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PRESENTATION

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

Yes. Good afternoon, and a warm welcome to everyone joining us today on the phone or via the webcast online. I have with me today, Gert-Hartwig Lescow, CFO; Tom Fischler, Investor Relations; and Peter Mueller, Financial Communication.

We would like to guide you through the presentation covering our results for the first 6 months, which we made available on our homepage this morning. We apologize that accidentally, the press release was already published yesterday afternoon due to a system failure at our external provider. In any case, the final figures contained in there had no meaningful deviations to the preliminary figures which we had already published some 10 days ago, following an ad hoc information release.

So now let's get started with the presentation. I will start with a high-level overview of the business development and the demand trends that we have seen in the region before Gert-Hartwig will go into the financial details of the quarter and 6 months period. And I will start on Page 3 with the business highlights. And after the presentation, we will open the floor to your questions as always. And in respect of everybody's time, we will end this conference in 1 hour sharp.

So on Page 3, what we see there, a short look back, where did we stand after Q1. As you are aware, we unfortunately had a very slow start into the year. And despite the currency-adjusted order growth in Q1 of roughly 2.5%, the net sales development was sluggish.

Next, to the normal quarterly volatility of our business. Adverse mix and currency effects, and last but not least, the weak delivery performance in our consumables business due to the ramp-up of our logistics hub in Frankfurt resulted in low net sales volume at the beginning of the year. The weak top line, together with the higher expenses, resulted in a negative Q1 EBIT of roughly minus EUR 40 million.

In the second quarter, our business development has improved. In Q2, the currency-adjusted order intakes continued to increase. And even as the growth rate is a bit lower than in Q1, orders increased in Q2 by 1.4% versus 2.6% growth in Q1. Our markets and Dräger remain on a growth trajectory. For the 6-month period, this adds up to a 2% growth adjusted for the negative impact of currency. Another positive point in Q2 figure is the strong catch-up of the net sales. With a currency-adjusted year-over-year net sales increase of 10%, the second quarter delivery was a solid growth.

In addition, currency headwinds decreased during Q2. The net effects are still negative. But after the strong headwind, our net sales of some minus 5 percentage points we had in Q1, the negative currency impact on net sales during Q2 declined by only around 3 percentage points.

So after 6 months, net sales is nominally pretty much on the level of the prior year. This corresponds to a growth of 4% if you take up the negative currency effects. This is well within the range that we have guided for the net sales development for the full year. No need for any adjustments here.

Moving on to our profitability. Even if the Q2 gross margin has improved versus the low margin that we had in Q1, the gross margin is still below the level 1 year ago. Also functional expenses have increased above the growth level of net sales.

In consequence, Q2 EBIT has improved versus a weak first quarter but is still below the Q2 level 1 year ago. So after the first 6 months, year-to-date EBIT is still negative at minus EUR 36.6 million since the improvement in the second quarter was not strong enough to fully compensate the negative EBIT in Q1. All in all, our financial performance is characterized by continuous positive currency-adjusted order entry cost, a strong improvement in the net sales development in Q2 bringing the year-to-year growth rate into positive range and well into the full year guidance range.

And finally, a quarterly EBIT improvement over the very weak Q1 but not enough to already report positive EBIT on the year-to-date basis.

Now I'm going to Page 4 and have a look at the top line trends, starting with the group figures on the lower side of the chart on Page 4. Order intake amounts to EUR 1.27 billion, corresponding to a year-over-year currency-adjusted improvement of 2.0%. That means, so far, we achieved an order growth rate which is at the lower end of the full year net sales guidance range.

In particular, demand for our safety offerings is above the level in the prior year's first 6 months, an increase of some 3.5%. This growth was supported from all 3 regions, at nearly all safety product areas. Not quite as strong was our order growth for medical products, 1.2%. While we see strong demand in AAA, plus 7%, our medical orders in Europe are only slightly higher, and orders from the region America did not reach the prior year's level.

In America, this is mainly a bases effect. Because last year in Q2, we had received several large medical orders in the U.S., which could not be repeated this year. Product-wise, the highest growth contribution comes from our consumables and services business and also from our thermoregulation business. Now I'll comment on the development within the regions, starting with the region America on the top of the chart. So far demand in the region Americas has declined. While our safety business remains on a good growth trajectory, our medical orders stayed below the level of last year.

