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Rheinmetall AG Conference Call

00:00:01 Operator

Good afternoon, ladies and gentlemen and welcome to the Rheinmetall AG conference call regarding the FY results 2020. At this time all participants have been placed on a listen-only mode. The floor will be open for questions following the presentation. Let me now turn the floor over to your host Mr. Armin Papperger.

[0:00:23] Armin Papperger

Ladies and gentlemen, thank you very much for joining the 2021 Rheinmetall earnings call and a very warm welcome also from my side. I will be your host for the next couple of minutes and walk you through this presentation together with my colleague and our CFO Helmut Merch. I will start with the 2020 highlights, will then hand over to Helmut to the financials and finally conclude with the outlook for 2021.

A year ago, we stood at the beginning of a crisis that affected everybody's life in a way that was completely new to all of us. I sincerely hope that you and your families have coped well with the situation and remained safe and healthy.

Before we continue with the 2020 highlights, let me draw your attention on our legal disclaimer on the following page. I will now start with the group highlights on page 3.

Although Corona was the overwhelming topic of 2020, we actually managed to do some business and in fact I would say that we have delivered a solid set of financials under these circumstances. Both business segments generated positive operating results and cash and in total we can report operating results of EUR427m and EUR217m of operating free cash flow. This enables us to propose a dividend of EUR2.00 with a high payout ratio of almost 35% at the upper limit of our range.

At Rheinmetall, we took great effort to care for our people and to support our customers and business partners wherever possible. While the Defence business was hardly affected and execution of our programs continued almost unchanged, Automotive was hit hard, especially in the first half of 2020. This difference in the business development accelerated our approach to initiate the transformation. The goal is to create stronger emphasis to Defence and to reduce our dependency from internal combustion engines.

Let me start now with the highlights of the Automotive business on page 4. 2020 was clearly marked by the pandemic impact on our Automotive business. Booked business declined by 25% to EUR2.7b. Already 14% of the won nomination letters last year are for alternative powertrains. Our currency adjusted sales declined by 19.3%. This was slightly better than the regionally adjusted LV production volume of minus 20.6%. The recovering volumes in the second half of the year and the strict cost management supported the return to a positive operating fiscal year result. Our consequent capex management helped to generate a positive operating free cash flow at EUR18m.

Now please join me on page 5 for the Defence highlights. Defence was hardly affected by the pandemic. Lockdown effects in the first half were compensated during the year. Order intake saw strong demand from Germany and Hungary for trucks and for our Lynx tank. The Hungarian Lynx order was the first commercial order for this vehicle underpinning our technological and commercial edge. Supported by these large order wins, our backlog climbed to a new record level of EUR12.9b. Sales increased by almost 6% to EUR3.7b and our operating margin jumped from 9.8% in 2019 to a double-digit 11.1%. Prepayments in the last quarter supported the operating free cash flow of EUR174m and we achieved a cash to sales ratio of 4.7%. Now please join me on page no. 6.

Earnings per share suffered first of all from the posting of special items of EUR337m including the impairment effect and from the lower operational Automotive performance. We considered it to be very important to show a strong sign of confidence in the long-term prospects of the company and we therefore propose a dividend of EUR2.00 to the AGM.

Have a look to page 7. Obviously, Rheinmetall is active in an industry that does not get full support from all stakeholders. But to be clear: We are convinced that Rheinmetall is contributing its share to a sustainable society that is willing and able to defend our values. Sustainability is part of our strategy and with the introduction of a 20% share of ESG targets in our long-term compensation scheme we emphasize our commitment. Last week, we applied to join the UN Global Compact, another demonstration of our commitment to increase transparency. We are dedicating more and more of our portfolio to alternative powertrains. On our way to carbon neutrality in 2035, 2020 again saw improved resource efficiency. Year over year we reduced our specific carbon emissions and also our water consumption by 5%. With these remarks I close my first part and I hand over to Helmut for the Financials.

[0:07:22] Helmut Merch

Thank you, Armin and a warm welcome also from my side. I start with the sales and results overview on page no. 9. Group sales declined by roughly 6% to EUR5.875m, with a slight headwind from currency and some support from M&A. Operational development of minus 5.5% was a little bit better than our guidance range due to better than expected Q4 demand in Automotive. The operating result declined by 15.6% to EUR426m and the operating margin decreased from 8.1% to 7.3%. Although Defence improved profitability, the segment was not able to fully compensate the earnings collapse in Automotive. Driving factors behind the EUR337m special items were the impairment charges of roughly EUR300m and EUR40m restructuring cost in Automotive.

Please turn to page no. 10. In 2020 operating free cash flow was better than expected. The strong Q4 order intake in Defence with higher prepayments and the solid Automotive Q4 performance as well as a continuously strict capex management in the segment supported the good cash generation ration. This is also reflected in our good cash to sales ratio of 3.7%, which is more to the upper hand of our 2 to 4% cash to sales guidance. Since we always recommend to consider longer time periods for the cash flow evaluation, the 24 months rolling operating for cash flow target of 2 to 4% corridorhas always been achieved over the last three years. Additionally, we have already indicated during the strategy update in early February to lift this range to 3-5% mid-term-wise.

Please turn to page no. 11. Despite the impairment charge in Automotive, we still operate a strong balance sheet with an equity ratio of roughly 28%. In combination with the excellent cash position on record level, this puts us in a very comfortable financial position and offers high flexibility to develop our future businesses. Furthermore, I would like to add that Moody‘s confirmed our investment grade rating post our strategy update in early February 2021.

