Materialise NV

Second Quarter 2019 Earnings Conference Call

August 6, 2019 at 8:30 a.m. ET

CORPORATE PARTICIPANTS

Fried Vancraen – Founder & CEO

Peter Leys – Executive Chairman

Johan Albrecht – CFO

PREPARED REMARKS

Harriet C. Fried - *Lippert/Heilshorn & Associates, Inc. - SVP*

Thank you for joining us today for Materialise's quarterly conference call. With us on the call are Fried Vancraen, founder and chief executive officer of Materialise; Peter Leys, executive chairman; and Johan Albrecht, chief financial officer.

Today's call and webcast are being accompanied by a slide presentation that reviews Materialise's strategic, financial and operational performance for the second quarter of 2019. To access the slides if you have not done so already, please go to the investor relations section of the company's website at www.materialise.com. The earnings press release that was issued earlier this morning can also be found on that page.

Before we get started, I would like to remind you that management may make forward-looking statements regarding the company's plans, expectations and growth prospects, among other things. These forward-looking statements are subject to known and unknown uncertainties and risks that could cause actual results to differ materially from the expectations expressed including competitive dynamics and industry change. Any forward-looking statements, including those related to the company's future results and activities, represent management's estimates as of today and should not be relied upon as representing their estimates as of any subsequent day. Management disclaims any duty to update or revise any forward-looking statements to reflect future events or changes in expectations. A more detailed description of the risks and uncertainties and other factors that may impact the company's future business or financial results can be found in the company's annual report on Form 20-F filed with the SEC.

Finally, management will discuss certain non-IFRS measures on today's conference call. A reconciliation table is contained in the earnings release and at the end of the slide presentation.

And now, I would like to turn the call over to Peter Leys. Peter?

Peter E. Leys - *Materialise NV - Executive Chairman*

Thank you, everyone, for joining us today. You'll find an agenda for our call on slide 3. I'll begin with a brief recap of our results for the quarter, after which Fried will come on to discuss some of the many growth initiatives in Materialise Medical, including the investment we made just last week in Engimplan, a Brazil-based manufacturer of cranio-maxillofacial, or CMF, and orthopedic implants and instruments.

After that, Johan will go through our second-quarter numbers in more detail and then I'll come back on to review our financial guidance for 2019. When we've completed our prepared remarks, we'll be happy to respond to questions.

Turning to slide 4, you'll see the highlights of our second-quarter results. Despite the macro-economic environment that remains challenging, Materialise continues to grow: our total revenue rose 7%, our consolidated Adjusted EBITDA was 10.5% and we were again very close to the breakeven point.

Materialise Medical continues to perform strongly, with revenues growing 17% quarter over quarter and with an EBITDA margin of almost 19%. The revenues of Materialise Manufacturing grew by 5%, for a double-digit EBITDA margin of more than 11%. This quarter Materialise Software performed below our expectations, with a growth of 2% and an EBITDA margin of 22%.

I will now turn the call over to Fried, who will, among other things, expand on the investment in Engimplan that we announced last week.

Wilfried Vancraen - *Materialise NV – Founder & CEO*

Good morning and good afternoon everyone. Thank you for joining us today.

Our strategy to invest in a select number of vertical applications of 3D printing in the medical field has been very successful, as is evidenced by the continuing strong results of Materialise Medical. Going forward, we intend to continue following that course. I would like to expand on a number of initiatives that are currently ongoing within Materialise Medical and that further execute and build on that strategy.

First, our recently announced investment in Engimplan perfectly fits our vision to invest in meaningful applications of 3D Printing in the medical field; more particularly, this initiative underscores our commitment to continue to invest in the verticals of CMF and orthopedic applications of additive manufacturing.

Engimplan develops, manufactures and sells, through a network of distributors, its proprietary CMF and orthopedic (mainly spine related) implants and instruments in Brazil, a large market with significant growth potential that is not covered by our international collaboration agreements.

While Engimplan's product portfolio currently consists mainly of standard products, they have certain custom solutions, including their own patient specific TMJ implant. Importantly, Engimplan is a very innovative company that is on the verge of introducing metal 3D printing in its production process. By including some of our own software and hardware solutions into Engimplan's product portfolio and by adding our technological expertise to Engimplan's production process, we believe we can create a lot of synergies and further strengthen Engimplan's market share in Brazil.

We acquired a 75% stake in Engimplan through a mix of existing and new shares. The remaining 25% remains with the founding family that stays in charge of the company's daily management.

Turning now to Slide 6 – another Materialise Medical initiative, our Mimics Enlight Medical cardiovascular planning suite, offers a good example of how we are leveraging the strengths of our Mimics Innovation Suite to provide concrete solutions to specific issues in selected medical verticals.

Mimics Enlight Medical, which was developed in collaboration with the Henry Ford Health System in Detroit, enables clinicians to reliably plan and screen patients for structural heart and vascular therapy. The first release of Mimics Enlight Medical supports clinicians in planning complex transcatheter mitral valve replacement procedures, allowing them to determine the appropriate size and positioning of TMVR devices and to better plan surgical strategies to place these devices.