But as I just mentioned, this is predominantly a base effect resulting from the strong medical orders in North America 1 year ago. In North America, where we had a strong business development in 2017, the comparable basis is much more challenging than in Central and South America. For the full year, we continue to expect to be able to grow the business in North America.

Unfortunately, we have experienced some delays in product approvals. The political risk for North America is high. Even if we are currently not much affected by the introduction of the latest import tariffs on the U.S. side, uncertainty is reigning. The situation in the countries in the southern part of the region is quite different. In Central and South America, we had a challenging year in 2017, and also 2018 is not the blueprint for increasing business. For example, there are several elections this year. This always leads to customer decision processes being slowed down and some force majeure challenges, like the strike of the truck drivers in Brazil.

Nevertheless, so far business development in 2018 is at least a bit more favorable than 2017 but flat on a growth rate in the first half of the year. Especially, demand for Dräger safety product is growing very well, but until now, it is still offset by decline in our medical orders.

Moving on to Europe. The order intake increased in the first 6 months by some 1.5%, coming from both medical and even more from safety. Conversion from orders into net sales has substantially improved compared to Q1. Net sales increased by currency-adjusted 5.8%. Germany, our largest single country in terms of net sales, has performed very well. A strong second quarter with orders growing double digit brings the order intake for the first half of the year to some 8%-plus. In the rest of Europe, several of the smaller countries are also growing at a good pace. But next to these positive examples, the region provides some concerns as well. For example, France has so far not been able to contribute to growth. The reforms from the Macron government, which will benefit the country and also our business opportunities in the mid-term, are currently on the short-term a burden for business development. And there is quite an extensive reorganization of the hospital landscape going on in the country, which has massively slowed down the investment activities of the anti-medical equipment market. In light of this, France will hardly be able to grow in 2018, but the development will improve, and the market starts to pick up again probably in 2019.

In total, Europe had a decent H1 top line, and we expect the region to stay on the growth trajectory also in the second half of the year.

Last but not least, our AAA region, that is Africa, Asia and Australia. With a constant currency order growth of some 6%, AAA is the region with the highest year-to-date order growth. Due to quite pronounced negative currency effects, the reported growth in nominal terms is much less favorable.

Due to FX headwinds, 6% order growth translate into roughly only 1% order growth nominally. The demand development within the region on a country level is quite diverse. The region has challenges in some countries in the Middle East, for example, but the majority of the countries are developing very positively. Some countries in the region, like China or Japan, for example, has high single-digit or even low double-digit order growth rates.

Product-wise, it is particularly the medical business so far that is developing favorably. Based on our sales funnel, our expectation is to also see an improvement in our safety business in the second half of the year. All in all, the performance of the AAA region is on track.

But before I hand over to Gert-Hartwig for a more detailed look on the financials, a few words on the new product launches during the first half of the year. We had several new products and upgrades in various modalities. I would like to share some examples with you.

Our medical portfolio, we upgraded our monitoring Infinity Acute Care System for the European customers or the CE countries with a major functionality update. The so-called VG7 update brings some important medical functionalities to the OR and the ICU workplaces. But not only medical functionalities there improved, also some technical features were added, like the new cockpit hardware platform capable of optimizing the monitoring and IT experience at the bedside. Together, these new features improve the Dräger patient monitoring solution in higher acuity settings in terms of efficient workflows, enhanced ergonomics and ease of use.

For our safety business, I have selected examples of new products for our gas detection portfolio. As you might recall, last year, we launched our top-of-the-line mobile gas detection device, the X-am 8000, which is able to measure up to 7 gases simultaneously. A great product, and customer reception is very positive. Now with the introduction of the new X-am 3500, we have broadened our multigas portfolio towards the mid-market segment. With the X-am 8000 and the new X-am 3500, we're now going to offer our customers updated product choices that are suitable to their specific needs and budget requirements.

