyst, Kepler Cheuvreux SA /Germany/

Q

[indiscernible] (00:46:37). Thanks so much. Good day, everyone.

Operator: The next question comes from Christian Ehmann from Warburg Research. Please go ahead.

Christian Ehmann

Analyst, Warburg Research GmbH

Q

Hello, everyone. Thanks for taking my question. I am free at the moment, so I am a little bit lingering on the defense segment or, let's say, the portion of sales here. So, could you remind us what the current margin profile of those €100 million defense contracts is at the moment, so is it accretive or is it still dilutive, for example, so we can have more of an idea how high this impact could be in the future, if everything materializes?

And the second one would be on the impact of those site closings, the cost savings, is this already included in your guidance by growing 1% EBIT margin per year on average? And my third question would be to the surcharge system, which you've mentioned really with the tariff. Could you please repeat how this exactly would play out over the next couple of months if we would see a plain 25% tariff impact on imported products? Thank you very much.

Gert-Hartwig Lescow

Chief Financial Officer and Executive Board Member-IT & Vice Chairman-Executive Board, Drägerwerk AG & Co. KGaA

A

So let me start with the last question, and I want to caution us a bit to not get ahead of ourselves, since we are talking about the pass on of tariffs that have not even been announced at this point. So what we were referring to is, of course, preparation on our side and the way they may be passed on depends obviously on the customer segment, to the degree that they can be passed on. And roughly, I would separate between medical and safety. In safety, by and large, we are in a market of private consumers, less regulated. So, it will depend to what degree is also our market companions experience similar effect and will need to pass them on.

On the medical side, there's a significant portion in the US of volume purchased by hospitals is a tool so-called GPO contracts, and they are typically frame contracts that hospitals can use. And we are in preparatory exchanges with some of the GPOs to see how to react to such an increase. And it was in that scenario that our

earlier comment is to be seen because in that GPO scenario, there is no – it is not foreseen to ad hoc change prices since we are in a regulated environment. And I would like to ask everybody and ourselves some patients to see where we actually do face customs and what volume of customs we faced at this point.

Your second question or your – yeah, your second question was on the site closing and whether the impact of that is included in our guidance. And the answer, yes, it is included in our guidance.

And the first question, your first question was on what the current margin profile is of the defense business. And again, there, I would also ask everyone involved for some patience, since I would rather not speculate on some contracts that are currently in preparation and see whether they are margin accretive or dilutive. It very much depends on the type of contracts and we have to see how we see the growth. Obviously with such a growth potential, we expect that that will add to our overall profitability in absolute terms. But I would, at this point, refrain from any speculation on what that is and perhaps also what country is more profitable than the others. It's too early for that.

Stefan Dräger

Chairman-Executive Board & Chief Executive Officer, Drägerwerk AG & Co. KGaA

A

However, I could add a little flavor to it. So in the past, it did not get so much attention, this sector, and now, it gets more attention and we found there are some examples, these unacceptable low margins. So, that had certainly also changed in the future our general approach that we scrutinize every single business, field and site and whether it contributes to our goal of increasing profitability.

Christian Ehmann

Analyst, Warburg Research GmbH

Q

Okay. Thank you very much.

Operator: The next question comes from Alexander Galitsa from HIEB (sic) [HAIB] (00:52:00). Please go ahead.

Alexander Galitsa

Analyst, Hauck Aufhäuser Investment Banking

Q

Yes. Thank you. A couple of questions from my side as well, maybe one by one, if that's fine. First one, if you could add color or explanation, what's really behind the strong increase in G&A in Q4, the plus 37% year-on-year? That's the first one.

Stefan Dräger

Chairman-Executive Board & Chief Executive Officer, Drägerwerk AG & Co. KGaA

A

You see, seeing a thing, in particular, that makes it special. So, I would say, it's a base effect, as this plant more constant over the year and the other lines of the P&L are constant over the year. So, the ratio...

Alexander Galitsa

Analyst, Hauck Aufhäuser Investment Banking

Q

Okay.

Stefan Dräger

Chairman-Executive Board & Chief Executive Officer, Drägerwerk AG & Co. KGaA

A

...is [indiscernible] (00:53:08) in Q1, but there's nothing of significance that you should be worried.