Mimics Enlight Medical received FDA clearance in June of 2019 and the commercial launch in the US is currently targeted for later this month.

Other planning tools that we have built from our Mimics platform include our shoulder and our knee planning tools. Similar initiatives are ongoing, including in the field of pulmonology.

Another promising program that is running within our medical segment is our collaboration with the University of Michigan to develop and commercialize a 3D-printed tracheal splint to help children suffering from tracheobronchomalacia, a life-threatening congenital airway disorder. The design of these tracheal splints is also done with our Mimics Innovation Suite technology.

The device has been accepted into the breakthrough device program in the US (formerly known as expedited access PMA). Today, the University of Michigan has treated 22 children with this device under the FDAs Expanded Access Program.

While the majority of our research and development efforts in the medical field are expensed, we also capitalize certain development expenses, in particular in relation to our tracheal splint project because of the exceptional results, and the development of our Mimics Enlight Medical planning suite. Following receipt of the FDA clearance of our mitral valve planner, we stopped capitalizing the development expenses associated with this solution because this version is now ready for commercialization.

At this point, Johan will come on to give you more details on our second-quarter financial results.

Johan Albrecht - *Materialise NV - CFO*

Thank you, Fried. I'll begin with a brief review of our consolidated revenue on slide 7. As a reminder, when we refer to 'sales' in our presentation, we mean revenues plus deferred revenues. Also, please note that unless otherwise stated, all comparisons in this call are against our results for the second quarter of 2018.

As Peter mentioned in his opening remarks, in this year's second quarter, we generated a 7% increase in revenue, driven by our Medical segment. Deferred revenue from annual software sales and maintenance contracts increased 2.2 mEUR compared to end 2018.

For the quarter, Materialise Software accounted for 19% of our total revenue, Materialise Medical for 30%, and Materialise Manufacturing for 51%. Cross-segment revenue from software products accounted for 29% of our total revenue.

Moving to slide 8, you will see our Consolidated Adjusted EBITDA numbers for the first quarter.

Consolidated Adjusted EBITDA decreased 157kEUR (3%), from 5,216 kEUR to 5,059 kEUR. Our EBITDA margin changed from 11.6% to 10.5%. Unlike the previous period, the 2019 Q2 EBITDA included a positive effect of 644 kEUR by the new IFRS16 accounting standard, that requires us to capitalize certain lease expenses as of 2019. This new accounting standard has little impact on our operating profit, as depreciation expenses increased by almost the same amount. The increased operating expenses, reflecting our continued investment in Sales and Marketing capacity, R&D and regulatory initiatives counterbalanced the growth of our topline.

Slide 9 summarizes the results of our Materialise Software segment.

Here, revenue was up by 2%, or 189 kEUR. Recurring revenue was up 23%. Non-recurrent revenue was down 14%, affected amongst others by delayed OEM sales. The combination of lower non-recurrent revenues with the continued expansion in our sales and marketing capacity, and R&D initiatives, have led to a decrease in the segment's EBITDA to 2,055 kEUR from 2,859 kEUR in last year's period. The EBITDA margin decreased to 22.1% compared to 31.3% in last year's period.

Moving now to slide 10, you will see that total revenue in our Materialise Medical segment grew 17% for the quarter to 14.5M EUR.

Revenue from medical device solutions rose 13%, accounting for 67% of the total segment's revenue. Growth was boosted by direct sales of all of our medical device business lines.

Revenue from our medical software, which accounted for 33% of segment revenue grew 28%,

EBITDA for the Medical segment was 2.7 mEUR compared to 2.1 kEUR. The EBITDA margin was 18.8% as compared to 17.1%.

Now let's turn to Slide 11 for an overview of the Q2 performance of our Materialise Manufacturing segment.

There, revenue was up by 5%. The increase in our traditional manufacturing business (excluding ACTech) amounted to 7.7%, driven by a growth in end part manufacturing, confirming the positive growth since Q4 2018.

EBITDA rose 25%, resulting in an EBITDA margin of 11.5%. This EBITDA growth reflected improved operational excellence.

In the second quarter of 2019 we added 4 printers as compared to the previous quarter, which brings the total amount of printers that we have in production in our Manufacturing and Medical segments to 192.

Slide 12 provides the highlights of our income statement for the second quarter.

Both revenue and gross profit rose 7% compared to last year's period.

In total, Sales and Marketing, G&A, and R&D spending rose by 8.4% over the prior-year period. S&M rose by 11%, G&A increased 7%, and R&D rose slightly by roughly 5%. This R&D cost increase excludes expenditures in Q2 2019 of 366 kEUR that were capitalized as intangible assets from the Tracheal Splint and Mimics Enlight Medical initiatives that Fried referred to. In total, the intangible assets related to those two development initiatives amount to 1,380 kEUR on our balance sheet, at the end of the second quarter of 2019

Net other operating income decreased by 470kEUR to 1,370 kEUR compared to 1,840 kEUR, reflecting a negative variance from miscellaneous elements that were particularly high in last year's period.

