Rheinmetall AG
Investor Relations
Conference Call FY 2018
Transcript

Publication: 10:00 CET
Conference Call: 13 March 2019, 14:00 – 14:54

Content

	Contribution	Course	Duration (min)
	Presentation - **Begin**	00:00:01	37:54
	Presentation - **End**	00:37:55	
	Questions:		
1	**Sven Weier, UBS**	00:38:18	03:50
2	**Cristoph Laskawi, Deutsche Bank**	00:42:18	03:29
3	**Christian Cohrs, Warburg**	00:45:57	05:46
4	Conference - **End**		53:22

Rheinmetall AG Conference Call

00:00:01 Operator

Good afternoon, ladies and gentlemen, and welcome to the Rheinmetall AG conference call regarding the full year results 2018. 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 Mr. Armin Papperger.

00:00:21 Armin Papperger

Thank you very much. Good afternoon, everyone. Thank you for joining our full year 2018 analysts' conference call. My colleague Helmut Merch and I will walk you through the slides of this presentation during the next couple of minutes before opening the floor for your questions.

After the press conference this morning, we are now very pleased to review our 2018 results to you and to present our guidance for 2019 and our updated mid-term outlook.

Before we begin, I would like to remind you that during this call, we will make some forward-looking statements, which involve risks and uncertainties as detailed in our disclaimer, which you can see in detail on the following page.

Let's start with page number 3.

We are very happy to report that we have achieved our revised growth guidance in both Automotive and Defence despite a very difficult market development, particularly in Automotive. Even more exciting is the delivery on our margin guidance. The last quarter moved in the right direction in all of our divisions which is highly gratifying. As a consequence we will provide you with an updated mid-term guidance in just a moment.

Moving on to the financial highlights on page number 4.

2018 was an extraordinary year for Rheinmetall from our financial perspective. We increased our sales to €6.1 billion and drove our operating result up to €492 million. This resulted in earnings per share of €7.10, an improvement of 36%. Therefore we will propose to the AGM to pay a dividend for 2018 of €2.10, an increase of €0.40 compared to 2017.

But for me the most important KPI improvement is the amazing order intake of €8.5 billion. It shows that our efforts to offer a competitive product portfolio has clearly been rewarded by our customers and presents a solid base for our future development.

Conversely, 2018 will be sadly remembered for the tragic incident at one of our South African sites.

Let me continue with the sales bridge on page 5 that provides you with some insight into the key drivers in each segment responsible for the respective sales development.

On a group level, we were able to grow our sales by 4.3% or 6.1% FX-adjusted to €6.1 billion. Main positive factors in the Automotive segment were the ramp-up of new products and strong new LV sales. Defence benefited from strong growth in Vehicle Systems and Electronic Solutions.

As you may recall from our Capital Markets Day, we spoke of the beginning of a super cycle in the Defence business and 2018 marked the beginning of this cycle. However, we shall talk about some of the challenges we face in the Automotive business when we come to the outlook for 2019 and beyond.

As you can see from our operating result bridge on page 6, you can read that both segments increased their already excellent prior year results. Automotive is benefiting from the early optimized international set-up and a very important point was the early dialogue with our social partners to gain flexibility on the labor costs.

Defence enjoyed higher levels of utilization and improved the quality of its portfolio, generating higher value added. Legacy contracts are phasing out and cost structure is improving, both contributing favorably to our bottom line.

The net positive effect from our restructuring efforts in Electronic Solutions and the property divestment drove EBIT to €518 million. The operational improvement and the favorable special effects deliver the foundation for our increased earnings per share and consequently for the material uplift in our dividend proposal.

Please move on to slide 7 for the Automotive highlights.

Automotive markets were again turbulent in 2018: The persisting diesel discussion, surprising turbulences from the introduction of WLTP, ongoing uncertainties around global tariffs and Brexit, just to name a few. Nevertheless, Automotive did very well. Sales grew by 4.2% at constant FX rates and the operating margin achieved a new record level of 8.9%. Management action to tackle and make our cost structure more flexible as early as possible definitely paid off.

Full-year operating free cash flow of €26 million was supported by an improved fourth-quarter cash generation. Details on the drivers will be provided later.