Alexander Galitsa

Analyst, Hauck Aufhäuser Investment Banking

Q

Okay. It does seem a bit of an outlier, I think, over the past eight quarters. Also throughout last year, you rarely added more than €70 million, and this year, it's €91 million in Q4. So that's why I'm just was wondering.

But anyways, I'll move on to other questions I have. The forecast for net debt that you have for 2025. I'm just wondering, so you expect basically the net debt that includes leases to go up from €165 million this year – or in the end of 2024 to a range of €180 million to €210 million. And you mentioned that this is largely due to higher leases. What looks a bit strange is that you presumably will generate free cash flow for 2025, I estimate maybe at least in the range of €80 million, almost €40 million will go down to paying dividend. So theoretically, you should still have €40 million in free cash flow left to reduce net debt, yet you guide for an increase so – which basically would suggest that in this scenario, you plan to €70 million of lease liabilities, which would be almost, yeah, more than 50% increase. So if you can just elaborate what's behind the anticipated increase in lease liabilities to that magnitude, if the consideration of all – what I said regarding the free cash flow is also correct.

Gert-Hartwig Lescow

Chief Financial Officer and Executive Board Member-IT & Vice Chairman-Executive Board, Drägerwerk AG & Co. KGaA

A

So part of the lease liabilities obviously run differently on the cash flow profile since they go into the investment cash flow. But then, again, the outflow is over the lifetime of the leasing contracts and there is no unusual increase in that sense that is planned. So, no extraordinary effect in your quantification and I so I'm with you. We expect also a solid cash flow for 2025.

Alexander Galitsa

Analyst, Hauck Aufhäuser Investment Banking

Q

Okay. But you would not expect lease liabilities to increase substantially in the – or like, what's your, I guess, expect – because I understand that you – part of the CapEx is cash CapEx, but also, presumably, you financed part of your fixed asset with leases. So, I wonder, for 2025, do you really plan a large addition to lease liabilities or that's not the case?

Gert-Hartwig Lescow

Chief Financial Officer and Executive Board Member-IT & Vice Chairman-Executive Board, Drägerwerk AG & Co. KGaA

A

No, we don't. No – not involved. Not, if you will, substantially out of the ordinary, if that's the question.

Alexander Galitsa

Analyst, Hauck Aufhäuser Investment Banking

Q

Okay, understood. Okay. I think, I have another one on maybe China, briefly. You already mentioned a couple of things that you expect the stabilization, if you could add any more color on maybe most recent updates you see from this market and whether stabilization means, in your case, return to maybe even slight growth, at least, in China.

Gert-Hartwig Lescow

Chief Financial Officer and Executive Board Member-IT & Vice Chairman-Executive Board, Drägerwerk AG & Co. KGaA

A

Stabilization means what you said. So, we have seen a decline in the turnover in the first three quarters of 2024 and the stabilization means just that, so low-single-digit variation, and we expect slight growth in 2025 versus the lower business volume of 2024. Just for the avoidance of doubt, what it does mean is the return to, if you will,

previously seen volumes of overall business. So 2025 will, in all likelihood, be still below the 2023 volume of our business in China.

Alexander Galitsa

Analyst, Hauck Aufhäuser Investment Banking

Sure. That's clear. Thank you.

Q

Operator: The next question comes from Harald Hof from mwb research. Please go ahead.

Harald Hof

Analyst, mwb research AG

Thanks very much. My question was regarding the Chinese markets, which has just been answered.

Q

Stefan Dräger

Chairman-Executive Board & Chief Executive Officer, Drägerwerk AG & Co. KGaA

Good. Thank you.

A

Operator: The next question comes from Virendra Chauhan from AlphaValue. Please go ahead.

Virendra Chauhan

Analyst, AlphaValue

Yeah. Hi. Thanks for taking my question. So I just have one question around your EBIT guidance for FY 2025. Now, if I adjust your FY 2024 margins for the one-off effect that you have called out, it works out to just over 5%. And going with your longer-term outlook that you have provided, ambition to increase the margins by about 1% every year, it kind of comes in closer to 6% and higher end of the outlook that you have provided. So I'm just curious what's driving the caution for you to give such a wide range, especially on the lower end. Thank you.

