

Rheinmetall-AG-Q2_2023-report
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O Operator
AP Armin Papperger.
DS Dagmar Steinert
S Speaker

O Hello, ladies and gentlemen, and welcome to the Rheinmetall-AG-Conference call on the financial results of the second quarter in 2023. 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.

AP Thank you very much. Thanks for your kind introduction. Good afternoon everyone, and welcome to Rheinmetall Q2 2023 conference call. I will start with the market update. Dagmar will provide the details on the quarterly financials, and then I will conclude with an outlook for the remainder of the year. As usual, please be reminded of our legal disclaimer on the following page. Let's go to page three. We have a very solid Q2 [01:00] on the financial side. Sales rose with 6%, but the more important information is the defence growth was 12%. So the driver of our business will be the defence business, operating results improved to 118 million, and the margin softened to 7.9%. The reason for that is some issues, for example, the IT incident that we had, but other issues in detail. Dagmar will give you that information on the financial part.

Operational free cash flow, lowered to -219, which is much better than Q2 yesterday, also more details on the financial side. A very important information is we have a very heavy backend loaded year this year. And even if that is heavy backend loaded in the first half of the defence business [02:00] has a growth rate of 12%. The growth rate in the second half will be more than 30%, so nearly 35%. And the biggest driver will be our ammunition business, which has a growth rate in the second half of about 48%. So you see from the profitability, the Q3 and the Q4 side, especially Q4 is the most important quarter this year, and it's even more important than the years before. So is it possible to make it happen? Yes. We are producing all the products at the moment, but the customers want to have the goods in Q3 and Q4, and as I told you before, most of them in Q4.

So, Rheinmetall backlog and Rheinmetall nomination tripled. This is also very good for the future. The Rheinmetall nomination grows [03:00] to 4.46 billion, mostly driven from German orders and also orders from Ukraine via Germany. So that we get from the Ukrainian government and mostly of them paid from the German government so that we are safe also from the cash side. The Rheinmetall backlog jumped to 30 billion Euro, around 30 billion Euro in between, now one month later, we have now a backlog of 40 billion. So that two weeks ago, it was the best week ever in the Rheinmetall's history. Only in one week we got 7 billion order intake. The third information is Expal deal is closed. We are very grateful also to the Spanish government that we could close in July, the 31st the Expal deal. [04:00] We had a pre-closing adjustment of 1.2 billion,

we had a cash out of about 1.1 billion. And we see now further growth of this core business. One information over the last weeks we only gave to Expal, and we will give also over the next two weeks, about 600 million Euro orders to Spain, which really helps us to grow the business and make Expal more profitable than they were before.

Let's have a look on the next page, we see some statements from three very important people for Rheinmetall on the German market. On one side, it's Minister Pistorius, the second one is General director of BAAINBw Annette Lehnigk-Emden and State Secretary Zimmer. And what is the focus [05:00] they give us, and they tell us also in our meetings? The priority is that the moment time and the companies who are able to deliver, they get the contracts and they get the contracts very fast. I have one example for that. Last week we had a negotiation about another ammunition contract that Rheinmetall will get. It's a triple digit million for ammunition. And the expectation is that we can do it in two weeks. So the government is very fast at the moment, number one. The second point is that the Minister Boris Pistorius, said there is a need of more than 20 billion, as we know, it's nearly 30 billion for ammunitions. So if you have a combination of a modern ammunition portfolio and a qualified portfolio, this is also very important [06:00] new development. We are able to deliver inside Rheinmetall, and if we deliver, we can grow our sales now.

On the next page, you'll see that this is not only a trend in Germany, it's also a trend in the whole NATO. So NATO increased the target, and the target now is we have to invest more than 2% of the GDP, for defence inside the NATO. What does it mean? Over the next two and a half years a very clear statement also from the office of the Chancellor to say, "Okay, we need now the hundred billion." And there is a re-planning at the moment in the German government, and they want to spend mostly the hundred billion in the next two and a half years. There are some projects and programs where it is not impossible, for example, the F-35, because [07:00] it's a very long term program. But all these programs, ammunition, vehicles, the logistic vehicles are coming back now into the hundred billion budget, so that we can use on one side the money of EPL 14, but also we can use the money of the hundred billions.

What does it mean for us? It means that for the next two and a half years, an imminent growth rate on the ammunition and on the vehicle side will be and from the governmental side, there must be a decision then from 2026 on that EPL 14 has to grow up to 75 billion, which is at the moment a gap of more than 25 billion euro on one side or on the other side, and this is my expectation, but it's a pure expectation of myself [08:00] that there is a need of a second money injection or as we say in Germany ein zweites Sondervermögen. If that does not happen, the next coalition, yes, we'll have a problem because they cannot fulfil what the NATO is forcing them. The need at the moment, and this is also very clear, is not only a hundred billion. The total need that we have here in Germany is up to 350 billion Euro. And that will help us for sure for the next 10, 15 years to make the Bundeswehr strong as it should be, the strongest army in Europe. As chancellor Olaf Scholz said. Rheinmetall can offer a lot of solutions in for the German Army. As you know, we are the biggest producer of ammunition, and you will see it later. And on this very successful week, two weeks ago [09:00] the ammunition contract for artillery and also for tank 4 billion for tank ammunition, 1.5 billion for artillery ammunition it's very helpful to have this frame agreement.

On the vehicle side, we booked also the Caracal vehicle digitization, a lot of new projects are running up like a new project called Varan, but DLBO will bring us over the next 12 months a lot

of order intake and air defence. Air defence is very, very new investment on gun based and short range missile based air defence. And for Rheinmetall, it is on one side of the sky next technology that we will give now very soon to Ukraine and the Sky Ranger technology. On the Sky Ranger for Ukraine, for example, we will have a combination out of the Leopard 1 chassis, [10:00] and also our Sky Ranger technology that opens us new markets. And at the end of the day, my expectation is that this is also a market, much more than 1 billion Euro that we will see over the next years. So Rheinmetall is best positioned to support the Germany Army. We have products, the products are ready and we are able to deliver.