An important move to address our future competitiveness and marked the inauguration of new production sites in China and Neckarsulm for products addressing the markets for e-mobility and innovative casting products.

Moving on to the Defence key events on page 8.

As already mentioned, our order intake in Defence is probably the best of all good news. While sales growth and margin improvements confirm that we are moving into the right direction, today order intake indicates that we will also grow in the future. Time pattern of the operating free cash flow has been a bit more pronounced in 2018, but Q4 contributed strongly.

A review of 2018 must include the tragic incident at our Somerset West site. The loss of eight colleagues has been a very distressing experience and we have given our consolation and financial support to their relatives. After the finalization of the official investigation, we have recently obtained permission to enter now the site.

With this, I now hand over to my colleague Helmuth Merch for the presentation of the financials.

00:08:11 Helmut Merch

Thank you very much, and hello to everybody. Let's get started with the financial overview on page number 10.

In general, I think it is fair to say that our balance sheet continues to be rock-solid. We have improved our equity ratio to now 32% and as a confirmation of our financial solidity we have returned to investment grade rating in April last year. We maintain firm control of our financial obligations and the development of our credit KPIs reflects this. The effect of IFRS Standard No. 15 on our balance sheet was not material, roughly €30 million in 2018.

However, the consideration of the leasing obligations according to IFRS Standard No. 16 in our net debt is visible: Whilst we had a net cash position of €230 million at the end of 2017, post-IFRS 16, this position was restated to €56 million. So first time adoption of IFRS 16 accounted for €174 million.

I will continue with details on our cash flow development on page number 11.

Reported EBIT gained a third or €133 million to €518 million reflecting the strong profitability improvement and favorable special effects from property sales. Net income rose further on the back of an improved net interest result and the same average tax rate in 2018 of 27%. The main driver for the increased minorities was a strong performance in 2018 of our RMMV joint venture with a plus of €22 million compared to previous year. The average capital employed increased to now €3 billion mainly due to the increase in working capital. So for 2018, we were able to increase our return on capital employed to 17.1% and created further value.

Please turn to page number 12.

The negative operating free cash flow in the first three quarters was almost fully compensated by the Q4 performance. As one announced milestone payment of around €100 million was only received after our year-end closing, we finished 2018 with an operating free cash flow of minus €35 million. Otherwise we would have ended in positive territory. Since milestone payments in the Defence segment can distort the picture of one reporting period, we commend you consider longer business cycles to address this issue.

Please join me to page number 13. The operating free cash flow declined by €311 million to minus €35 million. The main driver was a build-up of operating working capital, as already mentioned. While a very high sales volume in Q4 drove receivables up by almost €300 million, a further increase was generated by higher inventories which were driven by the increase in safety stock for critical components, such electrical components and plastics in Automotive. This increase should be a temporary one.

In the Defence segment, the export ban of trucks to Saudi Arabia led to a further rise. So the combined effect of both segments is around €85 million. As already mentioned, had milestone payment been made on time, we would have generated a positive operating free cash flow at the year-end.

Please turn now to page number 14. The for IFRS 16-adjusted net cash position of €56 million swung into a net debt position of €31 million. Q4 operating free cash flow helped to improve net debt from the nine-month low of €514 million to €31 million. The main financing instruments in our portfolio are the promissory notes and the EIB loan that we signed in 2017. The next major maturity in our credit portfolio will be in 2023, when the EIB loan of €250 million becomes due.

Please turn now to page number 15.

EPS reported a strong growth of 36% in 2018, but this included extraordinary effects of €0.44, so the underlying operating EPS was €6.66. In order for our shareholders to participate in the success of the company in 2018, we are proposing a dividend payment increase of 24% of €0.40 to now €2.10. Following €73 million in 2018, the total payout would rise accordingly to around €90 million in 2019 to all dividend-entitled shareholders. This represents a payout ratio of roughly 30% after 32% in 2017.

Let’s move now on to the highlights of the Automotive segment on page number 17.

Q4 markets started strong, but turned negative towards the end, especially in November and December. Nevertheless, we were able to outperform the market and achieved FX-adjusted sales growth of 4.2% in Q4 versus a market decline of minus 3.4% resulting in a sales volume of €731 million.

