Continental Media Webcast: Fiscal 2019

Comments of the Chairman of the Executive Board
of Continental Aktiengesellschaft,
Dr. Elmar Degenhart,
and the company's Chief Financial Officer,
Wolfgang Schäfer,
on the occasion of the
Continental Media Webcast: Fiscal 2019
on March 5, 2020

Check against delivery!

Please note that all statements are preliminary numbers that still need to be approved or determined by the Supervisory Board.

Wolfgang Schäfer, CFO:

Ladies and gentlemen,

The situation in 2019 was very challenging. That goes for the development of volumes on our markets as well as the technological changes in our product range, all of which strongly impacted our sales and earnings development.

We achieved the annual targets we adjusted in the third quarter despite the persistently challenging year-end. Overall, however, we had expected more from the past fiscal year, which was absolutely not satisfactory for us.

Our sales totaled €44.5 billion in 2019, representing slight growth of 0.2 percent year-on-year. Adjusted for exchange-rate effects and changes in the scope of consolidation, we recorded a negative organic sales development of 2.6 percent.

This means that we outperformed the market, since according to the latest estimates, global automotive production fell by about 6 percent worldwide in 2019. Our organic sales decreased by over 3 percentage points less than our markets. In other words, we grew more than 3 percentage points more quickly than our markets.

Our adjusted EBIT amounted to €3.2 billion and the adjusted EBIT margin was 7.4 percent. The margin in the previous year was 9.3 percent.

Overall, 2019 was by no means a satisfying year – not for the industry and not for Continental.

There were considerable additional special effects – which were not included in the adjusted result, but which impacted our operating result heavily. As reported at the end of October 2019, we have adjusted our market expectations not only for the current year but for the following years as well. This was a primary reason behind the write-downs in particular of goodwill in the amount of €2.5 billion. They do not have effect on liquidity, but they reduce our operating result. In addition, provisions of about €700 million were recognized for restructuring expenses.

These two situations essentially led to a negative operating result of €268 million. The EBIT margin in 2019 was minus 0.6 percent. Ultimately, that resulted in negative net income of €1.2 billion.

The former Automotive Group in particular fell short of our expectations. The sales of the three former Automotive divisions amounted to €26.5 billion in 2019. In organic terms, without the influence of exchange rates and changes in the scope of consolidation, this represented a sales decline of 3.3 percent compared to the previous year.

Measured against the weak production figures in the same period, our performance was still acceptable. As in previous years, we once again grew faster than our markets.

The picture was mixed in terms of earnings.

The EBIT margin of the automotive business was minus 7.9 percent. The year before, it was still positive at 7.0 percent. This was mainly due to the goodwill impairment and restructuring provisions I mentioned earlier. The adjusted EBIT margin, which reflects the operational performance adjusted for special effects, was 4.4 percent for the automotive business.

Our business with rubber and plastics technology performed reasonably well. With sales of €18 billion, reported sales of our rubber business increased by 2.3 percent. From an organic standpoint, they declined by 1.5 percent. The adjusted EBIT margin of 12.4 percent corresponded to an adjusted operating result of €2.2 billion.

With just an 0.2 percent decrease in organic sales, the tires business in particular held its own in a declining market. This was made possible by our high level of commitment in the overseas markets of North America and China.

Continental continues to be in a solid position. The equity ratio is 37 percent. The gearing ratio amounted to just under 26 percent at the end 2019. Two-thirds of the year-on-year increase of 16.5 percentage points was due to a change of an accounting standard (IFRS 16).

Overall, we have a very healthy balance sheet structure.

At the end of last year, we took advantage of a favorable window of opportunity and issued four bonds and refinanced our credit line. We once again obtained very good interest rate conditions. These and other improvements are the result and a further reflection of our fundamentally solid balance sheet structure and our strong finances.

We were also one of the first companies in the industry to include criteria in our new credit line that reward sustainable business practices in the form of lower interest rates.

We are very well positioned for the coming years in terms of our balance sheet. Overall, therefore, we have sufficient room to maneuver, even in difficult times.

Despite challenging conditions and a high level of capital expenditure, Continental achieved sound cash inflow before financing activities in the past fiscal year, with free cash flow before acquisitions and carve-out effects of €1.3 billion. In comparison, it was €1.9 billion in 2018.