So on next page number six, you see what happened over the last weeks. So in quarter two we booked the second lot of Puma. Then the 57 heavy tractor units with 50 million, Puma was more than 500 million, and 367 Wechsellader. This is a delivery fulfilled for Q3 [11:00] in 2023. So it's 1 billion euro, and this is the positive thing in July. It's not part of that quarter, but it's worth the information. We booked 7 billion in one week with Caracal, and the different ammunitions from artillery down to Puma ammunitions. So a very successful quarter three, but a more successful quarter three. But we speak first about quarter two. On the next page, you see what happened on the Ukrainian side. So Rheinmetall is a strong enabler also for the German government to help the Ukrainians. And as you see from the defence systems wire ammunition systems 105 millimetre ammunition, all of them are booked. Different vehicles on models in between 60. My expectation is that we can deliver up to 120, 14 Leopards. And as you have seen [12:00] in the news today we will also deliver another nearly 30 Leopard 1 to the Ukrainians. So expected is Leopard 1, mobile air defence Fox to produce the first production line in Ukraine, and additional ammunition contracts. A very clear message from the German government is, every ammunition you have ready, we will buy, and we will help the Ukrainians.

So 1 billion orders from the Ukrainian side where we signed the contract with Ukraine. And at the end of the day, and paid from the German side is 1 billion. My expectation for the whole year of '23 will nearly book 2 billion euros only from the Ukrainian side this year. So the next page, page number eight, you'll see, you have an overview about [13:00] the activities that we have in Ukraine. At the moment the first 12 people are trained here in Germany for our common joint venture. Rheinmetall, will have always 51% of that joint ventures. The first joint venture is with Ukroboronprom, and it is from our side, expected by end of Q3 '23, that we are able to start work. The people are very well educated and they get an education now on vehicles like Leopard, like Marder and all the other vehicles we have in the Ukraine, for example Also, the trucks, and we can start immediately now the activities.

The opportunity I see is that this business can grow only this factory. This business can grow up to 200 million euro per year [14:00] in maintenance and sustainment and the reason for that is because they need a lot of spare parts. We will give the spare parts to Ukraine, and some of the spare parts we will produce also there. Point number two is ammunition, and on the ammunition side is our expectation that end of the year, we will have also an agreement with the Ukrainian government on that. They won't produce medium and large caliber ammunition and number three is air defence. Expectation is quarter one or quarter two next year that we will have factory for assembly minimum and assembly of air defence equipment in Ukraine. The need from the Ukrainian side for air defence at the moment is after ammunition, I think the second biggest need to protect the soldiers of the Ukrainian forces. [15:00]

So let's go now to the next page, page number nine. And it's a really a success story, what our US boys are doing there. We are XM30 finalists. You know, this was the old name OMFV. It is the first time that a German company is able to go into the end fight and highly appreciate that we get 700 million US dollar for American Rheinmetall for the prototypes. And there are, at the end of the day around 14 prototypes that we have to produce, and I think a very good business for us, and a very good step forward in the US market. Let's go to page 10. **[16:00]**. On page 10, we see now the international orders. We won in Australia the Navy ship protection systems. This is for the Hobart class and also for the ANZAC class. There is at the moment, a business of 125 million, but an option up to 600 million, and we won also, as you know, in Australia, the seamine contract, which is about 400 million.

So there's this 1 billion. We lost the Land 400 phase three program. The Australian government gave us the information that they go into the final negotiations with our competitor. The reason is not technology or technique. The reason was also not price. What I understood of all the things, it's a very clear political decision **[17:00]** that we can give as Australian government, not a hundred percent of the eggs into one basket. But Rheinmetall remains committed to the Australian market for sure, because we got a lot of billions. Australia is a one of our home markets. I really would appreciate to win that, but you cannot win everything. So we have a hit rate of more than 90%. So we win 90% of the contracts that we offer. This was one of them that we didn't win.

The next point is Norway. On the Norwegian side is now a large single call from the existing contract from Norway. Very successful story for our RMV people, more than 150 million for around 300 trucks TG3 military. A very good starting point that will **[18:00]** come more Norwegian and also Swedish customers in Scandinavia are very happy now with the vehicles. They were very happy with the team in Munich and Vienna. And second supply of key components for the Leopard 2A7. This is a 130 million contract for 54 tanks. This are guns fire controls sensor units, and the delivery starts in 2024. And a even better story is Austria because it was very, very fast deal from our team in Vienna and Munich. And we have a frame agreement with Austria of 525 million also for trucks. So you see this truck is a military truck of west standard, and we enlarge at the moment our portfolio **[19:00]** on one side, but also the market on the other side. Now, let's go to page 11. And on page 11, I think a very interesting page. You can see the user of smoothbore guns, of Rheinmetall smoothbore guns, because all of these guns, the 120 millimetres smoothbore guns, are produced Rheinmetall or are in produced under license.

So the interesting calculation of that is you see that there are, at the moment in Europe with smoothbore are about 2,700 tanks. And we calculated now after NATO standard, that one tank for 30 days, for 30 fighting days should have about 400 grenades. If it is kinetic energy or high explosive grenades usually you have 60% kinetic energy and 40% **[20:00]** high explosives. If you calculate that, and if you see that the mean value of tank ammunition of high-tech tank ammunition is about 7,000 euro, you see that there is a need of 1 million rounds, and as we know, the stocks are empty of 1 million rounds of 120 millimetre for the 120 millimetre smoothbore gun. If you calculate the whole value, then you see it's 7 billion euros. So there is a need of 7 billion euro because the stocks are empty, and we calculate, we fill it over the next seven to 10 years. It's a huge opportunity, and if we can do it in seven years, it's 1 billion market per year. Rheinmetall is the only full qualified producer. We will not get 100% of the market, but a signal, a very clear signal, is the 4 billion **[21:00]** frame agreement from the German government that you see that the calculation that we have is a very, very realistic calculation.