Even more impressive is the operating margin of 9.4%, which represents a new record mark. As my colleague already mentioned, we have started early on to identify measures that allow us to react to market weaknesses with more flexibility and we saw this being already rewarded in the last quarter.

Operating free cash flow was negatively affected by the need to prepare our supply chain for shortages of critical components, as already mentioned, currently a common topic in the entire industry. Hence, working capital improvement in Q4 was less pronounced than in Q4 2017.

On page 18, I will present to you the divisional breakdown of the Automotive segment.

Mechatronics' Q4 sales went up by €24 million to €431 million, particularly as a result of a strong demand for our pump business. A negative effect resulted from a shift of central R&D expenses for e-mobility to the Mechatronics division, an effect of around €5 million. Furthermore, ramp-up cost for additional capacities and new products, for example, the electronic vapor pump, had also an adverse result effect. Both effects overcompensated the positive operating leverage from the sales increase. Margin remained still with 10% in the two digits.

Hardparts reported more or less stable sales in Q4. The operating result was positively affected by the higher contribution of the at equity consolidated entities, which reported an increase of plus €2 million. So all in all, margin in Hardparts improved to 6.4%.

Aftermarket sales development was stable. Slow sales in Middle East were not fully compensated by other regions. Efficiency measures such as process improvements helped to increase the operating result by 24% to now €10 million in Q4, generating a margin of 11.6%.

Please turn now to page number 19.

The global light vehicle market contracted in 2018 and the Chinese market was the main reason. On an annual basis, we saw a decline of minus 2.4% in our light vehicle business. Especially Diesel sales and the WLTP introduction in Europe had a major share in this development. Light Vehicle Diesel alone accounted for a sales decline of €73 million or reduction of 9,3% against previous year.

The sales in our non-light vehicle business overcompensated this development successfully and gained 11.3% or €115 million to now €1.1 billion. The main growth drivers behind were the truck market with a plus of 10%, our large bore pistons business with a plus of 6%, and our Aftermarket business which grew by 2%.

On page number 20 you will find the regional breakdown of our Automotive sales.

With roughly two-thirds of our sales, Europe including Germany is still our main market.

China reported the biggest increase in sales share of 1.6% in our consolidated sales. In our total management view on the Automotive segment, we have to add €1.2 billion on a pro forma basis of which around 75% were realized in China.

In all regional markets except Europe and Brazil we managed to outperform the light vehicle production benchmark.

On a global scale, we grew by 4.2% FX-adjusted versus a light market decline of minus 1.1%.

On slide number 21, we have highlighted the business activities of our joint ventures and our 100% subsidiaries in China.

In a declining Chinese market of minus 4%, we were able to grow our FX-adjusted sales by 5.7%. And this was supported by a general positive demand for new emission technology and the start of production for innovative products in China. However, we noticed that domestic OEMs and some large North American producers struggled noticeably in 2018, which we expect to continue also in the first half of 2019. EBIT increased by 3.6% from €76 million to €79 million, held back by adverse FX-effects of €2 million. Total margin grew from 7.8% to 7.9%. Start-up costs for the new piston plant and higher development costs had an adverse impact on our results.

On page number 22 we shed some additional light on the Diesel topic.

As you can see on the left-hand side, the share of new Diesel registration has further shrunk in 2018, with Q4 clearly below the annual average. This was also reflected in our sales figures.

Light Vehicle Diesel sales declined by €73 million or 9.3% compared to previous year, but we were able to overcompensate this development with sales to other end markets, for instance, truck and other non-light vehicle business activities were the main contributors. Our total light vehicle Diesel sales have come down now to 24% of total sales after 27% last year.

Please turn with me to page number 23.

Innovation plays a very important role in our business model and we are permanently restarting the product cycle with new developments of existing products but as well with new products for new applications. Key examples for this in 2018 were the development and market introduction of an electrical vapor pump and the development of a new aluminum casting technology used for light-weight structural parts and components for e-mobility. In recognition of our R&D expertise, customers awarded us with development orders of a total value of €36 million which are not included in the €157 million R&D expenses shown in the picture. The 2018 capex increase can be only attributed to the introduction of IRS 16 of €7 million.

With that, I would like to move on to the analysis of our Defence segment on page number 25.

