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Rheinmetall AG Conference Call

00:00:01 Operator

Good afternoon, ladies and gentlemen, and welcome to the Rheinmetall AG conference call regarding the full-year results 2021. At this time all participants have been placed on a listen-only mode. The floor will be open for your questions following the presentation. Now I hand the floor over to Armin Papperger.

Armin Papperger

Thank you for your kind introduction.

Ladies and gentlemen, thank you very much for joining the 2021 Rheinmetall earnings call and a very warm welcome also from my side. I will be your host for the next couple of minutes and walk you through the presentation together with my colleague Helmut Merch, our CFO. I will update you on the recent developments and announcements for the German government and what this will mean for our business. Afterwards we will provide you with a summary of the 2021 results. As usual, please be reminded of our legal disclaimer on the next page.

If you have now a look to page 3, we will start with the political statements. And this statement is very important for our company and also the defense companies here in Germany. Our Chancellor Olaf Scholz made a clear statement, first of all that the annual budget for defense in Germany will grow up to more than EUR50b and we will have EUR100b extra fund over the next 10 years. The first expectations were that they will be over the first four years, but now I believe that it will be over the 10 years, because otherwise it would be impossible to spend the money also from the industry side.

The second statement is a very important one also and this is from our Finance Minister Christian Lindner. And it said: These days there was still talks of a taxonomy that would be restricted investment in defense capabilities. I had a lot of discussions now over the last weeks with our government, and I think there is a very clear statement from the German government but also from a lot of other governments in Europe to say that it couldn't be that defense industry is a harmful industry and therefore so we are minimum neutral, maybe better in the ESG taxonomy.

If you go to page 4, you see now there are three different levels how we can support and how Rheinmetall can support the German Bundeswehr and also the Ukrainian armed forces. Level no. one is – and this is highest priority at the moment – how we can support for the Ukrainian armed forces. So we have different meetings with our Ministry of Defense, and there is also a strategy group working in the Ministry of Defense how to help the Ukrainian armed forces. There is a lot of help from Germany at the moment; we cannot speak about the detailed programs, because this is now restricted information from the German government.

Level two is a short-term increase in Bundeswehr capabilities. That means on one side Rheinmetall said very clear – and we have more than 250 people in our service team – who should help the German army in field so the equipment should be as soon as possible inside the army. It should not go into the maintenance, if possible they should stay with the army, and the people should have a reaction time of only two days, that they bring the equipment now into force.

Level no. three is closing the investment gap – and this is the biggest part for sure of money which is coming up, and this is also a very long-term strategy. And what does it mean? Financing and procurement of new equipment and prioritization according to the Bundeswehr plan. And if you see on the EPL 14, which will have a level between EUR50b and EUR52b, maybe EUR55b, and if you see the extra budget, you see then – on the next page, on page no. 5 – that the budget starting in 2023, and we have not exact figures at the moment, what happens in 2022, but in 2023 our expectation is, let it slowly grow up between EUR70b and EUR80b per year.

If we see that the EUR100b over the next 10 years should be spent, then our expectation is minimum then this EUR10b extra money plus a growth rate on the EPL 14 which has to be, otherwise we cannot reach the 2% plus that the chancellor said.

On page no. 6 you see – and this is a very important point at the moment, because we gave a very clear statement and this was Monday after Sunday when the chancellor made the decision – Rheinmetall produced one week before a potential list because we saw that something is coming up, what is possible to strengthen Bundeswehr. And this is a potential list, this is not a sales list. On the potential list for us it is very clear that we have a potential of EUR42b. In that EUR42b – and this now was our expectation – one of the biggest packs is ammunition. And this is true, ammunition is very high, as you know, on the German MOD a list where they said there is a need of EUR20b on ammunition, plus – and this is also very important – this is from the extra EUR100b package, plus at the moment EPL 14 had a budget of EUR750m to EUR800m per year, which is also on top of that.

So usually, if you see the EUR700m, Rheinmetall delivers about 50% of the ammunition of that. If you calculate it simple, then we said, if there is a EUR20b budget and that, okay, there is a potential of EUR10b – here on page 6 is, and this was as I told you before the Sunday – our expectation was EUR12b so it's about EUR10b which is potential. How the government will handle that to give it in frame contract or separated, we do not know at the moment, we are still in negotiations on that.

Second point are the trucks – and ammunition we are able to deliver after six months so that is the reason that we have a potential this year to deliver extra ammunition to our government. Second point the trucks. We need 12 months, but we also, because we have much more materials at the moment, and we decided two and a half/three months ago, that we will buy in material for the trucks for EUR100m, because we have a hedging agreement with our government that they need more trucks, so that we can deliver more trucks than expected also this year.

But usually we need without the material twelve months time to have a starting point, and the need is really huge. And this is also the feedback that we get. I don't know if there is a possibility to get the whole frame contract on that, but load handling system where only Rheinmetall is qualified, and also the unprotected cabin truck, where Rheinmetall is qualified on that, there is a need of in total 30,000 trucks.

The next point is the 8x8 and 6x6 fleet so it's Boxer and 6x6 vehicles, and on the 6x6 there is a need of about 1000 units. That will be a EUR3b program, and I think there is also a decision that we get the "Schwerer Waffenträger". So this is the equipment that we have in Australia. It's a Boxer with a lance turret on, so it should be the same equipment that we have in Australia, so there is a potential of EUR1b.

All that you have seen – ammunition, trucks, 8x8 and 6x6 – it's only the 8x8 at the moment we are sharing with our partners in Munich, but the next we are sharing 50%; this is the Puma. This is the second lot and there is a potential of about EUR4b on the Puma side, which will be EUR2b for Rheinmetall.