Let's go to the next page. On page number 12, we show you that the Expal acquisition is closed now on July 31st. It's very important for us because with that acquisition, we enlarged our product portfolio on one side, and we enlarged very strong our capacities on the other side. And we told you several times that we now have an additional for next year an additional capacity of 350,000 rounds. And the good news is all of that 350,000 rounds are booked. We have orders, we got orders last week or some days ago, [22:00] we got the lost orders, for next year they lost 120,000 rounds of artillery. And so we are fully booked for next year. So then the expectation is and as Rheinmetall brought as I told you before, 600 million euro order intake, 200 million for medium caliber, and 400 million for artillery. So for the full year, 2023, the expectation is 400 million sales. This is exactly right. We'll come to that figure. What does it mean for Rheinmetall? My expectation is between 180 and 200 million with the new contract that we booked sales for the last five months with a higher profitability than expected. So very profitable, very good business.

Let's go now to page number 13. On page number 13 [23:00], we see the operational updates of our civilian business. So, the civilian business at the moment is a relatively very small, growing, relatively flat business. But we take care about that, and I will give you some information about our emission reduction, the alternative powertrains, and also our innovations. On the innovation side, we really start our pilot project of the curb stones. So cologne, we'll start with that. There is an opportunity medium term to make more than a hundred million sales in this area if we have a breakthrough strategy in different cities. The second is on the alternative powertrain that we have new customers on the hydrogen recirculation blower. And we have launching customers for the high voltage cooling pump and [24:00] the cathode flaps which now have an order intake of triple digit million backlog. Emission reduction on the strategic truck contract for the (24:15) we booked and also the lightweight engine block. If you see the figures you will see that the driver will be defence and the civilian business will, let me say, will go back into the second line.

Now, I will hand over to Dagmar for the presentation of the Q2 financials. Please Dagmar.

DS Thank you, Armin. So let me start with the presentation of the financials on page 15. Overall, we can report a second quarter sales growth in line with the expected seasonality. Sales grew [25:00] as Armin already mentioned, by 6.4% to almost 1.5 billion euro, currency had a slightly negative impact in the second quarter. All divisions except material and trade grew or at least help their sales level year on year. Our operating result rose by 5 million Euro to 118 million euro, while the margin slightly softened by 20 basis points to 7.9%. Weapon and ammunition delivered an outstanding contribution. Negative is our at equity contribution from 4iG and our Chinese casting joint venture that continued to be a burden on the operating result. Reported earnings per share from continuing operations rose from 1 Euro 21 to 1 Euro 27. That is a 5% increase. [26:00]

Please turn to page 16 for a look at our operating free cash flow and working capital development. Operating free cash flow declined in the second quarter year on year by 40 million Euro to minus 219 million euro. In the first half of 2023, operating free cash flow improved by 317 million Euro to minus 325 million euro. This year's development resulted mainly from the necessary build up of working capital, and as we already told you, we are continuing to build up stock in order to secure our future growth potential. As a result inventory increased by over 800 million Euro in the first half of the year, collection of receivables and customer prepayments help to mitigate a further working [27:00] capital build up. Our division's vehicle system and weapon

and ammunition account for most of the build up. Both divisions shall be the backbone of our expected Q4 sales increase.

Moving on to page 17, I don't want to go into all the details of our balance sheet. I think the most important message is that the balance sheet remains very strong even after the payment of the purchase price for Expal on July 31st. So let's continue on page 18 for the divisional breakdown. Vehicle systems reported a very strong quarter with an increase in sales of 22% to 550 million euro. Again, tactical vehicles had an excellent [28:00] performance. Deliveries of load handling systems started to contribute towards the end of the quarter.

The operating result rose to 57 million euro with an improved margin of 10.3%. Operating free cash flow decreased by 237 million Euro to minus 253 million euro. Mainly as already someone mentioned due to the increased inventories, especially for logistic vehicles, weapon and ammunition sales progressed from 307 to 360 million euro, driving the operating result by 68% to 65 million euro in the second quarter. So you'll see cost inflation was overcompensated by leverage effect and a favourable product mix. Margins accelerated to 18.2%, which brings us a big step closer to [29:00] fulfil our margin targets. The operating free cash flow development benefited from higher customer prepayments, and despite the ongoing inventory build up jumped by 100 million euro to 49 million euro in the second quarter. Our division electronic solutions reported a small sales growth of around 3% to 249 million euro. Larger sales for soldier systems and air defence contracts are still expected in the running year 2023, less favourable product mix with a lower share of air defence projects explains the margin drop from 8.7% to 6.6%. Again, customer prepayments help the operating free cash flow to improve to minus 17 million euros.

Let us now move to the civil business. [30:00] As you might recall, we experienced a cyberattack on our civil business early in the second quarter, which effect on both divisions. We expect roughly 10 million euro burden for the full year, although we expect the impact to be limited for the full year sales execution in the second quarter was affected, and operational processes slowed down. However, we are confident of making up almost the entire sales shortfall in the second half of this year. Sensors and actuators sales remain stable at 344 million, but were held, backed by the cyberattack mentioned above. The operating result dropped from 24 million euro to 9 million euro. The operating result was hit by additional raw material cost increases that have not yet been passed on [31:00] to customers and mitigation costs for the cyber incident. Materials and trade suffered a sales decline of 16% to 154 million euro.

