Good Q3 Results – Challenges in Energy Sector

Analyst and Press Call
Third Quarter, Fiscal 2014

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Thank you for joining us to discuss the third quarter results of fiscal 2014. I will give you a brief overview of the key developments and then we will focus on your questions.

**Progress with implementation of “Siemens – Vision 2020”**

Back in May we announced our “Siemens – Vision 2020” concept, setting the long-term direction and priorities for our company. And we are well on our way: For now, we have focused on getting the organization ready for the new setup on October 1. Secondly, we are taking comprehensive measures to simplify processes and structures based on the new setup as of October 1. A dedicated “Vision 2020 team” is driving the implementation of the various topics together with our businesses and functions. We will provide the next more in-depth update on these topics during our Siemens Capital Market Day on December 9 in Berlin.

As for the third quarter we delivered a good performance with progress in most areas. Continued challenges in the Energy business held back an even stronger profit improvement for Siemens as a whole. As for the full fiscal year 2014, we are on track to deliver our outlook.

**Order intake remains level on an organic basis**

The macroeconomic picture continues to show a heterogeneous regional development. We have seen some acceleration of production activity in the US but overall continued slow growth in Europe. Germany’s auto industry still drives the economy, but seems to have reached or passed its peak. China is a robust factor in the emerging BRIC markets, while geopolitical tensions such as in the Ukraine and Middle East pose a serious risk for Europe’s growth in the second half of calendar year 2014.

In this environment, our order intake remained on the same level year-over-year on an organic basis. Among the Sectors we saw significant shifts: Large orders in the Energy Sector such as the €1.6 billion Gemini Offshore Wind Farm project in the Netherlands compensated for sharply lower rolling stock orders, such as the €3 billion Thameslink contract we booked one year ago. Emerging markets were the key growth driver – organic order growth there was 16 percent and accounted for 35 percent of the total order volume. Emerging countries excluding the BRIC
countries delivered impressive 27 percent order growth.

**Strong Euro affects development of top and bottom line**
Overall top line growth was again significantly affected by the global strength of the Euro – the headwind amounted to more than 400 basis points in revenue. As for Total Sectors profit margin, the currency impact is negative at around 40 basis points, affecting Healthcare and Industry the most. These effects are expected to continue to a lesser extent in the fourth quarter. Revenue on a comparable level increased modestly by one percent, mainly driven by the Transportation & Logistics business.

**Income and profit rise**
Total Sectors Profit improved by 37 percent over the prior year, which was heavily burdened by more than €400 million in “Siemens 2014” transformation charges. Higher contributions from our short-cycle businesses in the Industry Sector as well as solid project and productivity execution in the Infrastructure and Cities Sector drove profit. On the other hand the Energy Sector is facing operational challenges that held back overall profitability improvement and require time to get fully fixed.

Below the Sector line, profit of around €100 million benefited strongly from some positive effects in Corporate items. The main factor was income resulting from changes in the fair value of warrants issued in connection with the 3 billion US dollar bonds offering in fiscal 2012. This item remains to be volatile going forward.

In the fourth quarter we expect a certain swing-back for the below Sectors result as in previous years. We reiterate our guidance for Corporate items and pensions in the range of nearly €1 billion for fiscal 2014.

Our key metric “basic earnings per share” improved to €1.62 and adds up to €4.65 for the first nine months, that’s up 20 percent over the prior year. Free cash flow from continuing operations is up 13 percent over the prior year. But we see a lot of potential for improvement in our working capital management, particularly in the project businesses, although reduced prepayments continued to negatively affect Free cash flow.

**Energy – Strong orders but operational challenges are continuing**
Now let’s take a look at some key developments in each of the Sectors. First, the Energy Sector: The bright spot at the beginning – orders were up sharply with growth in all businesses and geographies, however on easy comps. In Power
Generation, we were able to catch up successfully and sold 16 advanced gas turbines in a very competitive market – mostly in connection with turnkey contracts. The global advanced gas turbine market is likely to be smaller in 2014 versus 2013. Power Transmission booked the fifth offshore grid connection platform BorWin3 – however this time with a strongly improved risk management concept. Looking ahead, we expect the market environment to remain highly competitive for our Energy Sector in all business areas.

In profitability, the Energy Sector’s overall performance year-over-year was disappointing: Power Generation achieved a strong 15.5 percent profit margin, benefiting from excellent results in the product business and some one-time gains, like the sale of an engineering business. Wind Power reached only a 2.7 percent margin, well below its earnings potential, for several reasons. While the revenue mix was less favorable with a lower share of higher-margin offshore business, new product launches and capacity ramp-up led to higher production costs.