The soldier system and the protection, it's starting from helmets with some electronics inside and the whole soldier system by itself, there is the first need that we see is the need of about EUR1.2b with a potential in total is higher.

On the next page seven you see now the ammunition. We see that the whole period will be a safe period of ten years with the budget that we are expecting, on the trucks over ten years, on the 8x8 and 6x6 six to seven years, and the Puma six to seven years and also the soldier system four to five years. The question is also, is it possible to do something faster? Everything is possible, for sure, but to be fair enough – and there isn't enough capacity there – we can hurry up but not a lot. So this is also a very important point.

Page no. eight is what are the highest risks? The highest risks are for sure material availability. We ordered some steel and also some electronics, especially also because of the pandemic situation. Rheinmetall has increased the raw materials in our stocks, and we are looking also for alternative sourcing. A very clear point is that there will be no sourcing at the moment for sure from Russia, but we also source not a lot from Russia so there the risk is not very high.

Personnel recruiting: We think that over the next one year we need 1,500 to 3,000 additional people, and minimum 50%, maybe 60% of them will be in Germany. But also we need them in Australia, the UK and Hungary for example where we have our new factories. And if you look onto our homepage you see at the moment we are on the way to recruit about 700 people.

Execution risk is always a risk, for sure, we have to take care about that, but we hire and we have a lot of new qualified people and we hire qualified people especially on the side of program management.

Capacities – and this is a point that you see now on the next page nine – on the capacity side I think Rheinmetall is really in good shape. So we have new factories in United Kingdom. As you know, there are four different spots in UK after buying 55% of BAE Land.

We have our big truck factory in Austria, in Vienna, and also in Munich in cooperation with MAN. Canada is doing electronics and also able to do vehicles. United States, we have some factories and we have now a new one in preparation of the infantry fighting vehicle program in USA we are growing up. Hungary is in good shape because we can start production end of the year so we are ready in the third quarter.

In Switzerland we produce ammunition and air defense systems, and in Italy we produce also ammunition, air defense systems, radar systems. Australia is ready now since one and a half years. So Australia could help also to grow up the resources and ammunition side; also South Africa.

And the main spot for sure is Germany and with Kassel, Unterlüss and Kiel and Munich we have vehicle production areas and also ammunition site and protection soldier systems in Bremen which is helping a lot. These are the main spots, where the need is at the moment also for the German Bundeswehr.

Page no. ten you see now how the growth rate is. We expected in 2022 a growth rate of 10% before Ukraine. After Ukraine we see that the growth rate will be 20%. So the question is also, what is the reason for that? And the reason is very clear that we have a possibility to grow in ammunition and also to grow on the truck side, because – what I told you before – the materials that we ordered , we are able to deliver them here and to give it to the Bundeswehr, so that we will have a total growth rate of up to EUR1b in defense from the level of 2021.

On the next page you see the NATO members – and this is also a discussion that we have in whole Europe – a lot of European partners are asking at the moment, what can we do, and how can you help, how the industry can help in different areas. We are prepared for that, and as you know, Rheinmetall is a very international company. We have a lot of factories in Europe also, and we take care about every customer as a number one customer.

So on page 12 you see now the short-term possibilities which are coming in. We are on the way now, and the Hungarian contract will be signed of ammunitions in the first quarter expected is this week, and the UK Boxer second lot is the potential of EUR120m. And the expectation is, and we know that the Prime Minister made a decision in Australia, but he didn’t make a press release now, but we are waiting every day also for a press release of the Prime Minister.

There is a huge potential very short-term not only in Germany but also in our international markets, but a total game changer for sure will be the German market now, which is coming up.

So if you look now to page no. 14, you see that the growth rate that we had was expected for the group 8% to 10% so our possible upside scenario is now that we grow between 15% and 20'% on the operational sales. And on the operational margins our expectation is that we have an EBIT growth which can be bigger than 11%, and the old expectation was 10% to 11%.

So now, if we go to the next page, it's page no. 16, you see that the operational free cash flow is really good or was really good of 7.4%. We have a record level of operational results of EUR594m, a really strong trigger on the dividend EUR3.3 which we propose to AGM. Order intake and booked business is on the same level that we had last year, in total about EUR1b, a bit because of the delay of the ammunition contract, a bit less on the defense side but more on the civilian side, and the total backlog of EUR24b.

You see the graphs on the next page, 17, where you see the Rheinmetall backlog. I think this is an important point to say EUR24.5b is a EUR14b order backlog defense, frame backlogs EUR3.5b and EUR7.1b on the civilian business, on sensors and actuators and materials and trade.

ROCE maybe is also very important on that and the ROCE is coming from 11.8% to 19%. This is also a great value so it was a very, very successful year 2021, and 2022 will be even better.

The dividend proposal, as you see on the next page, is now a payout ratio of 36.5% on adjusted earnings per share, and total payout to shareholders will be EUR144m. This is no problem at the moment with the cash situation that we have inside the company.

If you see now on page 19, we are doing a lot for ESG. ESG is very important for us. And let me start with the ratings selection on the right side. You see that MSCI up to Sustainalytics ESG risk ratings Rheinmetall is in the ranking really good. We are under the top 20% companies on ESG ratings. We have initiatives and targets, and we are now a part of the UN Global Compact. We have CDP first participation in Q3 2021. TCFD and SBTi, so everything is done, so a huge team is working to fulfill that because we think especially to protect our world is a very important thing. And regarding measures – we say very clear that the carbon dioxide neutrality should be in Rheinmetall in 2035. And this is not only on this page, what we do is very clear. Over the next two years the factory in Unterlüss, for example, will be carbon dioxide-free, and we do this with wood chips, and we take from our forest the wood chips on that. We have in our compensation policy an update: 20% of the ESG targets in our long-term incentives for all the leaders inside the Rheinmetall Group are ESG-based, which is very important and which is an essential part of our compensation.