Next to these multigas devices, we also introduced new versions of our single-gas device, the Dräger Pac. Longer run times, better displays and other improved functionalities improve the gas detection portfolio. And since our approach to helping our customers' problems is not only to sell them good devices but more about offering them complete solutions, we are also improving the processes behind the actual gas measurement as well, with solutions for wireless and cloud-based documentation on the spot measurement data, for example, or the recently launched new X-dock multigas module, which improves the process of testing and calibrating the new Dräger portable gas measurement devices. This combination supports cost-efficient workflows at the customer sites. You can find a description of some other new medical and safety products in our quarterly report.

With that, I turn over to Gert-Hartwig for his more detailed financial review on the H1 performance, and I'll come back with the summary and the outlook. Gert-Hartwig, please.

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

Thank you, Stefan. I also would like to welcome everybody to our conference call on the results for the first 6 months. Before I start the financial development of the group, I would like to clarify that whenever referring to growth rates, I will be stating values in constant currencies unless stated otherwise.

Please turn to Page 5 for a review of the Dräger P&L. Net sales in Q2 has started to gain momentum after the very slow start in the first quarter. Net sales of EUR 620 million during the quarter represent considerable increase compared to Q1 and also compared to the level 1 year ago, this corresponds to a quarterly growth of some 10%. But despite the higher volume of roughly EUR 40 million, earnings did not reach the prior year's level.

The reasons for this are a lower gross profit margin and higher expenses. Let me start with the margin and get to the expenses on the next page. The margin in Q2 was 43.3%. This is an increase of roughly 2 percentage points over the Q1 margin, but nevertheless, 1 percentage point below the Q2 margin last year. Negative currency effects were an important factor for the lower margin in the quarter. But next to FX and the utilization of our service infrastructure and higher-than-expected quality cost, the cost of goods sold burdened the margin also.

And last but not least, the margin was lower due to some negative product mix and margin effects. The net sales portion of lower-margin products areas was quite high in Q2. For example, we invoiced some larger deals in our safety rental business, which typically is high volume but carries lower margin. In total, higher volume, lower gross margin and higher expenses, our quarterly EBIT is at EUR 3.2 million.

In light of the higher net sales volume of the quarter, it is quite disappointing not seeing leverage coming through to the bottom line. The lower gross margin and the higher expense base overcompensated the effect from the higher volume. Mainly driven by the unsatisfying earnings development of the first quarter, the year-to-date gross profit margin is still roughly 2 percentage point below the level one year ago, and EBIT for the 6-month period is still negative at minus EUR 36.6 million.

As mentioned, next to other things, exchange rate played a role in the lower year-over-year earnings development, the driver being the strength of the euro versus many emerging market currencies. During Q2, the general FX situation did not change materially, hence neither did our FX outlook for the full year. We estimate the full year FX negative impact on the top line growth rate to be roughly 2.5 percentage points and the negative impact on the full year EBIT margin to be roughly a 1 to 1.5 percentage points.

Turning to the expense development on Page 6. Excluding the impact of currencies, our financial expenses after 6 months increased by 9.5% in the year-over-year comparison. The strengthening euro helps us on the expense side. Nominal growth rate with 6.7% is a bit lower. As previously announced, we are pursuing an investment plan with additional spending in research and development and sales and service during 2018 and '19. That means, next to other things, we are strengthening our capabilities in these areas. Consequently, our headcount is up.

The long side, with effect of cost increases, namely wage increases, personnel costs are up too. Looking at the different functions, the strongest expense increase is in research and development with an increase of close to 17% over the level of the prior year. We are hiring new R&D engineers to drive our product road map forward.

Also, sales and marketing expenses are up year-over-year, while we are hiring new customer-facing sales and service staff. This is well in line with our plan to invest into the areas that offer growth potential going forward. But in part, the increase is also due to the issues at our logistics hub in Frankfurt. As an example, in order to keep our delivery time for customers in line with their expectations and our commitments, the portion of air freight has increased, while air freight capacity is at a limit and tariffs are on the rise. Naturally, this means higher costs.

