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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome, and thank you for joining the Drager Q3 Earnings Conference Call. (Operator Instructions) I would now like to turn the conference over to Stefan Drager, CEO. Please go ahead, sir.

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

Well, good afternoon, and thank you for joining our conference call on our financial results for the first 9 months of the year. 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 reporting period with the presentation that we made available on our web page this morning. Following the presentation, we will open the floor to your questions. We published the preliminary figure 2 weeks ago. In the final figures we published this morning, there are no meaningful deviations to the pre-release.

Let's get started on Page 5 with the business highlights. In the first 9 months of 2023, our business development has improved significantly after the disappointing year '22. As a result of our performance in the year-to-date, we have raised our guidance for the full year in mid-October. While this is good news, we continue focusing on the 5 main topics that are key to our success, 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. So far, we have made good progress and are full on track to deliver on our promise to return to growth and profitability this year.

First of all, our markets are intact. This is demonstrated, in particular, by our order intake in the first 9 months of '23, which has been slightly above the high prior year figure and even exceeded our high net sales in the year-to-date. Order intake in our safety division was clearly above the previous year's level, with Europe and America making a particularly strong contribution and the Europe region was well ahead compared with last year.

In the medical division, the high level of the previous year was not quite reached. Growth in Germany and the Americas region was offset by a decline in the rest of the Europe region and the AAA region. On a positive note, we saw a strong order boost in Q3 in the Americas region, driven by strong demand for hospital infrastructure, anesthesia devices and ventilators from Mexico.

As you know, our order book is still well filled, which is a good basis to continue our growth path in the fourth quarter and '24. In addition, we possibly also could see better demand in the Americas region following the recent approval of new products.

In the year-to-date, we received FDA clearance for several key products such as the Babylog ventilator, VN 600 and 800, the Babyroo open care warmer and the EVITA ventilator V600 and 800 as well as VentStar Helix.

In July, we also received the important FDA clearance for our Atlan anesthesia devices. We expect to see first order intakes and maybe some revenues from the outline already in '23 in the U.S., but definitely more in the course of '24.

Second focus topic is improving our supply capabilities in order to take advantage of the growth opportunities. Our supply capabilities have improved noticeably in the year-to-date and therefore enabled us to generate strong sales growth from the high order backlog of the prior year and from the continued high demand for our products and services.

As you will recall, our high order intake in the prior year could not be turned into revenue to the usual extent. And some of the orders were accordingly postponed to '23. With the improved availability, especially of electronic components, we are now able to complete our products and deliver them to customers much faster than before.

In addition to the improved supply capabilities, net sales were also boosted by the strong demand for ventilators in China, which was due to the relaxation of the zero-COVID policy and the rise in the infection figures. In this first quarter, this effect had a major impact on our sales. But since Q2, the demand for ventilators from China has returned to normal.

The net sales boost in the first 9 months of the year was a major reason for our improvement in earnings, but also our active price management paid off, which brings me to our third main topic: price increases. In the past months, inflation has come down considerably due to a continued increase in interest rates by central banks. Nevertheless, some inflation remains and more importantly, the base effect. That means costs remain high. But thanks to our price increases, we have largely offset the negative effects. This has had a significant positive impact on our gross profit margin and is crucial to return to profitability.

Another vital topic, we are focusing on is improving our free cash flow. And we have already made some progress in this regard as free cash flow has improved significantly in the first 9 months compared to the challenging situation in the prior year. But we are not quite there yet, and we expect to see a further improvement in the current quarter.

Coming to the last focus topic, cost awareness. In the first 9 months of '23, our tight cost management resulted in a slight decline in expenses despite massive tariff increases and general inflation. We have achieved this without engaging in a dedicated restructuring program or broad layoffs - something we do not consider to be the right measure in an environment of strong demand in growing markets for our products and services.

As we are heading towards the end of this year, an adjusted dividend policy is also emerging on the horizon. At the end of September, our equity ratio stood at 46%. Therefore, it is safe to say the equity ratio for the full year will be above the threshold of 40%, which is our prerequisite to changing our distribution policy for shareholders. The details of a new payout policy will be discussed with the Supervisory Board in the first quarter '24.