We made a first release of the ESG factbook, and we did the introduction of corporate sustainable board, and every week the board is sitting together and every month we discuss that also inside the Rheinmetall Board on highest level.

Page no. 20, a small overview about the milestones in our acquisition strategy. So a small acquisition was Zeppelin Mobile Systems. What is the background about that? We are positioning in a key international market, and this is the service business where Rheinmetall is now inside and we want to extend our technical responsibility. This is now, with that factory and company we are able at the moment to bring also hospitals, and we offered also hospitals to Ukraine and to the Eastern European partners or field camps, because these are containers/tent solutions, etc. etc.

At the moment we see sales of EUR50m, but I think with the crisis that we have at the moment in Ukraine it can grow up, and it will be a margin which fits into the Rheinmetall margin between 10% and 15%.

EMT is the second point and the EMT is – we bought EMT not because we want to be only in the UAV business. That was also one point, but it is part of our digitization strategy. If I say digitization strategy, I mean the linkage between the German air force and the German army and the point is to have also solution and new solutions on the drone technologies to get more information to the army.

EMT sales at the moment at a level at EUR50m, but will also grow up, and our expectation on the margins in the future is also 10% plus.

Very important, even if it is at the moment a small company and a start-up but its Polycharge. Polycharge is a game-changer in electronics. For the electrification, this is very important. We have nano-laminated condensators on the DC-link capacitors and the points that we have here, it's very small and very high temperature resistant technologies which are here inside. We will build up a factory here in Europe for this Polycharge and we are partner in the United States from the Polycharge, we are a minority shareholder in Polycharge and we then have the majority and have it on the top line in Europe, because we have a joint venture with Polycharge here in Europe. And a very important point for us in electrification strategy with an annual sales expectation of EUR200m and about 10% [margin].

The biggest investment is a stake in 4iG. 4iG is the second biggest digital company in Hungary and we did it to establish, also to be partner in the network for the Hungarian government, networking of defense networks, for civilian networks, that they are in Hungary, to build up also on the satellite technologies, their micro-satellites, which are going in. Our expectation is that with a joint venture where Rheinmetall has not the minority but the majority in Hungary, where we have minimum 51% with, and 4iG is the second partner which has more than 40%, that we can from the defense side make the digitization strategy for Hungary and for Central and Eastern Europe.

There we see a multi-billion business and this was the main trigger for us to go into that area.

Now I will hand over to my colleague, Helmut. Helmut is going now into the financials.

Helmut Merch

Thank you, Armin. Also a warm welcome from my side.

I will start with the sales and results overview on page 22. We delivered an exceptionally strong Q4. Although sales were held back by ongoing semiconductor shortages, we also saw a cooled off market situation at our Tier 1 customers in Q4. But on the margin side we were able to deliver another record level margin of 16.4%, closing the quarter at roughly EUR300m operational EBIT.

For the full year 2021 we have been able to grow sales by roughly 5% and reported a record level operating margin of 10.5% or roughly EUR600m of operational EBIT, exceeding clearly the previous year's figure of EUR446m by 33%. The special items in our reported EBIT leading to EUR608m on a full-year basis are mainly related to our real estate project in Hamburg, which we do not include in our operating business. Please now continue on page no. 23.

The operating free cashflow for 2021 came in at roughly EUR420m. The main reasons for this positive, very positive development were a very strong operational improvement in combination with a strict CapEx management as well as working capital improvement driven by our divisions Vehicles Systems and Weapons and Ammunition.

Over the last years we have been very successful in improving our free cashflow generation. On a 24-month rolling operating free cashflow to sales ratio of 5.6% end of 2021, we have been above our targeted strategic corridor of 3% to 5%. Please now turn to page no. 24.

In 2021 we successfully renewed our syndicated loan of EUR500m until 2026 with two extension options. This had a favorable effect on our maturity profile.

Balance sheet and net financial position have clearly strengthened and are rock solid. Our equity ratio rose to roughly 34% and the net financial position improved to EUR118m after EUR4m in 2020.

Due to the currently good liquidity situation which is expected to continue, Rheinmetall is increasingly facing the challenge of avoiding negative interest rates in its cash investments. For this reason we decided in the third quarter of 2021 to invest part of its cash and cash equivalents on the capital market as a a kind of strategic liquidity reserve. The invested funds are available to Rheinmetall for disbursement at short notice. EUR162m were invested in the fund as of December 31.

To sum it up: At the end of last year we had a cash position of roughly EUR1b and additional securities held for trade with a value of above-mentioned EUR160m.

Please turn to page 25. Our pension provisions have seen a huge decline of more than EUR500m. The key elements for the favorable development are the good performance of our funded assets especially in Switzerland as well as the support of the German discount rates recovery. Due to the positive performance in Switzerland on our plan assets we have now an asset surplus of more than EUR100m for the first time.

Please move on to page 26. A top priority in the first COVID year 2020 was to manage cost and cash. The very strict cost control measures were still in place in 2021 and helped to operate also on an efficient CapEx level. For 2021 we report capital expenditures of EUR242m or 4.3% of sales of which EUR226m are cash effective.

The increase of CapEx which was cash-effective is related to the business growth and the additional defense program starts, where we need a certain lead time before we start with series production.

In 2021, research and development expenses amounted to roughly EUR340m. Of this, EUR55m were charged to customers, and EUR77m of the total research and development expenses were capitalized as development costs.