Our guidance since the beginning of 2018 for a very back-end loaded year turned out to be quite accurate. Q4 2018 with an increase of 24% year-on-year marked a new record of roughly €1.3 billion for quarterly sales and represented 39% of our total annual Defence sales. In combination with the high order entry of €1.1 billion and the very good margin of 14.3%, an increase of 300 basis points versus prior year, Q4 2018 reported historical highs. Even the absolute operating free cash flow of €479 million is an excellent figure and our cash flow to sales ratio again just fell slightly short of 40% in Q4.

However, annual free cash flow to sales of minus 0.9%, without a doubt, needs improvement. The already mentioned inflow of a milestone payment of around €100m, which we received in the first week of January, would at least have taken us to the lower end of our 2% until 4% bracket in free cash flow to sales guidance. At this point again the recommendation to contemplate at least two years of operating free cash flow, for a more accurate view on our cash flow generation capability.

Let us now have a look on the divisional development on slide 26.

Weapon and Ammunition increased sales by around 10% to €472 million and increased its operating margin from 17.9% to a very high number of 22.7%. The key drivers for this development were strong demand and a larger share attributable to our high-profit ammunition business. The backlog from Q3 that built up due to the fire hazard has been worked out.

Electronic Solutions reported the highest sales and result improvement in this quarter in relative terms. Sales increased by 40% to €346 million and the operating result even saw an 84% result increase. The good business development combined with the improving cost structure is clearly making inroads.

Vehicle Systems enjoyed high utilization and benefits from the phasing-out of the Dutch Boxer contract with all new contracts contributing positively to the margin improvement. Sales in Q4 grew by €78 million to €501 million and the operating result increased by 76% to €44 million.

Page number 27 shows the regional development of the Defence segment.

The order intake in Q4 and for the full year 2018 were absolute highlights. We substantially over-achieved our €5 billion target and Q4 contributed with €1 billion to this and region-wise Australia was a key contributor. From a regional perspective almost three-quarters of the order intake came from our so-called home market, i.e. Germany, Australia, and other European countries. The two key contracts in 2018 were the Australia Land 400 Phase 2 contract and the extension of the Australian truck contract in Q3 with a combined value of around €2.6 billion. This, of course, substantially de-risks the backlog where our home market accounts for two-thirds.

Page number 28 details the order backlog by division and over time.

Our backlog was driven by Vehicle Systems which won the two aforementioned Australian contracts. Our strategy is to increase our platform business and to install more systems. One key aspect of this strategy becomes evident in the increased share of the Division Vehicle Systems in our backlog. The idea behind is to enhance the basis of future business through maintenance, service and upgrade orders.

On page number 29, we present the time schedule of our legacy contracts in our top line.

Our two most recent legacy contracts were the Dutch Boxer contract and the German Puma contract, both only earned a mid-single digit contribution margin. A normal contribution margin for such types of business should be around 15% to 20%. With the phasing out of these contracts, as seen already in 2017 and 2018, the operating result improves respectively.

Please turn now to page number 30.

In 2018 our R&D expenses remained with 2.3% of sales within the guided band of 2% to 2.5%. Customer paid research saw a strong increase to now €68 million. Capex increased from €89 million to €101 million, slightly below our mid-term capex guidance. Innovation and capacity increases will be an important part of the next stages of our Defence “Super Cycle”. Most of this innovation will be project-driven and customer-funded, therefore our self-financed R&D should continue to stay within the guided range of 2% up to 2.5% of sales.

A second element will be the smart increase of our capacities for orders such as Boxer in Australia or in the UK, which followed two different conceptual approaches. While the UK approach was the acquisition of 55% of BAE UK Land systems and hence the immediate availability of production capacity and engineering know-how, we decided together with the Australian government to build the Military Vehicle Center of Excellence, MilVehCoE, in Brisbane, Australia as a greenfield investment. Although the set-up is based on a rental agreement with the Australian government over the next 10 years, 2020 will see an IFRS 16-induced increase in capex of around €50 million to €60 million, which will not be cash effective. So all in all, we expect to remain with our capex guidance range of 3.5% to 4.5% during the mid-term planning period.

And now for the presentation of the outlook, I now hand back to our CEO, Armin Papperger.