Please move now to page no. 12. A top priority of Automotive in 2020 was to manage cost and cash. We guided for a lower capex level of around EUR100m in our Q3 call and closed the year at EUR95m of which only EUR85m were cash effective. With the expected further normalization of the business environment, especially maintenance capex should again increase in 2021 and we expect overall a level slightly below 2019. But we have to watch closely the market environment. The increase of our Defence capex is obviously related to the business growth and the additional program starts, where we need a certain lead time before we start production. In 2020, the IFRS 16 effect was dominated by the capitalization of our MilVehCoe lease agreement in Australia and accounted for EUR53m. We continued to report elevated levels of capitalized development cost, because of the Lynx and the next generation of trucks developments. Capital expenditure rose to roughly EUR100m and is expected to see a further increase in 2021.

Moving now on to page 13. Although R&D spending in Automotive declined by almost 10% to EUR192m, the share of self-financed R&D remained almost identical. Developments for alternative propulsion as well as connectivity and advanced driver assistance systems build the core of our R&D activities. Some early stage projects for driver monitoring systems are currently investigated leveraging Defence sensor technology. R&D activities in Defence rose by 24% to now EUR180m. Focus projects were the development of the new 130mm gun together with ammunition and a new autoloader concept, our high energy laser system and of course the application of artificial intelligence and digitization in a variety of products, like for example our unmanned ground vehicle, the Mission Master in order to realize new concepts of operations, called platooning.

On page 15, I would like to start with the presentation of the Q4 results of our Automotive segment. Q4 2020 Automotive sales grew currency adjusted by 1.7%, which is in line with the regionally adjusted IHS Light Vehicle growth. In Q4 2019, Automotive was impacted, as you remember, by the effects from the GM strike and the malware issue, which hit especially the American Hardparts business. The overall results effect was quantified to be roughly EUR10m last year. In Q4, operating results rose now to EUR45m and margin improved by 100 basis points to 7.2% compared to 6.2% in Q4 2019. Q4 2020 included almost no additional effect from short-time allowances. Operating free cash flow went up by 42% to EUR115m. Lower capex was the main driver.

On page 16, we are comparing reported monthly sales development with IHS monthly production development excluding China. Q4 ended with the positive operational development that we already indicated in our November call and we were able to keep up the cost discipline while support from short-term allowance was almost immaterial.

On page no. 17 you will find the divisional presentation of the Q4 sales and results development. Mechatronics reported slightly improved business of around EUR364m and continued to benefit from the introduction of cost measures earlier in the year, which helped to improve results by EUR5m to EUR30m.

Hardparts was still facing a very weak market environment in both pistons businesses. Especially the large bore pistons business was significantly below the already weak Q4 2019. However, operating results rose to EUR19m with a solid contribution of the at equity entities and a D&A relief of EUR6m due to the impairment which we have booked in Q2 2020. This result compares to a Q4 19 result, which included around EUR10m negative one-time effects as already mentioned.

Aftermarket grew the business by 5% to EUR97m. Operating results were contrarily impacted by a EUR6m write down for a production line at our Czech plant and ended with a result of EUR5m.

Please turn now to page 18 for the overview of our Chinese activities. Q4 sales in China declined by roughly 6% to EUR311m because we lost business at one local customer which could not be compensated at the same time. Total EBIT declined by EUR3m to EUR23m predominantly due to the above mentioned customer loss.

Please turn to page 19 for the market development. Our light vehicle business declined by roughly 4% in Q4. The different developments in the fuel types are due to ramp up and ramp down of specific products. The growth in our non-light vehicle business is driven by a positive development in trucks and Aftermarket, which both grew by EUR5m.

Before we turn to Defence, I would like to draw your attention to a successful commercialization of an innovation for alternative powertrains on page no. 20. Historically, we had already booked some contracts for the supply of fuel cell components, but now for the first time we have entered into an exclusive supply agreement with Daimler for the supply of a hydrogen recirculation blower. The product itself is designed to improve the efficiency of the fuel cell. The contract is especially important to us, because it confirms that our innovative products are in demand and that we are well positioned to participate in the future development of the alternative powertrains. As I stated earlier, the share of new orders for alternative powertrains accounted for now 14% for the total booked business of EUR2.7b, and this contract was part of this.

Please turn now to page 22 for the Q4 Defence financial details. Q4 was very strong and remarked new historical peaks in order intake and operating result as well as operating margin. Order intake rose by 48% on the booking of the Hungarian Lynx order and the additional German trucks to EUR4.4b. The currency adjusted sales decline of 2.6% was as expected and reflected the different sales pattern in 2020, which was heavier front-end loaded by roughly 5%. The operating result increased by EUR7m to EUR217m or 17% operating margin with a strong support of Weapon and Ammunition and Electronic Solutions. The development of the operating free cash flow includes the business related build up of working capital and slightly higher capex.

Let‘s move now to page 23 for the presentation of the divisional details. Weapon and Ammunition saw a very strong sales increase of 21% to EUR528m and marked the best quarter ever. On this backdrop, operating result improved to EUR155m and we generated a historical margin of almost 30%. Despite a sales decline of 10% due to project execution schedules, Electronic Solutions was able to increase the operating result by EUR12m to EUR40m. This improvement was related to a more favorable product mix.

Vehicle Systems realized EUR499m of sales, around 20% below the previous year as well as a results decline from EUR71m to EUR29m. Q4 2019 saw a significantly higher share of project settlements, which were the main driver behind the sales and results development. Additionally, first preparations for our new vehicle programs were included in Q4 2020, obviously not generating sales yet, since the beginning of production of various large programs will start in 2022 or in 2023.