The research and development ratio as a percentage of total Group sales reached 6% after 6.4% in the previous year.

Please follow me now onto page no. 27. The fiscal year 2021 was marked by a significant sales recovery in the Sensors and Actuators and Materials and Trade divisions. These two divisions benefited from the renewed increase in demand from the global automotive industry compared to the crisis year 2020. The other divisions were able to increase their sales more or less slightly.

With EUR218m the Weapon and Ammunition division once again made the largest contribution to earnings. Operating profit improved in all divisions due to the above-mentioned increase in sales, a positive product mix effect and intensified cost optimization measures across all five divisions. All divisions have been able to improve their margin profile and to lift accordingly the Group margin to 10.5%.

We also saw in four of five divisions a strong generation of operating free cash flow. Please move on to page no. 28.

The positive development of the booked business in our civilian business continues. We reported booked business of more than EUR3.2b, which is 43% higher than last year's level. We saw again a high demand for alternative propulsion-related products and other new businesses. In 2021 26% or EUR820m of the booked business have been with orders for electrification, so less than 50% of total booked business is now related to ICE.

Please join me on page 29 for the presentation of our backlog details in the divisions Weapon and Ammunitions, Vehicle Systems and Electronic Solutions.

I would like to draw your attention to the right hand side of the chart. That shows we are coming to the point where the backlog transformation starts to accelerate. The order coverage for 2022 has increased by EUR400m to now EUR3.3b compared to last year, which is also a sign for our confidence to show further growth, as already explained by Armin, in 2022.

This brings me to my last slide, page no. 30. For 2022 we still see and expect uncertainties, but also opportunities for a dynamic upswing in our security business, as already explained by Armin. The war in Ukraine is worsening the macroeconomic uncertainties in major parts of the global economy. It also brings additional risks to the already stressed supply chains, especially for the civilian business we are operating in. The automotive markets continue to be characterized by comparatively higher volatility risks expecting for the time being a growth of Global LV production of roughly 9% for 2022.

On the other hand, security is the most important part of our business and with this conflict escalating, national security is now highest priority at all countries again. Armin already explained it and this is driving the development and we expect to see rising global defense budgets, and with positive impacts on our future businesses.

We will continue to monitor our supply chain very closely and have secured prices and volumes. Due to our combined price escalation and hedging strategy for raw materials and energies, we are more or less well protected.

Now I think we are open to your questions.

[0:35:13] Operator

Ladies and gentlemen, if you would like to ask a question, please press 9 and star on your telephone keypad. In case you would like to withdraw your question, please press 9 and star again. Please press 9 and star to register for a question. And first up is Sven Weier from UBS. Over to you.

[0:35:44] **Sven Weier**

Yes, good afternoon. Thanks for taking my questions. The first one is on the guidance and basically the upgrade you've been putting through compared to what is in the annual report. When I look at this additional volume which seems like EUR400m to EUR600m from Germany, I was curious how much of that have you secured already? I think there were some remarks on the tape today that you've received some orders already. I was just wondering, as the year goes by and you secure more orders, could there be further upside or have you taken this into account already? That's the first one. Thank you.

[0:36:29] Armin Papperger

Yes, first of all, we really made our internal planning, and as you know, this is not a clear guidance at the moment. This is the expectation that we see and this is what we discuss also with our customer, our German customer. The first contracts are in. We do not speak about these contracts at the moment, because if there is a special need also for the Ukraine, as I said, this is confidential at the moment. But it's right that the first contracts are fixed.

Our calculations are that the possibility that we have, and this is especially on the ammunition side, it's also on the truck side, because we have enough material in stock on the truck side because we prepared ourselves to deliver more, even before the Ukraine crisis. So we have to wait now for the fixed contract, because it's fine if you have a handshake agreement but at the end of the day, you need a fixed contract for all of them.

You are right, our expectation, and there is a range that there is a possibility between EUR400m and EUR600m, or we said EUR400m and EUR500m in that area, what we can bring out this year, what would help us to have a growth rate of up to EUR1b from the Defense side. So this is very clear, what we expect internally.

[0:37:55] Sven Weier, UBS

And what you said in the analyst briefing two weeks ago, I think you said the Defense business in Germany could at least double over the coming years. Have you further fine-tuned that expectation? Or is it still as it was and that should be the minimum?

[0:38:17] Armin Papperger

I think it is possible to be better, 100%. But at the end of the day, give us some weeks to have a clear picture also with our customer. Because – I'll give you an example.

I give you the example on the trucks side. If there is on the trucks side now really 30,000 trucks that they need. So we should over the next 10 years produce up to 2000, 3000 trucks per year only for Germany.

If we do that, then only the trucks have an extra potential of up to EUR500m or more per year. If that happens and if this contract is really fixed, then at the end of the day for sure it will be much more than only to double the sales, because we had a cross order intake always between EUR2b and EUR2.5b. Because this is the order intake usually it's going via more than one year we had at sales between let me say EUR1.5b and EUR1.7b. So if we only make with the trucks side this number that I told you before, there is more in. Because Ammunition has to come.

And the beauty is from our side at the moment, even if the situation is worse and everybody knows that and it's very clear for me it would be much better if we have peace and freedom on the Ukrainian side at the moment. But we have to take care about what's happened. So when the drivers in our business will be first of all the Ammunition business, ammunition is the biggest need that we really have at the moment, and Rheinmetall will have a strong growth rate.