00:30:59 Armin Papperger

We start our outlook with the Automotive risk map on page 32.

The risks we faced in Automotive in 2018 have not disappeared. On the contrary, we even had to add to the existing list. Especially the indirect exposure caused us to take a more careful view on 2019. The impact of Brexit, the trade and tariff dispute and the deteriorating business cycle in China were very difficult to assess, so we rather stay on the cautious side. The other risks can either be managed by ourselves, for example, the earlier procurement of critical components, or are already part of our long-term portfolio strategy to gain more powertrain independence. Diesel probably won't deteriorate further; the WLTP should be dealt with the latest in the second half of 2019.

Continuing on page 33, we would like to focus on the negative trend of the LV market forecast. In 2018 IHS was indicating around 2% growth for 2018 up until September and then gradually scaled down the expectations for the full year to now minus 1.1%.

For 2019 IHS now predicts a growth rate of only 0.4% for 2019. Based on our own assumptions, we come to the following scenario. We have a relatively high exposure to regions predicted with negative growth. 80% of our sales go to Europe and North America, which are both expected to shrink. Our customer portfolio includes some OEMs which are currently struggling more than others to restructure their business.

Therefore we are guiding in our base case only a negative or at least stagnating market growth.

Please turn now to page 34.

It is our primary objective to safeguard the high level of profitability in Automotive. In order to achieve an operating margin of more than 8%, we will have to generate a sales growth of about 1% to 2% per year. As already mentioned, from our perspective today, it looks unlikely that our sales will grow this year so to that extent. Should markets, however, deteriorate further, we will not be able to maintain our present level of profitability. We have already initiated a number of measures to prepare for such a situation, like the utilization of working hours' flexibility. So even in a negative growth scenario, we should be able to protect a solid margin level.

Now take a look at the Defence 2019 outlook on page 35.

We are confident that the German government will pursue its goal to increase the defense budget until 2024 to 1.5% of GDP. Due to various reasons, mainly the late formation of the Government in the beginning of 2018, we only saw a small number of Parliamentarian approvals for 2018 - the so-called €25 million proposals. In 2019, we expect much more of such projects to be approved with about one-third of them affecting Rheinmetall Defence.

As you can see on page 36 and as mentioned repeatedly, the super cycle is not only building on the German development, but is bolstered by a big pipeline in all our so-called home markets.

This offers a multi-billion potential list that we are currently tackling or even have won the support of our future growth trajectory. I will not get into details, but we are confident, based on our recent wins.

Please find the mid-term outlook for our expected order entries on page 37. With a record €5.5 billion ordinary intake in 2018 already in our books, we have gained confidence to deliver a comparable performance in the range of €4 billion to €6 billion in ordinary intake over the next three years.

After these preparatory remarks, we are coming to the 2019 guidance on page 38.

Please note that growth is expressed as operational growth at constant exchange rates.

In Automotive, we expect sales to grow in the range of 0% to 1 % compared to the last year. This translates into an adjusted operational margin guidance of around 8% for 2019 as explained. Defence is expected to grow sales in the range of 9% to 11% and we guide a positive operating margin development of 8% to 8.5%. On Group level, we expect to grow sales between 4% to 6% and want to repeat an operating margin of around 8%, which includes holding expenses between €25 million and €30 million.

Last but not least, we would like to present our mid-term margin guidance on page 39.

Going forward, we expect that Automotive and Defence will further align their profitability. We adjust the operating margin for the Automotive segment to the lower end of our old guidance to around 8% mid-term. For Defence, we increase the mid-term operating margin expectations by 2% to between 8% and 9%.

Ladies and gentlemen, thank you very much for your kind attention and we are now happy to take your questions.

00:37:57 Operator

Ladies and gentlemen, if you would like to ask a question please press 9 and star on your telephone keypad. In case you wish to cancel a question press 9 and star again.

And the first question comes from Sven Weier UBS, please go ahead with your question.

00:38:18 Sven Weier

Good afternoon, thank you for taking my questions. Maybe we can go through them one by one if you don’t mind.

The first one would be on the Automotive business. We just went through the full-year guidance and I think in the press conference you also gave some details on the first half, how weak it is. Could you give us a kind of a guidance how weak you expect the start for the year in the Q1, is that more like the mid-single digit decline that you've shown the scenarios, or what should we be prepared for at the start of the year? That would be the first one. Thank you.