Please find the details of the order intake and backlog on page 24. Q4 was extremely strong and we were able to post major programs for Germany and Hungary, helping to bring the total order intake into the aforementioned EUR4.4b. The order backlog stands now at EUR12.9b, and in addition, we have a shadow backlog of EUR3.6b for truck and ammunition framework agreements which will come into force over the next couple of years.

A significant share of almost 50% of the order backlog has lead times until 2022 or even later.

The German share in 2020 order intake was around EUR1.7b, which is a level we would expect for the next years to remain comparable.

Please move now on page 25. For the regional analysis we switch briefly to full year view. Again, large orders for vehicles were dominating the order intake and we reported now almost 90% of order intake in our European home market now including also Hungary.

The order backlog shows a comparable picture with slightly above 80% exposure to our home market in Australia, UK, Hungary and Germany. The new records figure of roughly EUR13b is an impressive documentation of the competitiveness of our innovative products.

Looking at the overall regional diversification, we can conclude that our export risk is going to be weaker in the future, as exposure to sensitive markets declines. This is even more important, because the export situation in Germany has been extended until the end of 2021 for all business with Yemen coalition forces, especially Saudi Arabia.

The license for the trucks to Saudi Arabia was finally cancelled in December last year and we are now claiming for damage compensation. Italy has extended the export ban until the running year too. In South Africa, Rheinmetall resumed to deliver in Q4 2020, but the situation is not fully resolved yet.

Please turn now to page number 26. Currently, our main focus is on the platform businesses. But again I would like to underpin the importance of the platforms for our future service business. Platforms are not only the vehicles, but as well our air Defence solutions and the soldier systems within Electronic Solutions. And all of these platforms offer great opportunities to generate further business for spare parts, maintenance and future upgrades as well as ammunition in the future.

Additionally, we are now looking to include other service business like helicopter maintenance and service and operations. In 2022 we already won the maintenance contract for the German CH-53 helicopter fleet. Last year, the service sales rose by 10% to now EUR536m and our mid-term sales target for this segment for 2025 is more or less EUR1b.

This closes now my part of the presentation and I hand back over to Armin again.

Armin Papperger

Thanks, Helmut. I will continue now on page 28 with the outlook for 2021. At the beginning of February, we presented our strategy update to you, and part of this will be the organization of the Group with the clear target to become more cost-efficient, to better integrate our technological capabilities and to have a more agile organization.

With the release of the Q1 result, we will report in the new structure as shown in the slide, with five core divisions and with the non-core pistons business apart. Our proposal process for the pistons business is progressing to the next stage in which we will start to invite interested parties.

Please turn to page 29. The business outlook is developing positively, although not reaching pre-crisis levels in all markets. But in general, we actually do not expect headwinds in 2021 from the macro side and we have not come across any material hurdles in the current tender landscape.

We are still expecting decisions on the Challenger LEP in the United Kingdom in due course and for at least one additional Lynx program in 2021. Additionally, due to the German election in September, a significant number of 25m budget requests will be decided before the parliamentary recess in July.

Move now to page 30. The consistent implementation of our restructuring measures will start to combine cost savings of around EUR20m already in 2021 and shall reach the full amount of EUR40m by 2023. Out of the total amount, EUR16m apply to Sensors and Actuators and EUR3m to Materials and Trade, the remaining EUR21m are accounted for by Pistons.

Please turn to page 31. As already mentioned before by Helmut in the financial sections, our order backlog has an execution profile with most of the larger programs starting in 2022 or later. This results in a slightly v-shaped sales distribution due to the fact that the Puma has been basically closed last year and the other programs such as the Boxer for the United Kingdom in 2023, the Lynx for Hungary in 2022 and the Australian Boxer do not yet compensate for the expired programs.

With these remarks let‘s conclude with the group guidance on page 32. As a consequence of the reorganization, we have decided to present the guidance only on an aggregated level, but still using the familiar KPIs. From now on, quantitative guidance will be provided on Group level only completed with a qualitative guidance on divisional level. The operational group sales in 2021 are expected to grow between 7% and 9% and we guide the Group’s operating margins to be between 8% and 9%. Please find the details of the divisional guidance on page 33 of this presentation.

I will not go through all the details for each divisions, but on this page you will find the 2020 pro forma sales and margins per division together with the corresponding qualitative 2021 guidance.

This closes my presentation and we are now available for your questions. Thank you. [0:29:46]

Operator

Ladies and gentlemen, if you would like to ask a question, please press nine and star on your telephone keypad. If you would like to withdraw your question, press nine star again. And the first questions are coming in. And the first question comes from Mr. David Barker of Bank of America. Please go ahead.

[0:30:35] David Barker

Good afternoon, everyone. Thank you for taking my questions. I've got two quick ones. Firstly is on your automotive volume guidance, and I guess that's across all of the new business segments. Some of the OEMs are talking more cautiously than the IHS production figures that you’ve quoted in the presentation. How do you think about the impact, things like the semiconductor shortage on your volumes? And do you think you can outperform or underperform the IHS forecast that you've quoted in the presentation?

And then my second question, and do forgive me if you've already given the clarity on this, but how are you thinking about free cash flow conversion in 2021 within your 3%-5% revised range that you mentioned a few weeks ago? Thanks.