The second biggest need in the list is logistic vehicles. It's unbelievable, but that's it. So this is the second driver of the business. The third thing, and this is what the minister says, our defense minister says very clear, we take care about our soldiers. So what the soldiers need, they need protection equipment. And the protection equipment on the soldier systems side etc etc. is coming also from Rheinmetall. But we are in a good situation and then in some area, other spots, we are also inside like what we offer on the helicopter, where we have not a final decision etc etc.

But only the three things are as huge that it is absolutely possible maybe that we – and that is what is that to be conservative and said that we double the sales.

[0:40:54] Sven Weier, UBS

Thanks for that, Mr. Papperger. I'm just wondering, on this EUR400m to EUR600m. This is just Germany, right? How should we think about countries outside of Germany? You talked about this earlier. Would you also see some additional sales potential that could still have an impact on this year?

[0:41:13] Armin Papperger

I think we have to take care about all the countries. I think that the biggest lever will be in next year.

[0:41:25] Sven Weier, UBS

Thank you. Maybe the final question I had was just on the free cashflow guidance, because there in the annual report you have the standard range of 3% to 5%. What if we go to this other guidance? At the end of the day, will that also have an impact on the free cashflow guidance? Or should we also think about the 3% to 5% in this scenario?

[0:41:52] Helmut Merch

Actually, Mr. Weier, the range is still in place. But if we were lucky to reach the expected higher EBIT range, then we could also imagine that we are above 5% ratio in the next two or three years.

[0:42:15] Sven Weier, UBS

Okay. Thank you both.

[0:42:19] Armin Papperger

Thanks.

[0:42:22] Operator

Next up is Christoph Laskawi from Deutsche Bank. The floor is yours.

[0:42:28] Christoph Laskawi, Deutsche Bank

Hi, thank you for taking my questions. Three, if I may, quick ones, actually.

The first one would be on the new business which is coming in, and the additional order intake that you expect, how shall we think about the operating leverage in the business? Is it essentially as you've shown in the past, or because you need to hire new staff and have training expenses, etc, that it actually should be slightly lower?

Then the second question would be on the upside from international business. Do you expect, as I guess you are in negotiations already, order intake announcements in the first half already? Or will this be more spread into the second half then early next year when there's more visibility on the budget of the country?

Then third question is, do you have an update on the piston disposal? I know it's ~~[Autos in focus]~~ Autos and not in focus that much right now, but if you could comment on that, thank you.

[0:43:33] Armin Papperger

Starting with the piston side, yes, there is a very clear process that we sell the piston business now in part. So first of all, there is a bunch of people who are interested in the large bore piston side. We are at the moment on the way to sell our activities in India with Shriram. We are yet on the way on the activities in Japan with Riken, Japan and China. So our expectation is that we will have the first success up to near June/July this year.

As you know, to sell the pistons in one piece was not good for us and not profitable for us. So the guys who wanted to buy it, we were not happy with the price. So we sell it now separately.

So the new business, my expectation is that the operational leverage, because most of the fixed costs are done. We must not build up new factories. We will have a good leverage and not a bad leverage on the business which is coming in. So that this will be good for profitability.

On the international business, we are in discussions with a lot of countries at the moment. As I told you before, we will have on the international business huge order intakes in the first half. This is my expectation. But also in the second half, it will continue.

We give no guidance on the order intake side but my expectation is that this will be the best year ever that we had on order intake in Rheinmetall.

[0:45:20] Christoph Laskawi, Deutsche Bank

Thank you.

Operator

We are coming to the next questioner, and it is Sebastian Growe from BNP Paribas Exane. Over to you.

[0:45:34] Sebastian Growe, Exane BNP Paribas

Yes, hi. Good afternoon. It’s Sebastian here. Three questions also from my side. The first one is more a bit of a discussion around Germany. You discussed already the mid-term sales potential, the doubling and at the same time we have now seen that the special fund is not coming on top of the target GDP quota of 2% but rather a means to get there. So two questions to it.

The first one is, how tangible really is the assumption that 20% of the budget is ultimately going into restocking or expansion on the ammunition side?

Secondly, it’s a more high level question, quite frankly. What’s your view why the budget has not been increased more sharply, i.e. why the EUR100b has not been coming on top?

And related to it, clearly, do we see any risk that the EUR100b is ultimately not going to be approved by the parliament? We have been hearing – I'm hearing more critical voice setting both inside the ruling government and also on the side of the opposition party, so I would be just interested in your views.

Then I have two quick ones after that.

Armin Papperger

So first of all, on the 20% level on ammunition side, I believe that this will come, because this is the only chance at the moment to prepare Bundeswehr, if it is Luftwaffe or if it is the Army, to prepare them for war. Because without ammunition, you cannot fight. We have not the ammunition; we have no ammunition, so the stocks are really – they are not empty, but nearly empty. So we have to invest in that area and we have to do that – there is a continuous investment over the next years on that area. So therefore I believe in that, because we know that there is a huge need on the ammunition side.

The second point is the EUR100b, it's not only to say, okay, 100 is a nice figure so let's say it's EUR100b. The EUR100b was a need that we know since let me say six months. The reason for that was – and that's a tricky point now. It's a combination and the combination, if you see the combination, that you say minimum 2% of the GDP, so EUR70b to EUR80b per year. If we have a basis at the moment of about EUR50b, which should go down over the next years, what was planned half a year ago, to go down to EUR48b, etc etc. This will be now between EUR50b and EUR55b. So this is the basis.

Then we use the EUR100b first of all to grow up to the 2%, starting in 2023. But then we continue and then we need on the base value between EUR50b – if it is spread over 10 years, between the EUR50b and EUR55b, we need add on some budget, maybe then to have a basis of EUR60b to reach the 2% again. The point is, it's linked, and this is the beauty on that thing, to go forward.

