THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

MTLS - Q4 2019 Materialise NV Earnings Call

EVENT DATE/TIME: MARCH 04, 2020 / 1:30PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Johan Albrecht *Materialise NV - Executive VP & CFO*

Peter E. Leys *Materialise NV - Executive Chairman*

Wilfried Vancraen *Materialise NV - Founder, CEO & Director*

CONFERENCE CALL PARTICIPANTS

Gregory K. Ramirez *Bryan Garnier & Co Ltd, Research Division - Analyst*

Jason Vincent Celino *KeyBanc Capital Markets Inc., Research Division - Associate*

Troy Donavon Jensen *Piper Sandler & Co., Research Division - MD and Senior Research Analyst*

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

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Fourth Quarter 2019 Materialise Financial Results Conference Call. (Operator Instructions) I would now like to hand the conference over to your speaker today, Harriet Fried, thank you. Please go ahead, ma'am.

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

Thank you, everyone, 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 fourth quarter and full year of 2019.

To access the slides, if you have not already done so, please go to the Investor Relations section of the company's website.

The earnings press release that was issued earlier this morning can also be found on that page.

Before we get started, I'd 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 could impact the company's future business or financial results can be found in its most recent 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 also at the end of this slide presentation.

With that, I'd like to turn the call over to Peter Leys. Peter?

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

Thank you, Harriet, and thank you all for joining us today. You will find an agenda for our call on Slide 3.

As always, I will begin with a brief recap of our results for both the last quarter of last year and the full year, after which Fried come on to give you some insights in what we believe will be the long-term trends in additive manufacturing, as the technology enters its fourth decade.

Fried will also discuss the way that COVID-19 virus could impact our sector in the short term. After that, Johan will go through our fourth quarter and full year numbers in more detail, and then I'll come back on with our financial guidance for 2020.

When we've completed our prepared remarks, we'll be happy to respond to any questions.

Now turning to Slide 4, you will see the highlights of our fourth quarter and full year results. In the last quarter of 2019, total revenue increased 3.5% to EUR 50.7 million, while adjusted EBITDA rose 28% to EUR 7.7 million.

In the fourth quarter, our Software segment did particularly well with a revenue growth of 21% and an EBITDA margin of 41%.

Year-over-year, our revenue grew by 6.5%, and our adjusted EBITDA increased at a rate that was more than twice as fast by 13.3%.

In 2019, our Software and Medical segments both posted double-digit revenue growth numbers of 11% and 16%, respectively, while the revenues of our Manufacturing segment decreased slightly by less than 1%.

At the end of the financial year, it is worthwhile to highlight a few other key financial indicators that underscore our financial strength.

In 2019, our cash flow from operations amounted to EUR 28.4 million, our capital expenditures were EUR 15.7 million, and we had cash and cash equivalents on our balance sheet for a total amount of almost EUR 129 million. While the short-term macroeconomic outlook is not crystal clear, we believe that the consistent good performance of our Software and Medical segments and our strong balance sheet, position us well to continue to realize our growth ambitions both organically and non organically.

And with that, I would like to turn the call over to Fried. Fried?

Wilfried Vancraen - *Materialise NV - Founder, CEO & Director*

Good morning, and good afternoon to everyone. Thank you for joining us today. After almost 30 years of consistent growth, Materialise will celebrate its 30th anniversary in 2020. Not only Materialise but the entire additive manufacturing industry is entering its fourth decade.

In the first decade of 3D printing, the key challenge was to make the technology simply work. Materialise played an important role in its journey, enabling printers to work better by connecting CAT systems and CT scanners seamlessly with 3D printers, and this we did through our flagship products, Magics and Mimics. Pioneers worldwide started to use our products or almost exclusively for prototyping purpose.

During the second decade of 3D printing, the additive manufacturing industry as a whole and Materialise, in particular, started focusing on making the technology meaningful by introducing 3D printed end parts in applications such as customized hearing aids, oral implantology guide and knee guide.

In 2010, with the start of the third decade of 3D printing, yet another dimension was added to the equation. We concentrated on making the technology worthwhile by introducing tools and solutions that increase the efficiency and productivity of the technology with the launch of our build processes and the stream mix as perfect examples.

This year marks the beginning of the fourth decade of the AM industry. What is going to be the core theme of this fourth decade? We strongly believe it will be sustainability. Our planet is in jeopardy. The younger generation challenge us to take action. Now is the time to show the technology and innovation in general, and 3D printing, in particular are part of the solution. The role that additive manufacturing can play in our joint quest to make the world more sustainable, will be the main theme for the fourth decade of 3D printing.