00:38:53 Armin Papperger

I think it’s about minus 5% that we see in the first quarter. We cannot oversee the second quarter, but we think at the end of the year as we have shown that we will have zero growth or a flat business over the whole year.

00:39:09 Sven Weier

And that minus 5 would also then correspond to the kind of 6% margin that you have at such a sales decline, is that fair?

00:39:18 Armin Papperger

Yes, that’s fair.

00:39:20 Sven Weier

Okay, good. And then I was just wondering on the new mid-term targets for the Defence business of 8 to 9%. Obviously I was just wondering what kind of sales makes you assume because, you know, on the one hand you are likely to be within that range this year already if the Puma completely phases out that’s another 50 basis points uplift. Are you assuming in the 8 to 9% in the medium term a kind of a more adverse mix, more vehicles, less ammunition, is that the reason behind or...?

00:39:53 Armin Papperger

The reason is, first of all, that we have to look at the very big programs. In big programs you always have risks and we are very careful, we have to deliver.

00:40:06 Sven Weier

And then a question on KNDS. I think what I took from your press comments that you have the support obviously from the German government. I was just wondering what timeline we should continue to have in mind here. Is that still something where you would see some progress then only towards the second half of this year?

00:40:29 Armin Papperger

First of all, the driver for KNDS will be the main ground combat system as discussed before. Our expectation is that in May/June there will be a decision of the first money for main ground combat system. The political discussions between the German government and the French government are in the loop and at the moment the discussions are in full power. We hope that we can give you more and detailed information over the next two to three months how to continue that discussion. Both governments, the German and the French government have made a clear statement that it makes sense to create a European champion for land systems.

00:41:17 Sven Weier

The last question for me was just on free cash flow. You mentioned already the milestone payment of a 100 million. Is 2019 and your budget going to be a year where you are inside the 2% to 4% percent range?

00:41:33 Helmut Merch

We are strongly committed to generate positive cash flow during 2019. I can say that from the increase of the outstanding receivables of roughly 300 million Euros, 230 million are already paid in the first ten weeks. We expect a nice recovery of the free cash flow statement already in Q1.

00:42:12 Operator

The next question comes from Christoph Laskawi, Deutsche Bank. Please go ahead with your question.

00:42:18 Christoph Laskawi

Hi, Christoph Laskawi, Deutsche Bank, thank you for taking my question.

Another one on free cash flow as a follow up to what Sven asked, basically on the Automotive side. You've highlighted that you need an elevated inventory to secure that you are able to deliver. I was wondering, do we continue to see a pickup of that also in Q1 or have you reached a stable level basically by now and we should expect that to trend around this level until the shortages are resolved?

00:42:49 Helmut Merch

Yes. I already mentioned that the increase of roughly 40 million should be a temporary one, so we expect to leave this level during this year. Also, additional working capital initiatives are installed. Therefore, Automotive will recover on free cash flow during 2019.

00:43:20 Christoph Laskawi

And another question, on slide 38 you marked quite clearly that you are not assuming a hard Brexit in your guidance. Are there any measures that you have already undertaken to deal with the potential risk of a hard Brexit? Could you comment on potential supply chain disruptions that you might face or additional cost that you might face in terms when a hard Brexit really comes through?

00:43:47 Helmut Merch

In general, we have to say that roughly we have 360 million of sales going to UK, thereof 250 is within Automotive and the rest 110 is within Defence. We expect no critical issue regarding our Defence businesses. In the Auto business we have to state that normally our sales go ex-work. If we expect additional fees, tariffs and so on, then the customer has to pay normally. I think we have to accept that there could be a delay in terms of deliveries and therefore I think we can only look and wait, what will really happen. In case, a hard Brexit will turn out then we will see delays of sales. That is what we actually expect. Then we have to see how much is it and how long does it take. But there is no real simulation of what is taking place during 2019.

00:45:12 Armin Papperger

So, for 85% to 90% of our sales to UK, the customers are responsible for the duties.

00:45:22 Christoph Laskawi

Are you in charge of getting the product there? We heard from other companies that they are securing additional flight routes over different ports or even air freight just to be sure that the customer gets the parts. Or is that also in charge of the OEM basically?