So the EUR100b are used for the biggest need. There was no money for F35. There was no money for STH. And now there is money for that. Now we can do it. Usually they wanted to press out this money for F35 for the helicopter out of the EPL 14. This is impossible, because the EPL 14 then is empty. So you have nothing for that.

So the beauty on this system is now that the EPL 14, you do not longer have the pressure of this big program inside. So the flexibility is much, much higher that the government and the planning chief have at the moment, to go forward. That is the reason that this was – I think this was a very clever decision from the Chancellor, to say not to have a pressure over the next years on the basic budget. Is that fair enough?

Sebastian Growe, Exane BNP Paribas

Yes, that makes sense on the related pushbacks that one can hear and see in the press at least, from some parts of the politicians?

Armin Papperger

I see that the Chancellor gave the word that this is for investments for Bundeswehr. This is not to invest, what we say, to drill water in the whatever, Sudan or whatever. This is very clear for the German Bundeswehr and for the equipment of the German Bundeswehr. I believe that first of all, let's say, my discussions I had with different politicians that also the Christian Democrats, the oppositoin at the moment is really fixed on that, that it is only for Bundeswehr. Otherwise, as you know, he wants to change the Grundgesetz, yes? And he's not able to have not the two-thirds majority and he only can do this with the Christian Democrats. So therefore I think it will be fixed.

Sebastian Growe, Exane BNP Paribas

Okay. Thanks for that, and then next point is quickly really on M&A. There were some press articles obviously a couple of days back now, I think, that you would be eyeing Oto Melara, for instance, and also Mass. So can you just update us on the status quo and also shed some more light around the strategic rationale if you're really interested in the asset? Because I've been hearing that Leonardo would not be inclined to sell the asset any longer. So any thoughts would be helpful.

Armin Papperger

It is, relatively easy. The Italian government made a decision that they want to replace some of their tanks and that they need a new infantry fighting vehicle. There is a budget for infantry fighting vehicles and for tracked vehicles. The total budget in Italy over the next 10 years is more than EUR8b and there is at the moment the budget freeze, starting from the next year, of EUR2.2b to EUR2.3b.

So we have since months discussions or nearly one year discussions now with the Italian government that Rheinmetall is interested to offer our infantry fighting vehicle Lynx. So if you offer an infantry fighting vehicle, you need an industrialization strategy in the country. The industrialization strategy is in different directions.

One direction could be to say, yes, we built up a factory like we did in Hungary, like we did in Australia. But to be fair enough and Italy is a country which has also industry. Therefore we offered, this is not a negotiation at the moment or other things that said, okay, I could offer to say, okay, I could invest also in company. I never said Oto Melara, but like Oto Melara. Or to make it with Iveco or whatever, to say, okay, we invest.

And the point from us is that I also go into the minority in that area, because it's the same discussion then in all the other countries to say, okay, if the Germans only take over, they do no longer take care about the Italians. So I said, I could – I offer also to buy 49% of Oto Melara to cooperate with Leonardo and to build our infantry fighting vehicle.

This is the idea. This is a model, and this model I discussed with the journalists also in Italy to say, okay, and you said, yes. It’s a good thing. And we shared that also for sure with the government.

Sebastian Growe, Exane BNP Paribas

Okay. Interesting. Then the last one is on the margin [one sees] and then you mentioned, Mr. Merch, that obviously each and every segment has been coming out better than the prior year, but also then better than expected probably even. Now you’re guiding to having the point stable margin. So is this more a reflection of cost inflation, especially on the wages?

And if I may catch you on the wages, can you just share with us what your anticipation is in terms of wage increases for the year 2022? And anything that you might want add in terms of mix effects would be much appreciated. That is it then for me, thanks.

0:53:53 Helmut Merch

So actually our base scenario was a margin guidance between 10% to 11%. Now with the expected potential, we raised these expectations to above 11%. So there will be a plus, there will be a positive impact from operating leverage. But on the other hand, as you know, there are strong and high increases on the raw materials side. A lot of them we already have priced in or we partly hedged. But we have also some impact. So this will be a light burden on the margin. But I think first of all, we have to get the orders. We have to execute and then we will see how far we are above 11%.

[0:54:52] Armin Papperger

It's impossible to say you at the moment, yes, it’s 11.5% or it’s 12% or whatever, because we do not have the contract. And if we have the contract, yes, then we can give you more details. But please, the situation changed now two and a half weeks ago and we are not able to make a replanning of the whole company in two and a half weeks. That's impossible.

0:55:13 Sebastian Growe

So do we have it, yes, thanks very much and fully understood.

0:55:17 Helmut Merch

Yes.

0:55:20 Operator

The next question comes from Christian Cohrs from Warburg Research. Over to you.

0:55:26 Christian Cohrs

Yes. Hello, good afternoon. Maybe the first question to come back on this margin issue. You upgraded the guidance verbally in the amount of EUR400 to EUR600m for the defense business. You said earlier that you have made your internal planning as of today. So maybe can you provide us? If you do not want to tell about margins, that's fine. But maybe can you provide us the split of the EUR400 to EUR600m into trucks and ammunition so that we can make our own margin assumptions? That would maybe be the first question.

0:56:07 Armin Papperger

So the biggest part will be Weapon and Ammunition because, as we are very fast in that area. The second biggest one will be trucks and number three will be ES.

0:56:23 Christian Cohrs

Okay, but no quantification of the, no splits. No, okay.

0:56:27 Armin Papperger

No, not at the moment.

0:56:29 Christian Cohrs

Okay, fine.

0:56:31 Armin Papperger

But it’s simple for you to say if you have the number one, and it makes it easier for you maybe the number one which we have is more than 50%.