Q

Stefan Dräger

Chairman-Executive Board & Chief Executive Officer, Drägerwerk AG & Co. KGaA

Well, as a general aspect of being cautious in an uncertain world, as you could see with the example of the customs, that it's – so more difficult than ever to forecast the future. So our goal is to grow by 1% point per year. And it's – you're right, it's necessary to take out the one-offs that we had in 2024. It's also, we – in 2023, we had one-offs which was the resuming of the delivery capabilities after the supply chain shortages of 2022, plus the big effect from ventilation in China after lifting the corona lockdowns at the end of 2022, then a lot of ventilators they needed.

A

So these both effects contributed in 2023. So there, we had officially 4.9%. But both of the effects I mentioned contributed approximately more or less than 1 percentage point. So the two, see, EBIT for 2023 was more around 3-point-some percent. Last year, it was about 4-point-some percent. So, about the same as the calendar year. So, from – our planning is if we're at the – have 5-point-X percent for this year, that's in line with our promise that we gave you. We do our best to come or exceed to maybe what is – what you referred to as the higher end of the guidance. But guidance is guidance. It is between 3.5% and 6.5%.

Virendra Chauhan

Analyst, AlphaValue

Okay. Perfect. Thank you.

Q

Operator: [Operator Instructions] We have a follow-up question from Oliver Reinberg from Kepler Cheuvreux. Please go ahead.

Oliver Reinberg

Analyst, Kepler Cheuvreux SA /Germany/

Q

Thanks so much for taking my follow-up and pretty quickly, if I may. I mean, also on China, I mean, the decline of nearly 50% is quite significant and significantly [indiscernible] (01:01:49) industry. Most players talked about a 10% to 20% decline. I mean, I understand that obviously the ventilator saw a bit of a special base effect, but it appears also that there's a bit of a market share shift happening. So I was just trying to get some kind of color. Is that basically like losing share to local competitions? And also, I mean, in theory, if we put it on the positive side, the gross mean there could be more pronounced recovery potentially. That's question number one.

Secondly, briefly, on ventilators, I think one of your competitors talked about they're going to see more stock in the first half, a benefit from certain market access from competitors. I was just trying to get a feeling if you see something similar. And then lastly, it's encouraging that the FDA inspection was without any kind of findings. So want to come back to a discussion we had earlier whether you're willing to also provide a kind of a more dedicated midterm guidance, which points to the next three years or so. Thank you.

Stefan Dräger

Chairman-Executive Board & Chief Executive Officer, Drägerwerk AG & Co. KGaA

A

Okay, Mr. Reinberg, I'm happy to add more flavor to the China question. A bit of everything that to you had suggested could be the root cause. Well, first, that's a great, I would say, depression in China. The customer confidence index, it plummeted in summer 2022 at a very low level. Since then, so, that is perceived as a recession, and, say, already there is a deflation scenario today, in effect, in China and it's now reflected. I think that's maybe not so directly connected for the economists, but I think it's important that the birth rate in China is the third lowest in the world. It's only lower in Korea and in the Ukraine. And that's because people do not trust in their government and their future anymore.

And so, given the overall economic environment, then the next point is healthcare system, given the, say, demographics, there is the great fear of rising costs for healthcare as currently China is around – the rate of around 6% to 7% spending of the GDP for healthcare, and that's the same level as an East European country. While as you know, we, in Germany, at around 14%. In the US, it's around 19%. And so that great fear of the Chinese government to their cost will rise. So, many things that have muted our business are put in place to, say, delay or reduce the spending for healthcare, in general, like the so-called, say, anti-corruption campaign. So, possibly also targeted in limiting the overall spending or delaying it because in the current economic scenario also that the government is short on money. Then, what effect does it have? It affects all medical device suppliers that are serving the market.

And I think [ph] spell it out (01:05:46), Mindray is our probably internationally most challenging market companion. They also have for domestic China a minus 11%, to my knowledge. And another medical equipment supplier, Adam, has minus 20% on the domestic China business. So, with our – we are coming close to minus 50%. So that is worse than the domestic manufacturers. Probably, Mindray is [ph] getting a very – the best at (01:06:22) only minus 11, but they are all affected.