On this basis and in view of our healthy balance sheet structure, the Executive Board is proposing a dividend of €4.00 per share for fiscal 2019. We are therefore still at a competitive level, after €4.75 in the prior year.

Despite the negative net income, we will show our appreciation for the hard work of our highly motivated, global Continental team with a special payment. We are currently holding talks with the employee representatives in this regard and will let you know the outcome in due course.

Moving on to our outlook, the current quarter has got off to a subdued start, as expected, due to continuing market uncertainty. This is now compounded by upheaval in light of the coronavirus epidemic.

As things stand, global production of passenger cars and light commercial vehicles will decline in 2020. We expect a decrease of between 2 and 5 percent year-on-year.

These estimates already take into account the impact of the coronavirus, as for as can be determined to date. In the Chinese market, we expect the number of passenger cars built to decline by more than 30 percent year-on-year in the first quarter. The current market forecast does not, however, include possible continuing and future disruptions to production, the supply chain and demand caused by the virus. Such disruptions cannot be gauged at the present time.

All in all, the economic environment will thus remain challenging in 2020.

On the basis of our assumptions about trends in the industries and markets that are relevant for us, we anticipate consolidated sales for 2020 of between €42.5 and €44.5 billion and an adjusted EBIT margin of between 5.5 and 6.5 percent.

In the new Automotive Technologies group sector together with the former Powertrain division, we currently expect sales of around €25.5 to €26.5 billion. The adjusted EBIT margin is expected to be around 3 to 4 percent.

In the Rubber Technologies sector, that is, our tires and ContiTech business, sales are expected to be around €17 to €18 billion. We anticipate the adjusted EBIT margin to be in range of around 10 to 11 percent.

And on that note, I will now hand over to Elmar Degenhart.

Dr. Elmar Degenhart, CEO:

Ladies and gentlemen,

As you just heard: in operational terms, we performed reasonably well last year, but we quite obviously were not satisfied with fiscal 2019 on the whole.

The entire automotive industry is experiencing a clear downturn.

The absolute decrease in production of passenger cars and light commercial vehicles has in the meantime reached the level seen in the crisis years of 2008/2009.

To top it off, there are trade conflicts that remain unresolved, drastically more stringent emission regulations in Europe, business processes and products that are changing rapidly due to digitalization, and, most recently, the market slump in China caused by the coronavirus epidemic.

A major market crisis in times of a revolutionary transformation in technology: the global automotive industry is currently weathering one of the worst storms it has faced, and the resulting effects will continue to be felt by us all for a long time to come.

All necessary adjustments are now being made in parallel: structures are being modified, capacities are being reduced, production is being scaled back or stopped, and costs are being cut. At the same time, we are working to realign our portfolio, expand the training of our workforce, and accelerate our transition to new and profitable growth technologies.

The current transformation alone affects everything that makes up our business, from products and processes to business models and structures. It poses major challenges.

But above all, we see huge opportunities for Continental!

Because, from a position of strength, we are shaping and expediting this transformation. We are the transformation.

That is why we positioned ourselves well early on, both technologically and in terms of our balance sheet. We are now much better prepared to weather the storm than we were years ago. We are highly motivated and have a clear plan for our future success.

A significant part of this plan consists of our profitable growth areas, which we are continuing to strengthen and on which we are concentrating our efforts fully. The first is assisted, automated and networked driving. Second, we are implementing new vehicle architectures and vehicle connectivity with the help of new, high-performance computers. The third area is software and data. For this, we are making our products intelligent – regardless of whether they are made of plastic, rubber or mechanics. As a data source, these products are giving rise to new services for mobility customers. Finally, the fourth area is our growing business with industrial and end customers.

In the race for the healthy ecosystem of future mobility, we are asserting our leading position with our extensive product range and expanding that position even further. All of us in the worldwide Continental team are convinced of this. Our openness to change is exceptionally high. Our team is extremely motivated. We can sense this, and it has also been confirmed by recent internal surveys. We have done our homework and are paving the way for our success with our transformation.

Our advantage right now is that we have a very solid balance sheet – which is very different to the situation we faced after the financial crisis in 2009. That is why we are continuing to invest substantially in the technologies of the future. In 2019 alone, we spent around €6.7 billion on research and development as well as property, plant and equipment, and software.