The operating result came down to just 5 million euro after 11 million euro in the second quarter last year. A negative impact from lower sales, a negative at equity contribution of around minus 1 million Euro and additional mitigation cost for the cyber incident burdened the operating result. Non-divisionary consolidation reports higher sales elimination due to increased intercompany business activities, and includes a negative at equity contribution from 4iG of almost minus 4 million euro. The operating free cash flow of the non-divisional [32:00] consolidation line includes a number of different factors. These include delayed VAT refunds from the first quarter, increase in trade payables and finally, reduction of tax prepayments for the German companies. All together resulted in a lower payment burden in the second quarter 2023.

Let us move to page 19, Rheinmetall nomination tripled year on year to above 4 billion euro Order intake for the defence business increased on the back of strong demand from Germany and Ukraine. This includes call-offs from existing framework contracts in the division vehicle

systems. Frame nominations jumped to 546 million euro. Booked business remained below previous year's [33:00] level, but saw a strong shift in the composition away from light vehicle combustion engines to trucks and alternative powertrains. The Rheinmetall order backlog has exceeded 30 billion euro, including recent orders from Germany for ammunition and the Caracal four wheel drive, the order backlog is approaching the 40 billion Euro threshold. So this close my remarks, and as you can see, driver of the business is the heavy backend loaded defence business this year. And I hand back to Armin for the outlook.

AP Thanks, Dagmar. So on page 21, you see we start the outlook. And on the outlook you see, first of all on this page, the picture of the grand opening of the, the new dimension of Rheinmetall on the air side, [34:00] we had a ground breaking of Greenfield production plant in Weeze and a lot of politicians and also the Premier of Northrhine Westphalia was with us. Very important for that is that the German government made negotiations with Lockheed that this production should produce at least 400 F35A fuselage sections. And if you see that contract in total, the contract of a minimum 400 fuselages will be over a period of 10 years, a 4 billion contract. We will add servicemen and women and we will ramp up now on the personnel side. We are very happy for the first 20 jobs, we got 500 [35:00] CVs, so very positive, no problem to get the people.

Let's have a look to page 22. Here you will see that we are investing in our future. We have to invest into our future. And as discussed also last time, it's very important that we have enough material in our stocks. So on one side, working capital will grow. It's on one side very good because we can deliver. On the other side there is a burden also on the operational free cash flow for sure. And on the other side the CapEx has also to grow. And the two things of the target of 2023 was about 600 million. It'll grow up to 650 and 700 million. And this is on one side 60 million investments in Bavaria, in [36:00] Aschau for the powder production. So we made a clear decision not to invest totally in the new factory. There was always a long term discussion about this factory in Saxony, we invest now 60 million and with that 60 million Euro investment, we are able to enlarge 600 tons of triple-based powder, a very fast return of invest because this is for tank ammunition and for artillery ammunition which are profitable, very profitable contracts. And the second CapEx side is for sure the investments that we have to do on the F 35. And on the working capital side it is very important that we still fill our stocks because as I told you before it's a backend loaded business and for that we need materials. [37:00] But again, here, it's very fast turning and we will get the money back very fast.

On the next page we see it we see that we have a backend loaded business. And if you have a look to Q1 and also to Q2 you see that in the Q4 on the sales side, on Q4, we will have more than 40% of our annual sales in the quarter number four. And I told you the figure before, with a growth rate of more than 35% and with more than 30% in Q4, we will make more than 50% of our operational results in Q4. So therefore, I'm very happy [38:00] from the profitability of the company that I have no doubt that we will fulfil our guidance and hopefully be better than that. So what are the main projects in Q4? This is on one side, on weapon and ammunition is what we have to supply to Germany. And the risk is relatively low because it's more from the same. It's tank ammunition, Medium Caliber Ammunition, it's artillery ammunition, and it'll be also deliveries to Ukraine. And Germany only in Q4 will be more than 300 million Ukraine, more than 100 million Euro with good profitability.

Vehicle systems are the ramp up of projects in Hungary. These are the Lynx programs and the PZH 2000. In UK is the ramp [39:00] up coming up now for Challenger 3, and for MIV and also the

Land 400 phase two program the boxer and Ringtausch, Leopard 2 and also Marders for Czech Republic and Slovaks for the Leopards and the Ukrainians for the Marder. All of them are very profitable products, and that is the reason that in Q4, we will make more than 50% of our profit in only one quarter. Very positive also that we have more trucks on Wechsellader for various nations, and our expectation is that we can make more than 200 million for Wechsellader UK, more than 170 million in Norway and Sweden more than 43, and also Ukraine in a double digit millions to deliver. We are on [40:00] the way to make them ready because it's also no risk and because it's always there. They're always the same trucks, and it has no technical risks inside.

So the outlook is now we have a very strong book to bill ratio. This was nearly three times on the sales and, and it'll grow in the second half. Germany contract award makes noticeable progress, Expal integration offers us significant capacities. And we have a very successful diversification in new markets as discussed on the F 35. So Rheinmetall is fully committed to timely capacity, and also increase and in order execution. [41:00] We want to be the enabler for the different governments who trust in us, and I'm sure that we will do. So if you go now on the last page, on the outlook of the guidance. So without Expal we say on the sales side between 7.4 and 7.6 billion tick in a box operating margins with all the contracts is, allow me to say more than 12% and operating free cash flow between 4 and 6%. Because of the investments it can be that we are on the lower level. It depends a little bit about the down payments, but we are also very successful on the down payment side. But our range of 4 to 6% operational free cash flow will stay.