[0:31:22] Armin Papperger

I will give you an answer about the semiconductors and Helmut will give you an answer about free cash flow. The internal effect of semiconductors is, for us, very limited. So we have enough semiconductors in our storage. So on supply side, we are in constant contact with our suppliers and we keep the situation really under control. On the sales side, we see some reductions of the call offs from the OEMs, but at the moment, the total impact for Rheinmetall is limited.

[0:32:05] Helmut Merch

Yes, coming to your question regarding cash flow. Here, you remember the existing range is still 2%-4% and we are going to uplift midterm the range to 3%-5%. So actually, for 2021, we expect a free cash flow ratio more or less at the midpoint of the existing range that will lead us to roughly 3%. And as you know, it's highly dependent on incoming orders and corresponding prepayments but this is our actual view on the running year, 3%.

[0:32:52] David Barker

Fantastic. Thanks. I'll get back in the queue.

[0:32:57] Operator

The next question comes from Sash Tusa of Agency Partners. Please go ahead.

[0:33:04] Sash Tusa

Thank you very much indeed. Good afternoon. I've got a couple of questions. First of all, on the customer loss in China, was there any specific issue that you could attribute that to? Was that an issue of the customer having problems or was this an issue of an incompatibility of your product or pricing or anything? Does that give any clue as to your overall market position in China?

Then secondly, I just was interested in the resolution of the Saudi exports contract. How much working capital do you have tied up there and would you expect broadly to be compensated for that or for your costs there?

And then finally, just from some of your comments earlier on today, you seem pretty optimistic about the Challenger 2 upgrade program. How quickly do you think that could have a material effect? Do you have a lot of work still to do on prototypes, for example, or could that enter production relatively fast [the way it went 34:10]? Thank you.

[0:34:15] Armin Papperger

Thanks for your question, Sash. And I will start with the Challenger. On the Challenger side, I am expecting, day by day now, that we get officially the information from the British MoD that everything is done. So we had very good negotiations and we are very happy to have United Kingdom then also as customer on the main battle tank side.

So at the moment we see that there is not a big negative impact because we made good negotiations about a down payment on the Challenger side and also the investments that we are doing at the moment in Telford. This in combination also with our MIV program and the Challenger program. So it's a limited impact. We have to invest something but a limited impact, in comparison what we get from the programs.

I go to the Chinese part. And on the Chinese part, there is an impact from a price issue. So we gave a bid and another competitor was cheaper and we don’t want to go under this price. So sometimes you win, sometimes you lose. We lost that. So it's not a big issue but it's not nice, but sometimes you lose.

And Helmut will give you an information about the impact on the Saudi side.

[0:35:54] Helmut Merch

So the actual situation around working capital is roughly EUR50m which is tied up with the actual situation. And now we expect either a complicated legal dispute with the government or an amicable solution during 2021. Both ways are possible but it’s not yet decided which way will be taken and what the timeline will be.

[0:36:26] Armin Papperger

Maybe one further information about that. The German government is looking if other customers are available for these trucks. And you know that we sold the trucks and the trailers. The trailers are coming from France. So the trailers are in Saudi Arabia and we have the money for that. So we reduced our exposure a lot. And from the trucks side is what Helmut said, looking for a new customer or getting the money from the government. Per law, the government has to compensate and has to give us money. And at the moment we think that we lose zero euros.

[0:37:12] Sash Tusa

Great. Thank you very much.

[0:37:14] Armin Papperger

Thank you.

[0:37:16] Operator

Next question comes from Mr. Christoph Laskawi of Deutsche Bank. Please go ahead.

[0:37:22] Christoph Laskawi

Good afternoon, and thank you for taking my question. The first one will be a bit of a follow-up on the free cash flow question before. When looking at the slide for the full year 2020 we see a good EUR150m of working capital outflow for the year. In theory, that should reverse to some degree and be supportive on the free cash flow. Hence I'm wondering a bit why you would only see around 3% cash conversion, or is there any cash outs that we are not seeing or would be special in the year end 2021?

[0:38:05] Helmut Merch

Yes, Mr. Laskawi. As we also indicated, we will see a higher CapEx level, either in Automotive due to the expected recovery on the volume side and also we expect further CapEx increase in the Defence segment. So we have an impact from this side. And I tried to indicate, and you know it from the previous years, it is always hard to fix a certain guidance on the cash flow due to the volatility in milestone payments and prepayments. And I think we are just in the middle of our existing range of 2%-4%. If we see a better development during the coming quarters, as you know, we will always try to give an update then.

[0:39:02] Christoph Laskawi

Understood. So – but there would be no exceptionals we should consider as cash out during the year?

[0:39:08] Helmut Merch

No. Not for the time being, yes.

[0:39:12] Armin Papperger

The point, Mr. Laskawi, is that we have, as you know, Hungary is the starting point now and we have to deliver in 2022 so we need working capital in 2021 on the Hungarian side. We got a down payment, but you get a down payment only once. So now you have to use these down payments and you have to deliver to the customer. And the same is on the MIV side where we have to make investments but there are no extraordinary things. It's all business as usual.

[0:39:45] Christoph Laskawi

Okay. So in theory it could that we've seen that working capital essentially flat because of the ramp up for Hungary and then it wouldn’t be a support, if I read that correctly?

[0:39:54] Helmut Merch

Sure.

[0:39:54] Armin Papperger

It totally will change the picture if we win another big contract and we get another, let us say, EUR20m, EUR30m down payment then, extraordinary high cash flow will come, as you know. And we are conservative in that. We expect that some contracts with associated prepayments will be won , but we are conservative and do not include this in our expectations.