Power Transmission continues to deal with broad-based challenges arising from legacy issues, amounting to a loss of €188 million in the third quarter. As I said previously, there is no quick fix for this matter. The Division’s new leadership team is working hard on the remedy, since the transmission business is a key element in the value chain of electrification. There is also operational progress: Meanwhile we installed four offshore grid platforms in the North Sea. The average completion rate is 80 percent. Commissioning will take place successively over the remainder of 2014 and the first half of calendar year 2015.

The Energy Sector has several legacy matters, such as Olkiluoto, the North Sea projects and others, which pose further financial risks going forward.

Solid quarter at Healthcare, despite negative currency effects

Let’s briefly move on to Healthcare, which delivered a very solid quarter despite continued negative currency effects, which weighed down the profit margin by around 110 basis points. In addition year-over-year comparables were tough.

Organic order growth of two percent was supported by a major service order for the particle therapy installation in Shanghai and a better development in Europe.

The Diagnostics business delivered a good performance. Management is concentrating further on its core in-vitro business by selling the microbiology business to Beckman Coulter for a very satisfactory price. This move is in line with
our “Siemens – Vision 2020”, which calls for focusing our businesses on core fields. We expect the transaction to close in approximately six months.

**Market environment for Industry businesses shows moderate growth**

Next, I want to highlight the key developments in the Industry Sector. The market environment for our Industry businesses shows overall moderate growth, which we expect to continue for the next months. Automotive and infrastructure-related industries like transportation are still the main drivers, whereas the picture in machine building is regionally mixed.

Geographically we saw significant order growth in China with 14 percent organically, based on a strong automation business and some larger orders in Drives.

Profitability in Industry Automation improved substantially due to a more favorable business mix with higher-margin products and sustainable lower amortization effects from the UGS acquisition. Profit margins in Drive Technologies returned close to double-digit through an improved cost position, which resulted from successful productivity measures and increased demand for our motion control products in the quarter.

As of the third quarter nearly all Metals Technologies activities are classified as discontinued operations and we expect the closing of the joint venture transaction with Mitsubishi-Hitachi Metals Machinery in the first quarter of fiscal 2015.

**Consistent profit improvements at Infrastructure and Cities**

Finally, the Infrastructure and Cities Sector continued on its path to deliver consistent profit improvements by stringent project execution and continued productivity efforts.

In Transportation & Logistics, large rolling stock orders in Europe and orders for components in China are now being converted into revenue and pushing growth rates up to 17 percent. Profit was also positively impacted by a €27 million change in the risk assessment of a rail project.

Power Grid Solutions & Products improved its margin by 160 basis points. This was mainly driven by higher profits in the Low and Medium Voltage Division. Growth in China continued, and both product and system businesses showed further healthy margin improvement.
Finally, Building Technologies again delivered good results by continuing its productivity improvement efforts and optimizing go-to-market.

**Integration of Invensys and LMS**

As promised, we will give you periodic updates on the performance of important acquisitions. This time we focus on Invensys and LMS. The Transportation & Logistics financials indicate that the Invensys rail business is contributing solid results on top and bottom line. We are very pleased about that. We have created the world leader in Rail Automation and the integration is slightly ahead of plan. Looking at the status, we are very confident to deliver the synergies as planned. By end of fiscal 2014, we will have already achieved more than one third of the expected synergies of around €100 million, largely through cost savings.

Stringent integration leads to a profitability ahead of our original plans. Since the profit margin adjusted for PPA and integration cost is in the mid teens, it is highly accretive to divisional profit.

Back in January 2013, we complemented our offering in PLM software with LMS, the leading provider of testing and simulation software. The integration of the team has worked well with very low attrition rates. We are growing at an above market rate in a currently slower growth environment. In the core automotive and aerospace industries we are executing on excellent cross-selling opportunities in the PLM field. We have made significant progress in Asia, where we, for example, greatly expanded our footprint with Toyota. Overall, the integration is on track to meet the desired outcome, although some elements may take longer than originally anticipated.

**Outlook for fiscal 2014 confirmed**

Let me briefly review our performance after three quarters of fiscal year 2014 using the “One Siemens Cockpit”: Three Sectors are well within the target margin, while Energy is not meeting its EBITDA target due to the challenges I elaborated on. In line with the improvement in profitability, return on capital employed after nine months stands at 16.6 percent for continuing operations, within our target range of 15 to 20 percent.

Before going to your questions, let me close by confirming our outlook for the year 2014.