If we have now a look to Expal, [42:00] as I said here, is between 150 and 190 with the newest contract from Expal. My expectation is between let me say a little bit less than 200 million on sales and an operating margin of more than 25 percent. So next quarter, we will give you then a new guidance, if we have a full overview about the Expal business. But at the moment, everything sounds very well. Thank you very much. And now we are open for Q&A.

- O Ladies, and gentlemen, if you would like to ask a question, please press nine star on your telephone keypad. If you would like to withdraw your question, press nine star again, please press nine star in order to ask your [43:00] question. And the first question comes from Sash Tusa of Agency Partners. Please go ahead.
- S1 Thank you very much indeed. Good afternoon. I've got some questions about Expal, the margins that you are forecasting for this year are very significantly higher than the sort of margins you indicated it had done in the past. And I wondered whether that was because we're effectively only seeing the best bit of the year in terms of deliveries and profitability, or is Expal actually more profitable than you expected at the time that you bought it? And tied into that, do you expect any integration costs for Expal?
- AP Yeah, thanks Sash. So first of all, as you see, it's a leverage effect [44:00] that that we have it's at the moment fully filled. The profitability is better because of this leverage effect. And on the other side, we could book some businesses which have higher profitability than Expal booked before. These are the two points. The second point is post merger integration process that we have. There is something, but it's not a lot of money that we have to implement because we do it very slowly. IT integration and the other things, we do it slowly, there are some costs, but this is on a very, very minor level.

S1 Okay, great, thank you. And then just another unrelated question you didn't mention, I think in the presentation, the German Schwerer Waffenträger(44:50) requirement where you've announced that there's been Germany and Australia have agreed on a deal, [45:00] but when do you expect that to come into your backlog?

AP Yeah, so at the moment, our first of all the Chancellor and the Prime Minister made a handshake agreement about that. Then the German delegation was in Australia together with the Chief of the Army and the Armaments director. There is also a very clear agreement now, there are contract negotiations between Australia and between Germany because this contract should go from the German government to the Australian government and back to the Australian government will give this contract to Rheinmetall Australia. The expectation is that the order will come end of the year. You never know what happens if governments go into negotiations, but the expectation is that the order is coming end of the year.

S1 Okay. Thank you very much.

AP It's a pleasure.

O Yes, thank you. We have a couple of questions that came in. The next questioner is Mr. George McWhirter [46:00] of Berenberg. The floor is yours.

S2 Good afternoon. Thank you very much for taking my questions. Just two more on Expal please. Firstly, please, can you provide some additional detail on the order intake and backlog trends in Expal since the closing? I think you mentioned you signed a \$600 million order there recently, and secondly, what sort of growth do you expect in Expal systems for the next financial year? Thank you.

AP Yeah. So first of all, yes, so, George we gave 600 million order, or it'll happen over the next two or three weeks 600 million to Expal. So our expectation is that, and this is exactly what we had in our plan in '23, we told you that we have 400 million. Next year we will have 600, hopefully 600 million plus sales for the full year. And the main [47:00] orders we have at the moment are these artillery orders. Then there a 200 million order of medium caliber ammunitions. And we are at the moment in, in negotiations also to give some more contracts inside. And nearly all of them is help from European countries to Ukraine. So we filled for 2024, and now we are on the way to fill for 2025 the order book for Expal. Another 200 minimum hundred, but or it would be better and I think it is possible to go up to another 200 million. So I think in two years' time is also what we expected that Expal can make about 800 million sales.

S2 [48:00] That's great.

AP That fair enough?

O Yes. Thank you. The next question comes from Mr. Ben Heelan of Bank of America. Your line is open.

S3 Yeah. Afternoon. Thank you everyone for the question. Firstly, and I wanted to touch on the F 35 contract. Obviously it's a big win. Can you talk a little bit through the potential there in terms of the financials? Is there a significant CapEx expenditure? Do you receive any prepayments to support that? How should we think about the revenues of that medium term? And then secondly

on civil business, obviously it was quite weak in the first half of the year. Is there any gauge in terms of how that is going to trend into the second half of the year and into 2024? Thank you.

AP Yes, Ben. So first of all, on the F 35 contract, [49:00] as I told you that the German government made a very good negotiations also for us, with Lockheed that 400 of this parts should be produced in this factory. So if you calculate over the next 10 years, it's the potential of only for that piece of 4 billion Euro. But what I think is there is more in, because the F 35 will be over the next 25 years, the most successful plane, like the F 16 was before. And so, we think there is more potential. And all the fuselages outside the US should be produced here in our production line in Weeze. But the minimum, let me say that we expect is 4 billion. We prepare ourselves to produce also other pieces inside. This is a very high tech production line, and in that high tech production line our [50:00] toolings that we have, our flexible toolings, so we can produce also other pieces and maybe we can help also in other air plane programs to produce components for them.

From the investment side there is a strong investment from the United States. So we get the tooling from the US side. So this is an investment of more than a hundred million. From the tooling side, there is no cash out from us. This is a hundred percent coming from Northrop. Northrop get mostly met, surely inside the contract paid from the German government. But our partner is Northrop Grumman, and on the other side we have investments then into the factory by themselves. This is another a hundred million euro. And our calculation at the moment, the biggest negative cash flow that we have is 15 million euro because we get some down [51:00] payments. And I think this is a very fair value in such a big program. Is that fine for you for the F 35?

S3 Yep, that's very clear. Thank you.

AP Second point on the civilian business. On the civilian business at the moment the problem that we have, we couldn't drive our business because of the IT, of the cyber incident. That was the reason that for example materials and trades is really dropping down on the sales side. And without sales, in the civilian business like in every business you can make no profit. Our expectation on the civilian business is still, and that is our clear target that we will be in a range between six and seven percent profitability on the civilian side. The growth rate on the civilian side [52:00] will be absolutely not comparable to that what is going on the defence side, it'll be a very small growing business or a flat business. But I think the target that we have must be possible that we have a profitability between six and 7% EBIT.