[0:40:15] Christoph Laskawi

Thank you. And sticking a bit with the cash, and you stressed you have a record level of cash on balance. The dividend surprise today already was positive in terms of cash distribution to shareholders. What would be your preferred ways of using the cash on balance? I mean, the question has been asked a couple of times already on M&A. [0:40:35]

Should we expect any transaction in the near term or could you use it in other ways to get it back to shareholders?

0:40:43.7 Armin Papperger

Yes, first of all, I think the best way to use it is really to buy good companies and to create value for the shareholders . So we are looking and we are constantly looking for 30 to 50 different companies, which really fit to us. There are some targets at the moment, really near. And you know, officially, we do not speak about these targets but these are targets on the electronic side, and also targets on the Defence side. So we want to use the money for that. And as you have seen, there is enough cash there; there is still more than 1 billion on the bank account. So we can use this and we want to use it. Second point is because over the next years, we will have a constantly really good operational free cash flow, one of the ideas is really to rise the dividends and at the moment, we are between 30 and 35% of the net profit as a payout ratio. And we discussed to bring it from 35 to 40% in the mid-term. So this is the next point to give it back to the shareholder.

[0:41:55.5] Christoph Laskawi

Thank you. And last question a bit more near term and on the Defence-side, for me. When looking at the order backlog to target sales for 21, you still need to get quite a bit of near term orders into the backlog in order to make the target. You also commented that a lot of smaller orders from Germany will be decided in H1. Could you comment around the order intake momentum that you currently see also at the beginning of the year, and how you would think that the order intake from Germany will evolve in H1 compared to the second half where potentially there's a bit of political risk attached to order intake?

0:42:38.7 Armin Papperger

I think that in the first half of this year, we have to grab most of the orders. There is still a possibility that we get orders later also in Q3, before the election also after the election. All the orders, which have a value smaller than EUR25m is not a problem because, as you know, the procurement office BAAINBW is working the whole year. But we need a decision to the middle of the year of the 25 million bits or bits which are higher than EUR25m. I had yesterday a good meeting with the planning chief and I think that everything is going into the right direction. So you know there is one decision or they made one decision about we call it Pionierpanzer (engineering) support vehicle. So this is a big order from Germany. We expect other orders from our frame agreement from the truck side. The Pionierpanzer is a quarter billions or about EUR250m (gross value). Same about or a little bit higher can be from the truck side out of the shadow backlog. So I expect this will be a good year, also from Germany. Another point which is really important about the budget and this is also a question that you also sometime asked me, Mr. Laskawi, what's going on with the political issues is there because of COVID a decline of Defence budget etc. I have seen the first figures for the next years in Germany and it's not a big line on the investment budget but German Bundeswehr is asking for more money even if they are nearly on the level of EUR50b they are asking for more money. And at the end of the day, they will ask over the next five years for another EUR10b per year for investments. If it is going through I don't know, I have no glass ball but it's a good signal for us.

[0:44:57.1] Christoph Laskawi

Thank you very much

[0:45:00.9] Armin Papperger

Pleasure.

[0:45:03.3] Operator

Mr. Sash Tusa has a follow up question. Please go ahead.

[0:45:08.6] Sash Tusa

I apologize. My question has actually been answered. It was about M&A. Thank you

[0:45:15] Armin Papperger

Thank you, Sash.

[0:45:20.0] Operator

Thank you. Next we have Miss Chloé Lemarié of Exane. Please go ahead.

[0:45:24.3] Chloé Lemarié

Yes, thank you. Good afternoon, everyone. I have a question on the Weapon and Ammunition Division and the uptrend in 2021 sales. What would be the key driver there for what would be a better sales momentum and for the rest of the Defence segment? And do you include in that any kind of relief from the Italian sales drawback that we've seen in the past couple of years? And if we look at 2022, 2023, how should we think of that segment growing with the rest of the division? And I'd have a just a clarification one on the M&A discussion you mentioned a target on the electronic side that would be here Electronic Solutions or would that actually be Sensors and Actuators? Thank you.

[0:46:22.8] Armin Papperger

Yes, let me start with on the M&A side. On the on the M&A side, we are looking on the Electronic side for Sensors and Actuators, that is right, and also on the Defence side, we are looking for electronic companies or also UAV companies. On the Ammunition side, the driver will be because we have as you know, this frame contract about 120 millimeter, there will be an opportunity now also over the next years because after signing the British contract (Challenger LEP), the 120 millimeters smoothbore gun is inside. And for sure they need ammunition, it makes not lot of sense to have a main battle tank and to have no ammunition. And the Brits had no smoothbore gun before. So therefore we see a big potential therefore and the growth rate. Then we have a new family of 155 millimeter ammunition. At the moment, the most of the distances, most of the artillery around the world can fire 40 kilometer or a little bit more. And we have now new technologies to fire more than 70 kilometers. So the long range artillery with high precision fuses is a point, which really helps us to grow the business on the ammunition side. So in Italy, there is still a good backlog. And so it's not canceled, the contract with Saudi Arabia is not canceled. And if we could continue also this business, it's not in our planning, then it would be even better than what we have planned.

[0:48:06.4] Chloé Lemarié

Thank you very much.

[0:48:07.8] Armin Papperger

It's a pleasure

[0:48:10.6] Operator

We still have couple of questions. And the next question comes from Mr. Sebastian Growe of Commerzbank. Your line is open.

[0:48:17.9] Sebastian Growe

Yes, good afternoon. Thanks for taking my questions. I don't know why it didn't come through for. Firstly, on Defence on the fiscal 21 margin outlook, when looking at Weapon and Ammunition and also Electronic Solutions, there was obviously all time high margins for these model. How far it goes back. The question that I do have is to what extent the sales mix within those divisions is probably sustainable and with that also those very high margins i.e. 15% plus weapon ammunition, the 10% Electronic solutions, maybe we could start there and then we take the others up.