The Group's operating profit was at a breakeven point, positive 36 kEUR.

Net financial result was negative (190) kEUR compared to a negative (375) kEUR last year. The variance primarily reflects the positive impact of the strong USD, mainly on the portion of the company's deposits.

Income tax amounted to 61 kEUR, compared to 42 kEUR in the second quarter of 2018.

Now, please turn to slide 13 for a recap of balance sheet and cash flow highlights.

Our balance sheet remains strong, with cash of 108.9 mEUR compared to 115,5 mEUR as of December 31, 2018. The decrease of cash reflects our capital at work, with debt reimbursement, moderate capital expenditures but not all financed, and the payment of the 2.5 mEUR convertible loan we extended in Q1 to Fluidda that we referred to in our previous earnings call.

Total debt rose 1.7 mEUR from year-end 2018 to 107.7 mEUR. This debt includes 5,1 mEUR of total lease liabilities from the new accounting standard IFRS 16. On a comparable basis gross debt decreased 3.4 mEUR in the first half of this year.

Capital expenditures amounted to 3.1 mEUR compared to 4.8 mEUR in last year's period. Approximately half of these expenditures have been financed. The 3.1 mEUR includes the 344 kEUR capitalized development costs explained above.

Cash flow from operating activities for the quarter was flat at 4.8 mEUR.

Total deferred revenue amounted to 30.1 mEUR as compared to 27.8 mEUR as of Dec 31, 2018. Of the 30.1 mEUR, 24.8 mEUR were related to annual software sales and maintenance contracts vs. 22.6 mEUR as of Dec. 31, 2018.

On July 1 we drew the second tranche of 25 mEUR from our credit facility with the European Investment Bank. At that moment, on July 1st, 2019, our cash position increased – on a pro forma basis – to 133.9 mEUR. Per definition also the debt increased by the same amount, but as first principal repayments only start in 2022, the structure of this loan further strengthens our balance sheet, allowing us to accelerate the pace at which we can advance our strategy through selective acquisitions, joint ventures and collaborations.

With that overview, I'll turn the call back to Peter.

Peter E. Leys - *Materialise NV - Executive Chairman*

Thank you, Johan. I wanted to conclude our prepared remarks this morning by touching briefly on our financial guidance.

While our medical segment continues to perform very well and our manufacturing segment is also performing relatively well given the macro-economic circumstances, our software sales have been below our expectations in the first and second quarter of this year.

There are several reasons for the softer performance of our Software segment in the first half of 2019: over this period there have been less new system sales than were generally expected; users of multiple machines were more cautious about adding new operators; and a number of transactions that we expected to close in the first half of the year were pushed out to a later date.

Based on the information we currently have, we expect that, in the second half of 2019, our Medical and Manufacturing segments will continue to perform well and that our Software segment will perform significantly better. However, this performance will not fully compensate for the shortfall of the first two quarters. Still, from a revenue and deferred revenue perspective, we are comfortable today that, on an organic basis, we will end the year within the guided ranges of revenues between 196 and 204 million euros and of additional deferred revenues from software annuals and maintenance between 2 and 4 million.

Because our Software segment has been the biggest contributor to our EBITDA, the softer performance of Materialise Software for the first half of the year impacts our outlook for consolidated Adjusted EBITDA. As a result, on an organic basis, we currently expect to end the year at the bottom of the guided range of 29 to 33 million euro.

We could compensate for the lower contribution to our EBITDA by Materialise Software by slowing down certain initiatives that are currently running within Materialise Medical or by reducing our investment in other areas such as eyewear or footwear. We will not do that. On the contrary, we will continue to push these initiatives forward as fast as we reasonably can, thus putting the cash on our balance sheet to work.

Our continued commitment to increase our presence in promising verticals of 3D printing means that we do not only invest in internal but also in external engines for growth. The acquisition of Engimplan perfectly fits that strategy, as Fried explained earlier.

In the case at hand, because of the particular financial profile of Engimplan, this investment is immediately accretive to our revenues, Adjusted EBITDA and net profit. Engimplan had revenues of 6.2 million Euro, an EBITDA of 2.4 million Euro and net profit of 2.1 million Euro in 2018, based on Brazilian GAAP and on the average EUR/BRL conversion rate of the ECB for the month of July. The transaction is expected to close still this week; all shares, both new and existing, that we acquire will be fully paid in cash, at closing. We will consolidate Engimplan’s results as of August 1, 2019. The expected contribution from Engimplan obviously further strengthens our confidence to maintain our revenue guidance for the full year and also gives us some additional comfort to maintain our Adjusted EBITDA guidance.

This concludes our prepared remarks. Operator, we’re now ready to open the call to questions.