S3 Okay. Very clear. Thank you. Can I just ask one follow up on weapons and ammo from a margin perspective, it was very, very strong in the second quarter, I know you mentioned it benefited from mid and it benefited from drop through. Is that the right level of margin we should be thinking about in that business in the second half of the year? Was there anything particularly exceptional in Q2 that will kind of normalize in the second half of the year?

AP It should be much better in the second half than in the first half.

BH Okay. Very clear. Thank you, Armin.

AP Thanks.

- O Thank you. The next questioner is Mr. **[53:00]** Yan Dercoles of Oddo BHF. Please go ahead, sir.
- S4 Yeah, good afternoon everyone. Couple of question on my side, maybe the first one on cash, on free cash flow without, I would say deferring the mid-November CMD. These I would say 650 to 700 million euro, calling into question, your vision of CapEx at around 450 million euros excluding Expal beyond 2023. And maybe the second question is, I would say is a modelling question because I was surprised by the consolidation line in Q2. So what is the magnitude of the consolidation headquarters line, which would anticipate for '23? And maybe the last one for me Can you come back on Ukraine, **[54:00]** because you mentioned during the call that you were expecting I think nearly 2 billion euros of order intake only for '23. So could we have a rough indication of the timing regarding the conversion of those orders into, into sales?
- AP If I start, and Dagmar will give you an overview on financial side. I give you an overview about the Ukrainian side. I told you 1 billion is booked, another billion is expected. So the order intake on the sales side, on the ammunition side is the, let me say the lowest. The minimum time is between four and five months. From order intake to delivery time. This is possible, for example, for medium caliber rounds. We are between six and eight months for large caliber because we have the materials **[55:00]** now inside, for example, for the tank ammunition. If they need Leopard, for the Leopards, they have a tank ammunition, or they can use it also for sure, for the Abrams. From the vehicle side we have for the infantry fighting vehicles usually 12 months. And the reason is because we built up the infantry fighting vehicles totally new. But the bulk of deliveries that will in Q3 and especially in Q4, there will be a bulk of Leopards and Marders that we will deliver now. So that in the quarter one and quarter two the relatively good margins that we will have on this Ukrainian deals is very, very low. And the content in Q3 and Q4 will be very high. So therefore that is the reason **[56:00]** that's more of 50% of the profitability will be in quarter four. So that is the reason that that we said we will fulfil the guidance and hopefully be better. Is that fair enough for you? Can I give to Dagmar?
- S4 Sure. You can give her.
- DS Okay. So starting with your question regarding the free cash flow in the consolidation line as I explained in the second quarter it was like extraordinary positive because we had these positive effects from a shift in VAT payments, which we received from the tax authorities in the second quarter, as well as a reduction of tax prepayments. Therefore overall it was a positive figure. And of course some **[57:00]** build up of payables. For the full year '23 in the last year, we had in this line consolidation a negative impact on the operating free cash flow of 164 million. And this will be exceeded this year. It will be definitely more because first of all, we changed a little bit the structure of intercompany payments. And on the other hand regarding our F 35 CapEx that's something what we will see in this line as well. So those are the major points or bigger points regarding the development of operating free cash flow in consolidation. **[58:00]** Does that help?
- S4 Yeah. Perfect. My question on the free cash was linked to beyond '23, because I understand that you will need maybe a bit more CapEx or maybe for the F 35, but also for some other programs.
- AP It's a propulsion system. One thing is we invest at the moment, 60 million into the enlargement of our propulsion systems. This is mainly an investment in Germany, in Bavaria where we enlarge 600 tons of triple base powder, and we need that because of the customers at the moment. They buy full shots, full shots on artillery sites. So you need the propulsion systems also for that you

cannot only produce the round by themselves, but also the propulsion systems. So we enlarge that. This is one of the trigger points that we can enlarge next year, our capacity in artillery up to **[59:00]** 600,000 because forging capacity is there, filling capacity is there, but we need for the whole round, the full shot also. This is one investment, it's about 60 million. We added that because this was not in our calculation, and this was not in our first investment program because yeah, it was not planned. Very simple, it was not planned.

So second point is an investment and another investment not the same size, but another investment is also into the high explosive in South Africa and a little bit also into the propulsion side. In total, Rheinmetall if I add everything has now about 7,000 tons of propulsion after that investment. This helps us a lot to create full shots for our ammunition. And number three is F 35. On the F 35 side, **[01:00:00]** as you said, there are some investments. This is a minor investment in comparison to the ammunition, but we do now this investments on the ammunition side, yes because I must say we have a very, very fast return of invest in this area, and we would be stupid if we are not investing now if we have the market.

S4 Thanks very much.

AP Thank you.

O Okay. Hey, yes, thank you. We have one more questioner in the queue, but before we continue, I would like to repeat the combination. Ladies and gentlemen, if you still have a question to stage, please press nine star. And at the moment, we are moving to our next questioner, which is Mr. Sebastian Grove of BNP Paribas Exane. Please go ahead.

S5 Yeah. Hi. Good afternoon everybody. I hope you can hear me well. The first one is on the order pipeline and ammunition. **[01:01:00]** You mentioned, I think on prior calls Mr. Papperger that there's more than a hundred billion potential in Europe. And the question that I have is simply, how much of this has been placed by now? You made also in an earlier answer the comment that the return on investment is like very, very short. So obviously that will all play into this that there's either already a good load or there's much more to come either way. In Germany, we have seen big contracts coming through, so I would be interested in your commentary around the European side of things when it comes to ammunition.