Operations at our logistics have had improved during the course of Q2 but are still not completely resolved. We expect a further normalization of the delivery performance in the current quarter. As a consequence of the weak earnings development in the first half of the year, we have taken measures to manage the further increase of functional expenses in order to reach our earnings target for the full year. We have cut the expense budgets of the regions as well as the central functions in the magnitude of approximately EUR 25 million. This will issue a lower expense growth in H2 compared to what we reported in the first half of the year.

Let's move on to some key ratios on Page 7. Cash generation so far is disappointing. Operating cash flow is significantly below the level 1 year ago. In the first 6 months of the year, Dräger had a cash outflow from operating activities of some EUR 67 million compared to a cash inflow of EUR 31 million in the prior year period. The reasons for this development are primarily the lower year-to-date profitability in 2018 and the unfavorable development of the receivables. Also, inventories increased by a greater margin than in the prior year period. These developments were only partially compensated for by the lower increase of the other assets. Cash outflow from investments are roughly on the level of the previous year so that also free cash flow is below the level of 2017.

On the positive side, we continue to see an improvement in 12-month average of the days of working capital. The total cycle time has improved by 5 days. Lower cash flow also results in high net financial debt, but with net debt-to-EBITDA at roughly 0.4, leverage of the group remains conservative.

What do we expect going forward? We expect to see an improvement of the cash generation during the remainder of the year. And as a result, also net financial debt will improve again. For the full year, we're expecting a slight improvement in net debt versus the level of 2017. Also, the year-to-date DVA development is on the low end of our expectation. With the 12-month rolling EBIT being significantly lower than 1 year ago and cost of capital slightly up, the Dräger value added has substantially declined. The DVA stands at EUR 13.8 million compared to some EUR 65 million 1 year ago. But here as well, we expect an improvement in H2 and to achieve the guided DVA level.

With this, I would like to hand back over to you, Stefan.

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

Well, thank you, Gert-Hartwig. Ladies and gentlemen, let me summarize today's presentation on Dräger's results for the first 6 months of 2018. Currency-adjusted order entry in the past 2 quarters was positive. And also net sales, after a very weak Q1, showed a strong improvement in Q2. Our currency-adjusted net sales growth so far is well within our top line guidance for the full year.

But earnings performance is clearly lagging behind. We are behind last year in the EBIT development, which gives us a challenging second half of the year ahead of us. Especially since the basis, our net sales and earnings development last year was a stronger in the second half of 2017.

As you all know, we always have a very back-end-loaded business here, and this will be no different this year. So what to expect going forward? On orders on hand, we are still above the level 1 year ago, and we have just concluded our financial review with our regional management. And as a result, we expect to see a decent net sales development in the months to come and thereby confirm our full year guidance for the currency adjusted net sales growth rate of 2% to 5%.

And earnings, based on what we see in our sales funnel and what the sales region forecast, we should be seeing some improvement in the gross margin coming from a better mix in H2, and also the lower expense growth going forward should allow for more leverage. In consequence, we reiterate our expectation for the EBIT margin despite the weak H1 earnings. But as we already said in Q1, it's more likely that the EBIT margin will come out at the lower end of the guided range.

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

QUESTIONS AND ANSWERS

Operator

The first question comes from Falko Friedrichs, Deutsche Bank.

Falko Friedrichs - *Deutsche Bank AG, Research Division - Research Analyst*

I would have 2, please. Firstly, out of the sectors that negatively impacted your gross margin in the first half of the year, could you tell us which can be considered temporary and should therefore not impact the next quarters and which ones might be more structural and could be a drag over the entire year? Then secondly, you mentioned that the functional cost should increase less in the second half than in the first half. In the first half, we had this 9.5% increase in constant currency. Can you give us more color on how much less than the 9.5% we can expect in the second half?

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

So perhaps to your first question, the factors that impacted the gross profit margin, that's currency effects, that's weak margin in service as well as high-quality costs and some mix margin effects. For the first one, we continue to expect some currency impact albeit a slightly lower one in the second half of the year just because the currency is -- the euro is relatively stronger. For the service and quality costs, those we -- what we see today is largely temporary in nature. Certainly, the quality costs that we see are coming from individual instances, where -- which we do not expect to either repeat or occur to a similar degree. And for the service, there will be some visibility in the third quarter but also a potential to recapture some of the effects. So clearly, temporary and even some upside. And for the mix and margin effects, there are 2 factors here. One is our product mix that we expect more positively based on the order entry in the second half of the year, pricing impact, we expect to continue in the second half of the year.