To conclude my opening remarks an update on the status of the FDA warning letter. We continue our work on the commitments to the FDA to lift the warning letter. Just a few weeks ago, we received an important 510(k) clearance from the FDA in regard to our Infinity central station, ICS. The ICS is the central alarm and information unit in our infinity patient monitoring system.

Among other things, the new ICS release provides end-to-end authentification and encryption of data in motion between ICS and our portable M300 devices, which also received clearance for an important update. That said, these releases come with cybersecurity enhancements and improvements that are directly associated with our warring letter and are a key milestone for us to close out the remaining commitments.

So for the remained focused on all related topics of the warning letter for which the FDA will conduct a reinspection for final closure at their discretion. With that, I turn over to Gert-Hartwing 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 9 months of 2023. Please turn to Page 7 for a view of the Drager Group. As usual, I will be stating currency-adjusted figures whenever referring to growth rates.

Order entry remained solid. All 3 quarters contributed roughly EUR 800 million order entry each. And compared to last year, the third quarter makes it a return to growth. With an increase of roughly 7%, the third quarter exceeded the prior year period and now also brings the year-to-date order entry above the prior year figure, at least on a constant currency basis.

After 9 months, order entry amounted to some EUR 2.4 billion, which was slightly 1.2% above the high prior year figure. When looking to the regional trends, order growth in Q3 was particularly driven by the Americas, which saw an increase of more than 30% as well as AAA. In Europe, demand declined slightly. Both divisions contributed to the positive overall development.

Orders in medical increased by roughly 9% coming from a decline in the first 2 quarters, while orders and safety were above the prior year in all 3 quarters. In Q3, safety orders rose by 4% to which I'll get into more detail in a minute.

The year-over-year growth in net sales surpassed growth in order entry clearly. In Q3, net sales increased by roughly 13% to approximately EUR 789 million, bringing the total after 9 months to more than EUR 2.3 billion, a plus of around 17% against the prior year. Both divisions achieved considerable growth in all regions, thanks to the very high order backlog at the beginning of the year and the improved delivery capabilities.

In addition to this, the Medical division also benefited from the China effect, Stefan mentioned before. Please bear in mind, growth rates in the current fourth quarter will come down considerably since the comparable prior year figure is much more challenging. At that time, in Q4 2022, our supply chain had started to improve, and we were already able to generate higher volumes again.

Despite the strong increase in deliveries year-to-date, book-to-bill remains above 1. Gross profit margin came to 44%, both in Q3 and in the first 9 months, which is an increase of 3.3% and 3.6%, respectively, compared to the corresponding period of the prior year.

The significant improvement was especially due to a more effective price management as well as higher production and service utilization. Based on the higher net sales, which came with a high margin, the absolute gross profit grew considerably to some EUR 347 million in the third quarter and to roughly EUR 1 billion in the first 9 months, an increase of around 25% compared to the first 9 months of 2022.

Despite the increased personnel cost for German employees, functional costs decreased by around 1% in the third quarter. This underlines that cost control remains a top priority throughout the organization.

As a result of the significant increase in sales and gross margin and effective expense management, earnings in the reporting period were clearly above the prior year figure. With EUR 29.2 million our EBIT in the third quarter led to an EBIT margin of 3.7%, bringing the total EBIT after 9 months to roughly EUR 77 million, which corresponds to 3.3% of net sales. Considering the usual seasonality at Drager, this is a good development since in the last 5 years the operating result of the first 9 months was only positive in the exceptional corona years 2020 and 2021.

Because of the earnings development, our Drager value added also improved strongly and returned to positive territory after the first 9 months. Overall, we achieved very good results year-to-date, and this especially against the backdrop of a deteriorating FX environment causing stronger FX headwinds than initially expected. For the full year, we expect the nominal net sales growth rate to be 2.5 percentage points below the currency adjusted rates.

Let's now take a closer look at the development of the 2 divisions, starting with the medical division on Page 8. In the third quarter, order entry increased by roughly 9%, mainly due to significant growth of around 45% in the Americas region, where we received a major order from a customer in Mexico for a hospital infrastructure project, predominantly medical supply units, ventilation and anesthesia devices.