AP On the 120, we have now between four and 5 billion, because only 4 billion from the German side, what we have as a frame agreement to be clear in this area, and these frame agreements are that they order year by year. The positive thing is that they have to go not longer to the German Bundestag for the 25 million. **[01:02:00]** If they give more than 25 million orders, so they can be fast. So Minister made it very clear, and as I told you, it's a triple digit a million we can do in two weeks now to get the orders, but the frame is 4 billion on the four to 5 billion on the tank side, it's 2.5 billion. 1.5 is from the German side. The rest is 1 billion from the others on the ammunition side is for the international business. And it's about, this is out of my mind now, now don't ask me if it is right, 50 million down or so, but it's about 1 billion for the medium caliber. And I will see maybe 300 million for the rest. So if you see it positive, it is 5, 7, **[01:03:00]** 8, nearly at the area of eight plus is what we have at the moment. But we are in negotiations with a lot of other countries. And for example, a positive thing, it's not in the books at the moment, but there are negotiations at the moment with Spain and if Spain wants to fill up the stocks and there are negotiations, or there is potential at the moment in Spain of an up 800 million Euro contract also

with Spain for only for artillery. But there are the Netherlands which are coming up, there is UK, which is at the moment not inside. The need from the UK side is also 1 billion also for the smoothbore because they have no ammunition [01:04:00] for the smoothbore. So if you asked me and said, "Okay, what do you think over the next years, what will be the backlog?" I think if I think very conservative on the nomination side there will be around 10 billion.

S5 Okay, that's super helpful. And then we can move on to vehicle systems and unfortunately a bit more of an unpleasant topic. Following the infantry vehicle decision, fighting vehicle decision in down under against the Lynx, obviously then the next contract unfortunately that you lost for whatever then political reasons, but there was earlier on the situation with the Czech Republic and Slovakia. So I was just wondering how you assess the commercial impact on potentials still for the very, very platform, if you could comment on that.

AP Yeah, so first of all, it's not helpful. This is very clear and I'm not very happy about that, that we lose contract because the vehicle [01:05:00] has shown a very good and successful train when they test a very successful testing. But anyway the point is that there are a lot of other countries who for sure are looking there. It's not easy to bring this vehicles inside, but I'm sure because these vehicles usually have a period of 25 to 30 years to come into the market, I'm very sure that now very soon, end of the year, the first vehicles will be on NATO trials from the Hungarian side because we delivered the first vehicles fully functional to Hungary. And I believe that there are a lot of other countries where the Lynx is successful.

The interesting thing was really the feedback that they said look the price is fine. This is not a problem. And also the technical solution is [01:06:00] a good solution. So this is very positive for my side that we did nothing wrong. So I still believe in the infantry fighting vehicle side. And sometimes yes, there are political issues. It was the same on the Slovakian side. There are sometimes are political issues that you cannot win. And I understand very clear the government, if they make such a political decision, and we must be fair and we have to look for the next contract, and there will be a lot of next contracts I'm sure about.

S5 It's a nice segue actually to my next question, because I think you mentioned on an earlier occasion that there's a total install tank fleet of around 8,000 units across Europe, and you said with the Ukraine war, there's obviously an obvious need to replace some of those, which will never come back. And there will also be an imminent need before the main ground combat system comes through at some point in time to fill the gaps, [01:07:00] so to speak. So where are we in that very, very journey? You mentioned that other countries are looking into the Lynx platform. I would also assume this goes for the Leopard. Any colour on where you are in this discussion when it comes to tanks, be it battle tanks, be it infantry fighting vehicles?

AP Yeah, so first of all, the Leopard 2 at the moment, the orders coming to the Leopard 2 because the Leopard 2 is a ready tank. It's developed in the seventies. It's ready, it's war proofed and it's a good tank. So that is the reason that these contracts are going at the moment to Leopard. What we did on the Panther side is to install new technologies in a main battle tank. I think this is absolutely the right way. So the booking of the Leopard is helpful at the moment also for the German industry, very helpful in different areas. Also, for Rheinmetall, you have [01:08:00] seen this in the presentation on the Norwegian side, we will book also hundreds of millions or more on this side. We stay on our strategic way to say, "Okay, we need also new technologies and main battle tanks, and this new technologies are implemented in the Panther." So this is more

firepower, this is less weight as you said, more than 10 tons less weight, better protection systems which are inside and better connectivity. And also other, like laser technologies, et cetera. Also, other technologies on this tank.

Now let's go to the main ground combat system. And if you see the comments that Minister Pistorius and also the French Defence Minister said, they spoke about 20/40, 20/50 in between. So for Leopard and for Panther, I see for the next 25 years, [01:09:00] a lot of space, a lot of space to do something because more than this 8,000 main battle tanks, yes, they have to do something. And so, therefore the main battle tank business and the infantry fighting tank business will be over the next 20 years, a very fruitful and very good business.

S5 Any indication as to when this cycle not really start coming through, or is this several years down the road rather? How should we think of this?

AP No, no.

S5 In terms of order replacement, I mean that.

AP As you see, the Leopard is coming now, so there is at the end of the day from the Norwegian side, from the German side, Lithuania, et cetera, et cetera, let me say two hundreds maybe three hundreds of the Leopards I see very near, which is a good business for the German industry and also [01:10:00] for Rheinmetall.

S5 Okay. Very helpful. Thank you so much.

AP Thank you.

O Yes, thank you. The next questioner is Mr. Christian Cohrs of Warburg Research. Please go ahead.

S6 Yes, hello. Good afternoon. Thanks for taking my questions. Just very few left, first for the civilian business you mentioned also the margin decline attributable to difficulties to pass on higher material costs. Is there any chance for recovery? Do you have negotiated any escalation clause, et cetera, so that any insight would be helpful? Secondly, on CapEx, I fully understand the need to, to invest but for 2024 and the years beyond, is it fair to assume that CapEx will be roughly back at the five percent of sales ratio? Thank you. [01:11:00]

AP Dagmar will give you an overview on the CapEx side and on the material side. I said we have a delay of four to five months in our escalation clauses to get from the OEMs, the money if the material costs are going up. At the moment that the trend is going, that the costs are really going up. So we have still in our books not, but we hope end of the year we have it then in our books, and so we have a better profitability so that we get a compensation from the OEMs on the material side.