We have thoroughly prepared our organization for our future concept for success: organizationally, in the form of our realignment. This will enable us to operate on a more decentralized basis in the future. We will thus register changes in our environment earlier and be able to respond to them much faster and more flexibly.

We have prepared our corporate culture to embrace change. We initiated this process years ago and are now benefiting from this head start. Our values promote cooperation in times of transformation. Today, our passion to win is exceptionally strong. To use a football analogy, we are in the locker room, fully focused on the game and raring to go.

Structurally, we are countering the sustained downturn in the automotive markets with our Transformation 2019–2029 program. Our goal is to increase productivity and ensure competitiveness in the long term.

We are taking all necessary measures with a sense of responsibility and foresight. We will support our employees to the best of our ability, for example by expanding our company’s internal job market and with the help of our global training initiative. We are increasing the employability of our individual employees with customized programs. With our own educational institute, we are specifically addressing the needs of semi- and unskilled employees in Germany.

Since our structural program was announced in September 2019, the economic environment has deteriorated further. The spread of the coronavirus at present has also exacerbated the current situation. We are already seeing this on the stock markets as the economic climate has become infected by the virus. Uncertainty is growing.

We are monitoring this development and its consequences carefully. In addition to the ongoing structural program, we are also looking into how we can effectively respond to the weakening overall situation and its impact in the medium term. Above all, we are at present pursuing two goals that are crucial for our success: continuously rising productivity and our sustainable competitiveness.

As matters currently stand, we expect to have initial findings from this process in May 2020 and will provide further information in due course.

As you can see, we're just getting started. We are reducing costs and increasing our efficiency. We are creating flexible structures and processes. We are increasing the employability of our individual employees and we are concentrating fully on fast-growing, forward-looking technologies while further accelerating their development.

Let me give you a few examples.

One of the most important areas of focus, and for us the most promising, is the combination of electronics, software and sensors. All three are decisive for the mobility of the future. We currently generate 70 percent of our sales in the automotive business with these. Soon, this figure will be 80 percent.

With new functions, the amount of software in the vehicle will rise tenfold in the next 10 years. We will benefit from this software boom, because Continental has over 51,000 engineers working on new trends and technologies, of whom already more than 20,000 are software and IT experts. They are developing the high-performance computers I mentioned for the vehicles of the future, enabling a high degree of connectivity. This makes it possible to install new functions as well as safety updates, which are downloaded via a wireless connection.

Our new vehicle computers are reducing complexity. And they are raising driving ease to new levels. New all-electric vehicles for large-scale production are benefiting from this, for example. We are doing pioneering work here, which is putting us at the forefront when it comes to software expertise for connected cars.

Our high-performance software, sensors and electronics are at the heart of assisted and automated driving. With sales of €2 billion in 2019, we are a leader in this field. We continue to achieve strong growth with these safety technologies. Last year alone, order intake in this area amounted to nearly €4 billion. From a technical standpoint, we are currently one of the few providers worldwide capable of supplying systems that enable highly automated driving on freeways. As you can see, we are shaping the future!

The same goes for our tires. Thanks to their especially low rolling resistance, for example, our tires for hybrid and electric cars offer increased range while also ensuring longer tire life. Our Taraxagum technology, with its rubber derived from the dandelion plant, also provides a future alternative to rubber from tropical trees.

We are even reinventing the tire for greater energy efficiency, and we are making it more intelligent with sensors and software. In the future, tires from Continental will collect data and provide the driver with reliable information not only on the temperature and tire pressure, but also on the depth of the tire tread. Damage will be detected at an early stage to prevent accidents. In doing so, we are boosting safety and tire life, thus minimizing unnecessary downtimes.

In 2019, we produced a total of more than 142 million passenger car tires. That puts Continental on the champions league winners' podium, making it one of the top three car tire manufacturers worldwide.

Ladies and gentlemen, our technologies make driving and roads safer, cleaner, more intuitive, and intelligently connected. They protect all relevant environments: ecological, economic and social. This is comprehensive climate protection for everyone, and we make it possible, each and every day of the week.

It is also why we are convinced that if you want the mobility of the future, you need Continental.