0:56:41 Christian Cohrs

Okay. Okay.

0:56:43 Armin Papperger

So now the model is fine.

0:56:45 Christian Cohrs

Yes, thank you. Second question also relates to modeling, actually. So you said that you intend or that you expect the German business to double. Now, the difficulty is that this EUR100b one-time fund and the regular defense budgets are to some extent interlinked. But I mean, the invest, so talking alone about the regular budget increase, the invest part from approximately EUR10 to EUR20b per annum. If you keep your market share, this would alone be already a doubling of your German sales prospectively. And now the effect of the EUR100b at least to some extent, should come on top. So isn't your expectation of just a doubling of your German business in defense? Is this not the, or does this include a big portion of caution?

0:57:51 Armin Papperger

Maybe. Maybe I'm a too conservative guy. Sorry for that.

0:57:57 Christian Cohrs

Usually not. But this time, this time, yes.

0:58:02 Armin Papperger

No, no, but to be fair enough. It's, and I gave you the statement let me say two days after Sunday to double. Now we are deeper inside and there is more potential. But please, please give us a little bit more time.

0:58:18 Christian Cohrs

Yes. Understood. Understood. Then a technical question. You were talking about acquisition. So maybe can Mr. Merch provide us with a figure what is the potential cash out for M&A this year and then add on a strategic question, now with the big change in the German defense industry, but possibly also in Europe, are you looking for more M&A generally, to add capacity and also potentially expertise to your portfolio?

0:58:52 Armin Papperger

Yes, if it fits, yes. We are sure because let me say, you see our balance sheet is really rock solid. And so we are looking for that, but it must fit. I tried to bring you in the situation for the few four acquisitions that we made, that this really helps in our digitization strategy and also in our electro mobility strategy. And if it fits, it's fine. If the price is fair, it's fine. But on the other side, the operational growth that we will have over the next year is super.

0:59:30 Helmut Merch

So one amendment, Mr. Cohrs, we will see some outflow in Q1 for the mentioned transactions, EMT drones and 4iG. And this will be a cash out in Q1 in a total amount of roughly EUR200m.

0:59:55 Christian Cohrs

Okay, understood. And then the last question, now with the rising importance of defense, and I mean, Mr. Papperger, you are I assume quite active now in discussions with the MODs. Do you think it still makes sense to have Rheinmetall as a technology company, rather than a pure defense company? So shouldn't you increase focus in order to free up management capacity?

1:0:26 Armin Papperger

Yes, absolutely. We think always about that. But at the moment, Mr. Cohrs, I have other problems than to think about selling some companies.

1:0:35 Christian Cohrs

Okay. Understood.

1:0:37 Armin Papperger

But maybe there is some time then we will focus that again. As you said we started with the piston selling, but at the moment, really, we are working day and night to help our Bundeswehr and to help our NATO partners to fight against the Russians also in Ukraine and to protect Europe.

1:0:56 Christian Cohrs

Understood, thank you.

1:0:58 Armin Papperger

Thank you.

1:01:02 Operator

Next up is Sash Tusa from Agency Partners. The floor is yours.

1:01:08 Sash Tusa

Thank you very much, indeed. Good afternoon. I've only got a couple of small questions now, because most of mine have already been answered. But I just wondered whether you could firstly, just give us an idea of the split of your R&D between defense and non defense segments. And then I get the feeling that just since your focus on making major strategic disposals is much less than it would have been a month ago, you haven't talked at all about capital allocation, which was a subject that was very high on the priorities in the previous year. Is this a function of the fact that the share price is sufficiently high that you don't think you need to do buyback to support it? Or you don't think that the multiple is worth it? Or do you have much bigger requirements for your cash flow in terms of working capital or capex?

1:02:07 Armin Papperger

So first of all, we think that we must not build up new factories and other things. So it's not so that we have to invest a lot of cash into the factories. We need toolings and we need other things. So as I told you, we told you that the buyback program for this year is planned, but we look for sure for the share price. And it's a different situation. If you have a share price of 80, then 160. So this is also for sure. But we always think about that and we are open about also those things. On the R&D side from from the cost side, I said it's not very clear, because we get a lot of money from our, in the programs, from our customers. And this is not officially in our reports what we get in, but I can give you one figure. Usually the mean value that we give on the defense side is on an area, if you calculate in that what our customers are giving us in the program, it's around 10% that we do. On the civilian part, it's less.

1:03:15 Sash Tusa

Okay, thank you very much.

1:03:24 Operator

Now, we're coming to the next questioner. It is Richard Schramm from HSBC. Over to you.

1:03:32 Richard Schramm

Yes, good afternoon, gentlemen. Just a quick follow up on the point you made and sorry to be asking again about the capacity needed for all this growth you have had. I mean, if we double sales then in my understanding, there has to be a significant investment also, not only in headcount, but also in equipment and maybe one or the other new factory or at least an expansion of an existing factory as well. So can you elaborate really a bit why you are so sure that you can get around without any meaningful capital spending over the next years on this huge volume increase you are facing here?