DS On the CapEx side we definitely have a peak in the running year in 2023. I mean, we already had yeah, a high percentage of sales announced as CapEx. Now we increase that again, and then of course yeah, we will come down, but it's too [01:12:00] early to give you any guidance on the CapEx of the next year.

- S6 Okay, understood. And then maybe just a follow up ...
- AP Maybe one more information for what Dagmar told you is that, and the reason for that is also very clear, because we get at the moment order intakes that is not in our planning. There are a lot of orders where the customer is calling us and said, "Okay, I give you a contract in three weeks." So that is the reason that the backlog is growing so strong in this areas and because of we have a lack of positive, it's a positive information if the customer is coming in, and give you more contracts. But we cannot make the final calculation on the CapEx side, but CapEx will not explode. But the investments that we do at the moment on the ammunition side, for example, yes, this will be, [01:13:00] let me say stopped next year, we will not invest more. The only investment that we would do more invest, let me say in another ammunition factory or whatever, only if the government is giving us then another 10 years contract, which has such a lot of value that we have a return of invest, let me say, of one or two years in this area. But otherwise we will stop the investments there. This is point number one. But there are other things, yes, where we want go back on a level of five, this is our target that is very clear, but we can give you not the exact figure. Is that helpful?
- S6 That's very helpful, thank you. Maybe just a follow up on that, I mean, besides investing into new capacity, it is maybe also able to or possible to acquire capacity as you have done with Expal, and [01:14:00] that's actually my follow up question. So you will be most likely be very cash generative in the years to come. So do you have further ideas or maybe even concrete targets already on the radar screen with regards to M&A?
- AP Yeah, there is something, there are a lot of things at the moment and the point is that, I cannot give you the details because we are still in negotiations with them, but there is a company in Romania at the moment which is very helpful inside the vehicle production. And the idea is or the mission that we gave the people is that in Romania we want to have a company between 300, 500 million sales per year. We are in negotiations and we hope that we can [01:15:00] have a final decision end of the year. It should be vehicles and air defence systems, especially through the Eastern European part. This is number one. There are also discussions on the ammunition side if there is something, because of missiles, as you say, there is at the moment as there is a centre of gravity, which is Rheinmetall at the moment. As you can see especially on the ammunition side, there are some discussions about that, but we only do it if the business model and the business case is on the same level that we have on the Expal side, where both partners Rhone Capital and also Rheinmetall are very happy with the deal.
- S6 Understood. Thank you.
- AP The pleasure.
- O And we have one last question. It comes from Hemal Bhundia (01:15:54) of UBS. Please go ahead.
- S7 Thank you, Armin. Thank you Dagmar. Two quick questions. [01:16:00] Firstly, you mentioned that the guidance backend loaded of course, how much of the guidance is under your control and in how much visibility do you have for Q4 call offs now already? And is there any risk of slippage? And secondly, on the free cash flow guidance of 4 to 6%, which end should we aim for? Thank you.
- AP Yeah.

- DS Well, I would start with the answer on the free cash flow guidance. We confirm the range of 4 to 6%, but looking at exceeding CapEx and the strong growth we see, so we have to build a working capital not only to assure this year's performance, but also as well, of course the next quarters in the year '24. And therefore we see it more at the lower end of that range. But the cash is not gone, the cash will come, and I'm very confident [01:17:00] that we will deliver soon.
- AP Is that helpful?
- S7 Very helpful, thank you.
- AP And from my side is the backend loaded business that we have is, as I told the annual sales of ammunition will be about 45% in, in Q4. So nearly 50% of our sales will be in Q4. How is that possible? It is only possible because we are still in production in all of those things. So we started production in July, for example, for the 35 millimetre for the Gepard, and we are in and we will deliver that in in Q4. We started all the ammunition of 120 millimetre, and the customer wants to have most of them in, in Q4. There are a lot of artillery productions at the moment [01:18:00] from Spain, from South Africa, from Germany, wherever we are. And most of them is Q3, but most of them is Q4. So we are in production. So the risk from the production side is very low because we have all of the materials in our stocks. This is number one.
- The second point is electronic solutions, for example, will make 40% of the sales also in Q4. And the reason for that is because the delivery of the vehicles, the sensors and fire control systems, et cetera, et cetera, will be delivered in Q4 or Q3 to the vehicle systems and then will be implemented, and then we get it into sales. Little bit less has vehicle systems, but also vehicle systems delivers all the Leopards for the Ringtausch, most of the Marders [01:19:00] and most of the Hungarian Lynx in Q4, this is because it's in one side in the contracts and on the other side, it's in negotiation. It was negotiated with the customers because of the material income and the ramp up that we made over the last 12 months in our different factories. So as you know, there is always a risk that's very clear, but at the end of the day, if I think as an entrepreneur so it's there, the contracts are there, the material is there, and I'm very fair about that, even it would be delivery in 1st of January or so as an entrepreneur for me, the one week does nothing, it happen because the business is at the moment so good and the profitability is so good, but I expect that [01:20:00] we can fulfil it end of the year.
- S7 Brilliant. Thank you.
- AP Pleasure.
- O Thank you. There are no further questions in the queue. Back to the company.
- AP Thank you very much for your time. Thanks for the interest in Rheinmetall. Hope we see you soon. All the best. Stay healthy. Thanks. Bye-bye.
- DS Thank you. Bye.