00:45:41 Armin Papperger

Yes, OEM, it’s in charge of the OEM.

00:45:44 Christoph Laskawi

Excellent, thank you.

00:45:46 Armin Papperger

So risk is very small.

00:45:52 Operator

The next question comes from Christian Cohrs, M.M. Warburg. Please go ahead with your question.

00:45:57 Christian Cohrs

Good afternoon. Thanks for taking my questions. Maybe we go through them one by one. First, Mr. Papperger, you just mentioned in your mid-term outlook that you always also have factored in some risk related to the big programs, which are available on the market. Maybe can you elaborate in the past, like we see Dutch ... with the Puma and Boxer you had an earnings contribution which was too low. So going forward now with the big tickets available what have you done and what will you do to manage the risks associated and linked to this big ticket sizes. That’s question number one.

00:46:38 Armin Papperger

First of all, the basic calculation is better, much better than the Puma and Boxer calculation that we had. The base profit in our calculations is in good shape. That’s number one.

Number two, we have a much better program management. We implemented five/six years ago a new program management team and also a new risk management team for the big contract. And quarterly also the board of Rheinmetall takes care about this big contract.

And number three, we have now also discussed with the customers contingencies inside, because every big contract has risks and you need contingencies and the contingencies are in different areas between 2% and 5%. There we take care about that. If everything is running well, there is also potential for better results, for sure. We are very careful because we have to deliver.

00:47:51 Christian Cohrs

Understood, that’s clear. Then maybe just some smaller questions. First, Electronic Solutions has posted a nice margin improvement in 2018, I think now standing at 5.6%. Is there still more to come? Is profitability improvement of this division also a driver for the division margin expansion in 2019?

00:48:22 Armin Papperger

Yes, we go into the right direction. And mid-term target for Electronic Solutions is also that we are between 7% and 8%. We go into that direction. The restructuring process in Electronic Solutions was very positive.

00:48:40 Christian Cohrs

Just two questions remaining. First, if I am not mistaken you booked a 40 million impairment in Defence in Q4. Could you maybe elaborate what's the background for that?

And then maybe just the very last question, in your outlook in the annual report you are guiding for a lower ROCE in 2019 despite higher earnings. Factoring in that you just reiterated your capex protections and also working capital should rather improve and not go up, what's the background of the ROCE deterioration in 2019?

00:49:26 Helmut Merch

Basically, Mr. Cohrs, we are planning not with additional, positive one-off effects. We had this with 26 million, which also boosted EPS and also the ROCE. I think we have to expect in absolute terms an increase in capex and also to a slight extent in working capital. So we expect a growing balance sheet and therefore we are a little bit cautious regarding to predict a growth in our ROCE KPI. That is the one question.

The other is, I am not aware of an impairment of 40 million in Q4. It is a full-year impairment. If you look to our development of depreciation, that is a very high increase of over 70 million, and thereof are 41 million extraordinary. The biggest one is the impairment of an R&D project which we have explained in Q2. That was the former AMPV, that is a small armored 4x4 vehicle. Here we started very early development and finally it turned out that we are not able to find the right partner to market it. Here we have the impairment in Q2 of 24 million Euros and the rest are minor impairments in the division of Electronic Solutions also regarding some R&D projects and also some million in the Automotive. These 41 million will not turn out to be repeated in 2019.

00:51:45 Operator

At the moment, there seems to be no further questions. If you would like to ask a question, please press 9 and star on your telephone keypad.

00:52:01 Armin Papperger

Ladies and gentlemen, if there are no further questions I would like to conclude this conference call with a short résumé from our side.

We are coming from a superb 2018. We have presented our vision to you, how our resilient Automotive business and our further improving Defence are expected to perform in 2019. In the mid-term all is set for further growth and higher profitability. While the first half of 2019 and especially the Q1 will be challenging in Automotive, we are confident that we have identified the right measures to cope with this development.

On the other hand, we are excited regarding the potential of our Defence business and we are fighting with confidence to win the next big tenders. One of our focus areas will definitely be to improve the cash generation of our operations and we promise to keep you up to date on our progress.

Thanks for your interest and have a good day. Thank you very much.