And for the international companies, there is also the effect that after this additional ventilator business by the ending of the lockdown, the Chinese government realized that medical technology is a key, important factor and

has classified it as strategic, which is not easily seen or reflected. However, the European Union has done an investigation. And only a few weeks back from now and early this year, they have published result for over one year of investigation where we, as Dräger, contributed significantly [ph] in the thought that the – (01:07:19) it's not a level playing field. And it's the second action after the battery electric vehicles where the European Union says this is unacceptable. This is putting European industry at a disadvantage. And the – it will have counteraction like maybe Chinese companies will be excluded in European tenders in the future. So that's been discussed because it clearly is making life more difficult for all non-Chinese players. So that altogether, certainly, we will not come back to the per-corona level to where we were with our business. Although this year, we believe it will recover but only slightly from the poor level of the last year.

Now, your next question, ventilators, yes, we greet the fact that others are leaving the market and that's not our intention. We believe it's a very healthy and sound market where we have a lot of expertise. The grandfather of my grandfather invented the mechanical ventilator. We have the longest experience and the greatest production capacity, and very happy to have it in our market and continue to serve it. I made a personal video to customers worldwide that they can trust that we would stay my name as – on each and every product, and we have good experience in serving these markets and there will be some benefit from others going different routes.

The last question on the FDA, the lifting the warning letter, so the last step where we think it's possibly tighter if we have won approval for a monitoring software version. It's still underway. And as approvals for monitoring software were subject of the warning letter that it's quite likely that this – say, successfully finishing this one, it's a proof that all the processes at the site that have been audited successfully with no findings to really work as intended, and then this is completed. Then that should be the last step for the warning letter being lifted. And that, I think, could be expected late in this current year as that approved by itself, by definition, and there's a lot of detailed work and it takes time.

But it's – that's quite likely that these are tied together because that was the subject from the original warning letter. So, that is the most likely what I think is going to happen.

Oliver Reinberg

Analyst, Kepler Cheuvreux SA /Germany/

Q

And would you then be willing to provide a new midterm guidance again?

Stefan Dräger

Chairman-Executive Board & Chief Executive Officer, Drägerwerk AG & Co. KGaA

A

After that has been lifted?

Oliver Reinberg

Analyst, Kepler Cheuvreux SA /Germany/

Q

Yeah.

Stefan Dräger

Chairman-Executive Board & Chief Executive Officer, Drägerwerk AG & Co. KGaA

A

Well, the warning letter itself has no effect on our business, actually. It has more an effect on the share price and what you as an analyst or investor think than on our customers. However, the product itself, which is under review, where the new version is submitted for approval, that will have an effect on the business. That's much needed in the United States. And we do have it in Europe already. And to have that same availability for our US customers, that will have an effect on the business. On the midterm guidance, I would say, maybe Gert-Hartwig

can confirm. I would think that's already figured in because we knew at a certain point in time it would come and then the business will reflect it.

Gert-Hartwig Lescow

Chief Financial Officer and Executive Board Member-IT & Vice Chairman-Executive Board, Drägerwerk AG & Co. KGaA

A

They've just confirmed that. And to the degree that further details are asked for in addition to what we have said, average margin expansion of 1 percentage point. We will – as we have said previously, we view that and look into that, but the bulk of the profitability improvement is already encapsulated in that statement.

Oliver Reinberg

Analyst, Kepler Cheuvreux SA /Germany/

Q

Perfect. Okay. Thanks so much, indeed.

Operator: Ladies and gentlemen, that was the last question. I would now like to turn the conference back over to Stefan Dräger for any closing remarks.

Stefan Dräger

Chairman-Executive Board & Chief Executive Officer, Drägerwerk AG & Co. KGaA

Great. Thank you very much, everybody online, for your interest and talking with us. With this, we are coming to the end of conference. Thank you very much and look forward to hearing from you or seeing you sometime soon. Have a pleasant afternoon and good rest of the week. Bye-bye.

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