[0:48:59.6] Armin Papperger

Yes, I agree that we want to stay on that level 15 plus for ammunitions and also around 10% for Electronic solution. As you see in our strategy meeting, we told very clear that all business units have to have 10%, Weapon and Ammunition has to make for sure much, much more. And also on the Vehicle Systems side, we want to reach this target, which is much harder because as you say, our Electronic Solutions and also our Weapon and Ammunition business sometimes is delivering to vehicle systems. So they cannot make profit on profit. This would be unfair to our customers. So that is the reason that we sometimes are then between let me say around 9% which is a good business, if you have an internal business.

[0:49:48.9] Sebastian Growe

That makes sense but is there anything really that was kind of special and completely above the norm for any of the two or would you say that this was just kind of a good reflection of what might be possible and I'm really referring to Weapon and Ammunition and Electronic Solution.

[0:50:07.2] Armin Papperger

So I think the best thing is to say in Weapon and Ammunition we have a lot of work to do and we are doing good sales. So the mixture that we have is a good mixture, but it will be also a good mixture over the next years. On the Electronic Solution side we are going more from sensor side to the system side. So systems and systems of systems like soldier systems like infantry fighting vehicle where we do all the electronics for the systems inside. So this is a better margin than the sensor business. On the sensor business usually we are not able to make such profitability that we do on the systems of systems side. And another thing what Helmut told you before in his presentation, is that we do also on maintenance, more and more maintenance part, especially on soldier systems. And driver number three is digitization which is coming forward. And as you know we won the first big contract in Germany about that. We are looking now to create all the digital systems in Hungary. And if we grow in that area, we can stabilize the profitability around 10% or maybe better.

[0:51:30] Sebastian Growe

And I was expecting the next question I would have had on the long-term margin, I think. On the occasion of quarter three results you said that you might provide an update. Now you had the 9%-10% target before, you have achieved more than 11% and then fiscal 2020 you are also saying, and thanks for the color really around service, that this is going from 14% towards close to 20% on my numbers by 2025. So that all sounds like it could be easily 12%. So is there anything really wrong in this sort of assessment? Any sort of special costs that you would have to incur in order to just make the EUR5.5b in revenues work? Nothing.

[0:52:06] Armin Papperger

No, Mr. Growe. Nothing is wrong. But you know that we are really conservative. We want to deliver what is going into the guidance and we want to deliver 100% of what is inside. And as you know year by year, at the end of the year, usually we deliver more and this is exactly what I'm expecting again.

[0:52:32] Sebastian Growe

Okay, very good. The last one around Defence and order pipeline, is what I'm after. You have been giving some color around Germany but the UK has been also clearly around, the Czech Republic. We have seen now three years and a sequence every time more than EUR6b of orders. The normal run rate should be EUR4b to EUR6b, I think, that you defined. I know that it's always difficult to pinpoint it in advance, but nonetheless and all the pipeline, and provided that you really get all those bigger tickets in Germany home, the 25m plus orders, what would be a reasonable number to assume for 2021, please?

[0:53:11] Armin Papperger

Yes, I make the calculation very simple for you. The expectation is Germany about EUR2b. If you have an expectation about – roughly about the UK, about EUR1b. The expectation in Hungary also about EUR1b, so then you have EUR4b. And the rest is smaller order intakes that we have. So my expectation is that we are again on the upper level between EUR4b and EUR6b.

[0:53:42] Sebastian Growe

Okay. And then the last one, just quickly on automotive and the portfolio process of the pistons business. Can you just provide an update the timeline still holds for quarter two/quarter three as you indicated before? And if that is possible, then I would clearly be interested in also the number of interested parties that you have seen now?

[0:54:01] Helmut Merch

I think there are actually roughly 100 interested parties which we have on our list. But now our advisor, which is Goldman Sachs, is providing us a shortlist of interested parties, between 20 to 30. And then the normal process of looking into the figures, into the data room will start. Therefore we indicated that a quick story would end up in Q2. But I think we have also to have in mind the actual and running COVID situation. This could stretch a little bit the timeline. Therefore I think a realistic target is a signing during Q3 of 2021.

[0:54:57] Sebastian Growe

Really, really good, thank you.

[0:55:00] Helmut Merch

Welcome.

[0:55:02] Operator

Next we have Mr. Sven Weier of UBS. The floor is yours.

[0:55:08] Sven Weier

Yes, hi. Thanks for taking my questions. Hope you’re well. The first one is on the order intake again on the defense side. I think at the press meeting, Mr. Papperger, you said you have a few interested parties in Europe. Now on the call you said you have one firm, one. So I was just wondering if you could give us more color on what the Hungary auto win has done for that pipeline and how much it has accelerated. Just simply more color on that very item. That's the first one, thanks.