For the functional expenses, based on the fact that some costs in the first half are one-time in nature, and secondly due to support by our cost reduction, we expect that the nominal growth, which was in the mid -- even higher than 5% nominal growth, we expect in the lower single-digits growth. So clearly, yes, the growth will be lower in the second half of the year.

Falko Friedrichs - *Deutsche Bank AG, Research Division - Research Analyst*

Okay, perfect. Maybe one quick follow-up. Could you maybe put the strong increase in admin cost into perspective for us? Would that also be part of those restructuring efforts?

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

The cost savings will also affect the admin, and some of the increase is, in fact, one-time in nature of what we have seen in the first half of the year. It includes some key projects, some legal settlements and in fact, also some cost allocation. So yes, the lower spending in the second half will be -- will also be admin. And since admin is also in the regions and the expenses are in the regions, what's key for us is also the SG&A spending overall for the group, and we want to manage the SG&A ratios to the 30% range.

Operator

And we have another questioner, Aliaksandr Halitsa, H&A.

Aliaksandr Halitsa - *Hauck & Aufhäuser Privatbankiers AG, Research Division - Equity Analyst*

So I'd like to ask you on the EUR 20 million kind of cut that you announced to the budget, initial budget, in order to reach the full year EBIT margin. So does it potentially mean that these expenses are kind of catching up with you than later in 2019, 2020? And then also if you could once again maybe explain the issues with the logistics you are currently facing.

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

First question for the savings, it's a reduction that reflects several items. They go to the COGS item, and they go to some of the regions and reflect the lower development in net sales. So to that degree, they will not catch up per se because they reflect the changed business outlook. For some of the central cost, we are talking about postponement to some degree in order to match our spending, and we have not changed our investment program for research and development and -- to support our innovation road map, and also we have not changed our outlook to strengthen needed capabilities in sales and service going forward. So we will revisit the spending level for '19 and '20. We are not talking about, if you will, holding our breath but to adjust our spending through the business development in the countries and in the group.

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

Okay. And the -- your second question, what is exactly behind the logistics issues? We transferred our outbound logistics to a logistics provider. We have been working with logistics providers for over a decade now. So this is a normal industrial process and standard. So however, in these last transitions, there were some, let's say, shortfalls, which you would normally compensate as you go on the fly with additional resources. That is general resource shortage in the logistics market, transport capacity is short, as you may be aware, there is no truck drivers available. There is no air -- very hard to get a hold of air cargo space. So several effects came together that caused the overall logistics being sluggish, and we did not perform to our customers' expectations to some extent. That is now, for the largest part of the world, a thing of the past. We have overcome. But that added some extra cost, which we needed to compensate. So that's part of the first question that you had, that we compensate this not only in supply chain but throughout the company's expenses overall to make up for that, say, unexpected additional spend that we had to come back to normal. As this coming back to normal included also, say, redistribution of the load for the logistics, some back to our own facilities, that we do it ourselves, and some other third parties. So that's behind the logistic issues.

Aliaksandr Halitsa - *Hauck & Aufhäuser Privatbankiers AG, Research Division - Equity Analyst*

And maybe I'll just follow-up on the first one with this kind of, say, budget cut postponement. Is it possible for you to kind of distinguish what share could be attributed to the cost of goods sold that's kind of fading due to lower sales? And then what has been -- what part has been attributable to postponement in R&D activities?

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

The total split is from -- our total target is about EUR 25 million, of which 20% is from the COGS, 20% is coming from R&D, and 60% is from SG&A.

Operator

At this time, we do not have any additional questions. (Operator Instructions) Mr. Dräger, there seem to be no further questions.

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

Probably due to the warm weather, we already finished early before the complete hour. Thank you very much for all of you for being with us, ladies and gentlemen, for your interest in Dräger, and for your questions. It's much appreciated. We look very much forward to talking to you about the next result that we will present in pretty much 3 months' time from now. So thanks again for being with us. Have a pleasant afternoon and a great evening. Bye-bye.