The AAA region also contributed to our overall growth, while Europe recorded a decline. Looking at the first 9 months of 2023, order entry was around 2% lower than in the prior year period. This was due to the weak development in AAA in Europe, but particularly due to a base effect, as demand for patient monitoring and anesthesia devices declined significantly after the strong increase in the prior year period. On a positive note, this decline was contrasted by tangible growth in our service business.

Sales in Q3 remained strong in all regions with an overall plus of nearly 8%. In the first 9 months, growth was even higher as net sales increased by more than 15%, driven by double-digit growth in all regions, but particularly in Europe as well as AAA, where sales in the first quarter benefited from the China effect - this demand for ventilators from China has returned to normal in Q2.

Overall and in addition to be ventilators, anesthesia devices thermoregulation as well as hospital infrastructure and consumables were the main growth drivers in the first 9 months. On top of that, our service business performed well. Due to the improved production and service utilization, the gross margin in Q3 and for the 9-month period increased significantly by 3.6% and 2.8%, respectively.

Combined with the strong net sales growth, this led to a strong increase in gross profit by around 14% in Q3 and by around 20% after 9 months. Cost containment continued to be effective. In the third quarter, functional cost decreased further by around 4%. However sales and increased gross margin and lower expenses led to an improved profitability compared to the prior year period.

After operational losses in Q2 and Q1, our EBIT in the Medical division in the third quarter was slightly positive and EUR 0.3 million. After the first 9 months, we are close to breakeven at minus EUR 2.3 million, a substantial improvement against the prior year loss of nearly EUR 117 million.

Coming to our safety division on Page 9. In the third quarter, business development in the safety division continued to be favorable. Order intake increased by 4%, thanks to growth in all regions. Product-wise, demand was mainly driven by gas detection devices and our service business. After 9 months, order entry was up by nearly 6% due to the same reasons, like in the quarter.

In the quarter as well as year-to-date sales increased significantly by 20%, supported by considerable growth in all regions as a result of the positive order trends and the noticeable improvement in delivery capability. The gross margin went up significantly due to the effective price enforcement as well as the higher production service utilization.

In Q3, the margin rose by 2.8 percentage points and after 9 months, the improvement was 4.5 percentage points. As a result of the strong net sales growth and the higher gross margin, gross profit increased by almost 24% in the third quarter and by over 30% year-to-date. Functional expenses rose by around 4% in Q3. But overall, they continue to trail favorably as they remain roughly at the prior year level in the first 9 months, 2023, mainly due to lower administrative costs and reduced logistics expenses.

High net sales, an increased gross margin and lower expenses supported the strong EBIT improvement in the safety division. In Q3, the EBIT amounted to just below EUR 29 million, coming from a slightly negative figure in the prior year quarter. At the same time, the EBIT margin increased from 0 to 8.5%.

Looking at the first 9 months, the improvement is even more pronounced. While the EBIT amounted to EUR 79 million after minus EUR 31.5 million in the prior year period. The EBIT margin also made a big leap of 12.1 percentage points to 8.2%. All in all, a very good development in our safety business.

Let's move on to some key ratios on Page 10, starting with cash flow. Earnings after tax were around EUR 160 million above the weak last year's level. This improvement drove a substantially higher cash flow generation with operating cash flow increasing by more than EUR 325 million to roughly EUR 47 million. The positive effect on cash flow from the higher earnings was further supported by working capital development, while inventory levels have also slightly improved working capital management continues to remain a focus of ours for further improvement in the coming months. As Stefan said, we expect to see further improved cash flow conversion in the current quarter.

Investments were on the planned level, mainly for a replacement investment. While still slightly negative in the first 9 months with around minus EUR 2 million, we expect free cash flow to clearly be positive for the full year. The fourth quarter usually contributes good operating cash flow driven by decreasing inventory levels as production and deliveries increased towards the end of the year.

Next, to free cash flow, our liquidity development was further impacted by the high cash flow to redeem the remaining participation certificates in the amount of roughly EUR 209 million, which was only partially financed by a new loan of EUR 100 million. Both transactions took place in the first quarter and conclude the improvement of the capital structure.