[0:55:40] Armin Papperger

Yes, thank you, Mr. Weier. So on the defense side, one of the drivers for the next years will for sure be the infantry fighting vehicle. On the infantry fighting vehicle, on the international side, I always said that Hungary was the first milestone and now the rest has to come. So I am tomorrow with the Slovaks. The Slovaks are interested in that. There I see they want to make a decision this year, and maybe very soon. Then, there are negotiations with the Czechs. On the Czech Republic side I think there will be a delay. Because there is a like, by the way, Slovaks also, is a small governmental crisis with the prime minister but on the Czech side I personally think that they will make a decision after the election. Then there are other opportunities in Europe. There is an opportunity and there is a need over the next years, it's not for this year, it's not for today, it's for tomorrow, but there is a need in Italy. The Italians are looking for new infantry fighting vehicles. And there are other partners in Europe, especially in Europe who are looking for the infantry fighting vehicle. I personally think that also Australia will make a decision this year, and if you count up, we think that minimum one of the contracts will come. So the area of the Slovaks will be around EUR2b. Australia would be even better because it's around EUR5b. There will not an order intake this year in Australia. The order intake will be next year. I personally think and the tests are running and we are doing well at the moment on the test side. So the feedback that I get from my Australian team is a very positive feedback. It would be wonderful if the Slovaks and the Australians would come, for sure. But then my expectation of EUR6b would be not good enough, so it must be then a little bit higher. But at the end of the day, we are happy if we get always around EUR6b order intake. Is that fair enough?

[0:58:07] Sven Weier

Yes, sounds promising, for sure. The other follow-up I had on the defense pipeline, Mr Papperger, was related to the transport helicopter where I think the MoD has pushed back the tenders because it was supposed to be too expensive and all those things. What is your most realistic expectation on this very project, please?

[0:58:29] Armin Papperger

Yes, Mr. Weier. The minister made a clear decision that we need a heavy helicopter. There is not a final decision at the moment if they want to go with Lockheed or want to go with Boeing. As you know we are together, we are partnering with Lockheed or Sikorsky. I personally think that the minister wants to make a decision before election. If it really works, I have no clue, because there are issues at the moment because, as you know, the process changed. They have now an FMS process (Foreign Military Sales process) and in an FMS process they buy off the shelf. So the Germanization has to go down, or there is really no Germanization inside on this FMS case. The role of Rheinmetall will be the same that we had before. We are looking for the maintenance contract. There is always the question, what do you think if the government wants to have a separate maintenance contract? We have an agreement with the company. If the K (Helicopter CH-53K) wins, we have an agreement with Sikorsky and we are here the only one who have the agreement with Sikorsky, no other ones has an agreement about the maintenance. And the intellectual properties are with Sikorsky, and not with the German government. The German government will not and cannot buy the intellectual properties on that.

So I see that it would be a really good business model for us. And I personally think it would be also good for German Bundeswehr if we do it here in Germany and they have a strong partner with Rheinmetall on their side.

[1:00:26] Sven Weiher

Okay, thank you. And then you just mentioned elections and I wondered, I mean, we spoke on the call before, you know, the Black/Green coalition possibility, which

I think was the base case until a few weeks ago and how pragmatic the Green Party could eventually be about Defence, but now there's obviously also potentially another scenario for so-called “Ampel” coalition. And I mean, we know that the SPD has been not so the forthcoming partner on Defence in the last four years. So, you know, it's early days and we'll have to see what really comes out, but what would be your take on such an outcome?

[01:01:04] Armin Papperger

Yes. As I always tell at the end of the day, it doesn't matter which political coalition is really ruling Germany. At the end of the day, we have to take care about that. And there is one thing, this is really important: As long as Germany is in the NATO, it doesn't matter which coalition is really ruling this country. We have to take care about that to be a strong part of the NATO. Most of the parties, and by the way, also the Green Party, yes, which would be then, yes, I think they should be and they must be part of this coalition. It has a clear structure too that we want to stay in NATO and that Germany has to play an important role. But nobody of us has a glass ball, what is really coming up. I personally think, but this is only my personal opinion, that we still get a black/green coalition.

[01:02:09] Sven Weier

Yes, let's see what happens in the next few months.

[01:02:11] Armin Papperger

Yes.

[01:02:11] Sven Weier

Thank you for that. The final question is from my side on the pistons disposal, and I think in the February meeting, you said that, you know, if the price was right, you would also generally rule out that the whole Automotive business could be for sale, if I remember correctly. I was just wondering, I mean, now we said we have over 100 interested parties in the process. I mean, is there anybody who has also expressed interest for the whole auto business, or are you limiting ...

[01:02:43]Armin Papperger

No.

[01:01:44]Sven Weier

... the process exclusively to the pistons business?

[01:02:48]Armin Papperger

I didn't speak about our Sensor and Actuators business. So, and the question was what is with the rest of the Hardparts business about that? There was my answer very clear: If there is someone who is paying an extra ordinary good price, we have to think about. This was my answer. I never spoke about the Sensor and Actuator business on that, because I personally think with the strategy that we have at the moment on the Sensor and Actuators, also on the hydrogen technology, where we go in, where we are at the moment in different R&D programs with the German government, where we expect EU money, European Union money over the next month, especially on the hydrogen technologies, where we have really good technologies. We will show you during the next capital markets day, these new technologies that we have. And we expect that we can grow on the sensor and actuator side fromEUR1.2b to EUR2.2b. I think there is a really good chance for our shareholders that we create more money for our shareholders with that business. But at the moment to be very clear, there is only one decision that we made and the decision is that we want to sell the piston business. And the other question was really new and I answered that, you’re totally right. If there is somebody coming who is paying us unbelievable lot of money, then I think also about other things, but not Sensor and Actuators.

[01:04:37] Sven Weier

Okay. Fair enough. Thank you very much Mr. Papperger.

[01:04:40] Armin Papperger

A pleasure.

[01:04:42] Moderator

We have one more question in the queue. It comes from Mr. Joseph Ayoola of Morgan Stanley. Please go ahead.