1:04:26 Armin Papperger

Absolutely. So let's start with the vehicles. On the vehicle side, we have as I told you in the presentation, huge factories first of all in Unterlüss which are working at the moment, most of them one shift. So first of all, it's that we are working with, we build up three shifts and we work three shifts. So only with that, if you work on not only one shift but two or three shifts, you can minimum double the capacity in that area. So we have also lines in Kiel and in Kassel only starting from the German side. I give it now really long because for the understanding of what's going on. So there is also that most of these factories are working one shift on the vehicle side. So vehicle is, I see absolutely no problem if the material availability is there. So this is the most important thing and we have to take care about that. Second, we have a huge, a really huge, maybe one of the biggest factories in UK, in Telford. This is the old, this is the biggest tank factory in the United Kingdom and this is now under Rheinmetall control and we can really produce hundreds of tanks per year there. It's an unbelievably huge factory that we have there. Another huge factory is now in Australia and this is brand new and we are building at the moment the trucks and the 8X8 and hopefully very soon the Lynx in Australia, but there is more space. Then we have Hungary as a new factory and all of that we did without a huge cash out. So it's there. It's not that we said okay, we are fully popped into our factories that we have. It's a lot of capacity that we build it up with governmental money from the government and we rented that stuff. And in like Australia after 10 years, we get it for one Aussie dollar. So this is a fantastic situation for Rheinmetall, which is really good.

So next point, the trucks. Trucks in Vienna and Munich. So the capacity of Volkswagen on truck side and where we get the chassis or so, but this is endless. No investments of that. They are producing 100,000 trucks and if we produce 3,000 or 4,000 trucks, it doesn't matter for them. So we get enough chassis, we got enough cabins etc, etc. So this is not a problem. Our special truck production in Vienna has a total capacity of 6,000 trucks per year. So if we work by day and by night. We do at the moment a small investment on the painting shop because this is, we do a bottleneck analysis on the painting shop, and if we make this investment, which is some EUR100,000, immediately we have the possibility also to work here in two shifts. And at the moment we produced in one shift 2500. So in two shifts, you can nearly double that. But minimum let me say 4,000 trucks which are there. Then we could produce the double size trucks that we have in at the moment for Germany, but we also have international customers for that. So from the vehicle side, I hope this is a very clear answer. Is that clear? Is it fair enough what I told you?

1:07:52 Richard Schramm

Yes, absolutely. Yes.

1:07:53 Armin Papperger

So now I'm going on for the next one. I do it really really to explain because it's always, we do not take enough time for this explanation. Now ammunitions. On the ammunition side, we have the capacities from the Cold War. We didn't reduce our capacities. And one fun example, I always give this example: 120 millimeter tank ammunition, in over the last year. So we made sometimes in one year, 20,000. In the other three years, we made maybe 40,000 rounds. If we have very high we made 50,000. We have a capacity of 240,000 rounds. And the point for us was that we couldn't even think about to produce one shift the whole year. We produce sometimes only three or four months in these factories, but we changed the personnel. Now we try to build up for one shift the whole year and if we need more, we do it in two shifts. The same is for artillery. The artillery we have capacities in South Africa, in Germany. In Germany, we produce maybe 5,000 rounds a year, we have the capacity of 100,000 rounds. So it's not only that we can double it, sometimes we can make 10 times more ammunitions than we have. So and we must invest nothing. I said, I think I said, sorry to say. We have to invest in some toolings and some maintenance stuff, for sure this is clear, but not new factories. And then on the ammunition side another point. And then we said, these are the two biggest products that we have. On the ammunition side, there is a decision from the Hungarian government and we will have the contract this year that they will build also up an ammunition factory, under the cost of the Hungarian government and to produce this huge ammunition contract, one of the biggest ammunition contracts ever we book in now, which is nearly EUR1b. And with the contracts which are coming up, it's more than EUR1b. So is this fair enough on the ammunition side to understand that there are not huge investments?

1:10:09 Richard Schramm

Yes, also understood.

1:10:13 Armin Papperger

So number three, electronics. On the electronics side, you don't need huge investments. But what we did is to have a new production line in Spain, and we invested that, and this is a cooperation that we have between our civilian business and between our defense business. So ICP boards, we are able now to produce 10, 11, 12 million of the boards in Spain and this investment is because we need it on our civilian business, especially for our pumps and electric engines. And therefore we need from the electronics side not huge investments and what we have is we have also a lot of sub suppliers, which are helping us, and we enlarge, we have to enlarge the base of our sub suppliers, number one. This is what we are doing at the moment, the guys in the background are working on that. And on the other side, a lot of our subs are only also, and this is what we checked, they also worked one shift. So the shifts only, we need personnel, but we don't need big investments. And I think so far, sorry to be so long, but it's always the same point and it's important that we understand that point that there is not a huge cash out scenario from us.

1:11:36 Richard Schramm

Okay, that was very clear, many thanks. So at the end of the day then this leaves you with the, finding enough qualified employees here to fill the second or maybe a third here, right?

1:11:53 Armin Papperger

Yes. We have to bring them in, we have to educate them for sure. This is also for the blue collar worker side, it's also an education process. But we are very well-trained about that. We will bring them on the planning side through our academy. We have huge academies where we can educate them in this area and we have to prepare ourselves. But it is not starting tomorrow, but what you said, the lines that we have at the moment we can fill up and we have also time to educate people. So and I, my expectation is that this 1,500 to 3,000 people that we have time, 12 maybe more than 12 months time to educate them and to bring them in and then it is running. But the real lever is starting also in, is next year. So this is, this year is only a small level where we go up. Next year it will be more.

1:12:50 Richard Schramm

Okay, that was it from my side. Many thanks.

1:12:53 Armin Papperger

No problem. Thank you.

1:12:58 Operator

Gentlemen, there are no further questions.

1:13:06 Armin Papperger

Okay. Thanks for your time. It's an interesting time also for us and we take care about that and we have to serve now NATO and the industry has to take care that our soldiers are well-protected and all the best from our side to you. Stay healthy and hopefully there will be not another escalation in the war, that the NATO is not inside. Because then the picture is another totally different picture. Thank you very much for your time.

1:13:34 Helmut Merch

Thank you. Bye.