Traders balance sheet is in good shape. Net financial debt-to-EBITDA has further improved quarter-over-quarter. After 4.6% at the end of the last year, mainly due to the weak earnings development last year, leverage improved to 1.5 in the first half of 2023 and further improved to 1.1 at the end of Q3. Thus, the company is back to healthy leverage levels.

With improved earnings and a slight decline in the capital employed, Drager's is finally earning its cost of capital again. ROCE is at 8.4%. The equity ratio has improved as well and climbed by roughly 2.5 percentage points to 46% in the first 9 months. As Stefan said, in his opening remarks, this will trigger a higher pay-out ratio to shareholders in the coming years.

That's all from my side, back to you, Stefan.

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

Thank you, Gert-Hartwig. Let's move on to our outlook. Ladies and gentlemen, we are in the middle of our most busy quarter of the year, and so far, we remain on track to deliver on our promises. We are returning to growth and profitability in '23. This is also reflected in our raised guidance. We now expect to reach the upper end of our net sales forecast and deliver an EBIT margin of 2% to 4%.

As I said in my introduction, our successful turnaround is based on 5 main topics that the entire organization has been focusing on throughout the year. Leveraging intact market growth, improving our supply capabilities, defending and increasing our prices, optimizing our free cash flow and strengthening our cost awareness. These topics remain on the agenda going into '24.

The economic environment remains challenging overall, particularly due to the continuing installation, geopolitical tensions like the wars in Ukraine and Israel and the slow growth in the global economy. On the other hand, we see opportunities, for example, through a further reduction in inflation. This could reduce the increase in our procurement and logistics costs.

And generally, our markets remain intact with steady demand and further growth opportunities for Drager. We want to continue to deliver growth and robust results so that possible external shocks do not put us in a poor financial position again like last year, but instead, we can continue to operate our business independently.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). The first question comes from Christian Ehmann from Warburg Research.

Christian Ehmann - *Warburg Research GmbH - Analyst*

I have 2, please. So as you've already mentioned, you said that the demand from China has normalized in Q2. But given the important impact of the China demand in the first half of this year, how comfortable are you to again show some robust growth in the next year on an order book basis? And the second question would be more detail-oriented one. So can we expect the personnel costs in Q3 to be representative also for Q4?

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

Well, Stefan speaking. I'll take the first question on China. So as I said that the -- so the tailwind from the extraordinary situation with the rising COVID figures in the first quarter will not repeat, and we are now back to normal, the ventilation business. And in general, we see a say more challenging environment with more uncertainties in China.

Currently, there is say action going on from a political side that many hospitals are accused for nonproper procurement procedures. And several hospitals say, officials procurement people they have been fined or arrested and this results in a currently very muted ordering situation. So that is, say, I would say even below what we consider a normal situation that can't go on for too long. So it's holding the breath. Sometime in the, hopefully, not too distance orders will resume when the business goes back to normal in China, the procurement of medical devices in the hospital, which is a pure political thing going after the hospitals not after the manufacturers in this case.

And your speculation about '24, we will not comment because today, we are not talking about '24.

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

And your second question was on the personnel cost. Yes, we have, of course, some ups and downs, but overall, the third quarter can be used as an indication also for the fourth quarter.

Christian Ehmann - *Warburg Research GmbH - Analyst*

A follow-up, if I may. The -- you talked about repercussion for order for the -- for maybe your contacts in the Chinese health care market. Do you expect these repercussions to have a lasting impact on your ability to approach those ordering agents? Or is it more like you expect this to normalize in the future?

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

It will normalize in the future, but at the moment, it has an effect on all medical equipment suppliers and suppliers to hospitals. Not specific to Drager.

Operator

(Operator Instructions)There are no further questions at this time. I hand back to Stefan Drager for closing comments.

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

Okay. Maybe one last chance. If there's one question left in the audience, that's still in the last chance opportunity to ask the question now. As there's no further questions then I would like to close the session. And thank you, everyone, for being with us today for being online and for your interest in Drager and hope for better and meet you again in the future. Thank you, everyone, and have a pleasant afternoon and evening. Goodbye.

Operator

Ladies and gentlemen the confrence is now concluded and you may disconnect your telephone. Thank you for joining, and have a pleasant day. Goodbye.