[01:04:52] Joseph Ayoola

Good afternoon. And thanks for taking my questions. I just had one on the auto margin and prosperity in Q4, which is partly clarifying as well. It looks like you had, I think EUR10m of impairment charges in Q4, which was included in the operating result. I'm I reading that correct, sort of on the line, you would have had EUR55m of debt excluding that? And then sort of looking at that sort of strong performance in Q4 when it comes to thinking about Sensors and Actuators and determining trade next year, how should we think about the sustainability of that exit rate of profitability? Was there anything wonderful in there you highlight? Thank you.

[01:05:36] Helmut Merch

Yes, as you already mentioned, we had a good operating margin in Q4 for the Auto business with roughly 7% including this, right off of the Czech production line and so this should not occur again. And if you look to the second half of our auto business in 2020, here we made an average operating margin of roughly 6%, and this is a promising signal for the development in 2021. And especially looking for the Sensors and Actuators, here, as you probably are aware, we saw historical margins in a consecutive row of four years of roughly 9%. So this will not be able to reach during this year, but as Armin already told you, we have a minimum EBIT hurdle of 10%. So we are very much convinced that Sensors and Actuators will reach these target within our mid-term range, which we will end up with 2025.

[01:07:02]Joseph Ayoola

Great. That's very helpful. Thank you.

[01:07:05]Helmut Merch

Welcome.

[01:07:07] Moderator

There are no more questions in the queue therefore, I will repeat, ladies and gentlemen, if you still have a question to raise, please press nine star on your telephone keypad. I'm going to have one more question. It comes from Mr. Alexander Hauenstein of DZ Bank. Please go ahead.

[01:07:36] Alexander Hauenstein

Hi. Yes. Hello, Alex Hauenstein. Thanks for taking my question. It's about Defence. I'm wondering with regard to the drone activities in the current warfare, and especially when we look at the recent conflict of Azerbaijan and Armenia, we saw that attack drones quite changed the warfare landscape. And I'm wondering how this trend might impact over the next couple of years your demands with regard to vehicle systems, but also maybe posting some opportunities on the other side for maybe Weapons and Ammunition, or your Electronic Solutions business. So maybe you can give us some updates here also in that sense about what you are currently doing in your portfolio with regard to drone, not attack drones maybe, but also what you still have in portfolio here. I remember a few years ago, you gave an update about the airport security thing, and yes, maybe you can share some views here how you think about this trend and how you as Rheinmetall try to cope with it and materialize maybe. Thank you.

[01:08:51] Armin Papperger

Thank you for the question. So let's start with the loitering ammunition. Very soon Rheinmetall will have also loitering ammunition in our portfolio. So we invested in that area and we think that loitering ammunition has also a future. So loitering ammunition is munition that we can fire over a distance of up to 30 kilometer, which is able to make a top attack. If you have a loitering ammunition, you need also tank ammunition for sure, because tank cannot fire, usually it should not fire loitering ammunitions because as you know, it's totally different because it's a much faster speed and it's totally different role that you, how to fight with your enemies. But we also have countermeasure systems against this loitering ammunition. So our people on the R&D side are working on good countermeasure systems, also on loitering ammunition. The other point is, and this is one of the biggest problems is the area of swarm attack. And this is a clear statement, I got it yesterday also from our planning chief to say, we need something against swarm attack. On the swarm attack, you usually cannot fight with missiles. So what you need is you need a gun based system, and we have a perfect system for that. This is the 35 millimeter airburst munition. And I expect this year an order intake for a new air Defence system. Maybe, and I think so it should be boxer based. The Hungarians are looking Lynx-based, an air defense system with a 35 millimeter turret. This with a searching radar and a tracking radar. So we are able 24/7 to protect our troops. This is for convoy protection. This is exactly against that, what you have seen in Bergkarabach. So we are working on countermeasures directly on the tank, and we are working on this 35 millimeter ammunition or turret. So is there an impact on the ammunition side? We think no because it's an add on ammunition because it has another mission. And if you have an auxiliary ammunition, yes, you have to fire a lot of ammunitions inside. This, because you want to block the enemy. With the loitering ammunition, there is a possibility to have much, much cheaper the opportunity to go into tank brigades and to destroy them. But as I told you, we are working on counter systems, and I think this is a good business, long-term also for us.

[01:12:07]Alexander Hauenstein

Okay. Thank you. And with regard to the airport security, I think that you were working at this. We’ve seen some, yes, some clients buying it or they’re still in a prototype phase or /

[01:12:22]Armin Papperger

No, there is still only on the prototype area. As you know, there are some programs from Munich, from Frankfurt, from Dusseldorf, from the German airports on that. But no of these airports bought the final system. This is a nice product but to be fair enough, it's a niche product. Yes, because we will not survive only with that. It's a nice niche product.

[01:12:49]Alexander Hauenstein

That's for sure. I remember roughly the value which especially the investment for you. Thank you.

[01:13:00] Moderator

Ladies and gentlemen, if you would like to state your question right now, press nine star on your telephone keypad. Thank you.

[01:13:16]Armin Papperger

It seems to be that there are no further questions. So ladies and gentlemen, thank you very much for your attention. So the year 2021 will be really an exciting year for us as we move on with our agenda to become a more Defence focused business and to bring our technologies to new promising applications outside the classic mobility business. So we have the right capabilities at our disposition and the right people to use them on our way forward. I have to say thank you very much for your time. Thank you very much for your attention to our company and keep us in good mind. Thanks to all. Bye-bye.

[01:14:02] Helmut Merch

Bye-bye.