The manufacturing industry at large has no other option but to cut as much waste as possible. We must not only reduce the amount of raw materials we use in production, but also recycle them as often as we can.

We have to make sure we produce the first time right, minimizing transportation by setting up manufacturing units closer to the end points of sale. We must manage our inventories more carefully by producing more to order and less to stock.

In all these instances, additive manufacturing can significantly enhance the choice for sustainability. A massive increased use of additive manufacturing will require a quantum leap in process optimization and control.

Materialise is developing the appropriate software tools to enable this leap. But the sustainable world is not only about a plant, it's also about people. People look for solutions that address their needs more accurately. This is in particular the case in the medical field. Here, again, 3D printing can come to the rescue. Additive manufacturing enables the production of personalized products at virtually no extra cost, provided the design automation tools and digital backbones that support the personalized supply chains are available.

Materialise is a pioneer in developing these indispensable software solutions. These and other related topics were to be discussed at Materialise World Summit that we had planned for May 14 and 15 in Brussels. The Summit has been postponed, however, to November 5 and 6th because of the worldwide, both mandatory and voluntary restrictions on mobility in response to the COVID-19 virus. That brings us from the great opportunities of tomorrow to the harsh situation today. The global impact of the coronavirus that is also impacting Materialise. The region that is affected the most, aided by the virus itself or by the drastic measures that aim at containing its spread is Asia. That region is a growth market for both the additive manufacturing in general and for Materialise.

Both our Software in -- and Medical segments sell software in Asia. China, South Korea, Japan, are countries that are most impacted by the crisis.

In 2019, approximately 10% of our sales were from those Asian countries. We see that our activities in the region are affected in the short term. Our sales teams are less mobile. Fewer new machines will likely be deployed in the region. And overall, companies that struggle with their daily operations may temporarily slow down their investments in innovation.

An economic down -- showdown in those countries will impact us. But this will most likely be limited and temporary, particularly in delayed software sales, of which a portion is recurring will be recoverable at a later stage.

The second region that is being impacted by the virus is Europe, the key region for our Manufacturing segment. The European manufacturing services market in general has been difficult lately. The delays of imported supplies from Asia and the slowdown of export to that region, both will not help in the short term. As a result, we expected a difficult situation of the manufacturing market in Europe will last longer than we had expected before the outbreak of the corona crisis.

Unlike software sales, business that our manufacturing unit may lose in the first half of 2020 may not be easily recoverable in the second half of the year as our production capacity is limited.

To conclude, 2020 presents itself as a challenging year. While we will deal with the short-term impact of the continued difficult macroeconomic situation, we are determined to continue to invest in meaningful and sustainable applications of 3D printing, including the orthopedic, CMF and cardiovascular initiatives within our Medical segment and the variables initiatives of our Manufacturing segment.

And now I'll pass the word to Johan.

Johan Albrecht - *Materialise NV - Executive VP & CFO*

Thank you, Fried. I'll begin with a brief review of our consolidated revenue on Slide 6.

As a reminder, when I 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 last quarter of 2018.

As Peter mentioned in his opening remarks, in this year's fourth quarter, we generated a 3.5% increase in revenue. Materialise Software turned into an especially strong performance with a 21% increase in revenue, and Materialise Medical realized 14% growth. These excellent performances were offset by a revenue decrease of 11% of Materialise Manufacturing, which continued to face significant macroeconomic headwinds in this quarter.

Deferred revenue from license and maintenance fees increased EUR 3.7 million during the quarter, and EUR 5.1 million over the entire year because of the strong recurrent sales in both Materialise Software and Materialise Medical.

For the quarter, Materialise Software accounts for 24% of our total revenue, Materialise Medical for 34% and Materialise Manufacturing for 42%.

Cross-segment revenue from software products accounted for 34% of our revenue.

Moving to Slide 7. You will see a consolidated adjusted EBITDA numbers for the fourth quarter.

Consolidated adjusted EBITDA increased EUR 1.697 million, 28% from EUR 6.052 million to EUR 7.749 million.

Our EBITDA margin increased from 12.3% to 15.3%. Unlike the previous period, the 2019 Q4 EBITDA included a positive effect of EUR 641,000, resulting from the new IFRS accounting standard that requires us to capitalize certain lease expenses as of 2019. This new accounting standard had little impact on our operating profit as depreciation expenses increased by roughly the same amount.

Slide 8 summarizes the results of our Materialise Software segment. Here, revenue grew by 21% or EUR 2.1 million. As we expected, the rebound we realized in Q3 from the softer first half of the year, accelerated significantly in Q4.

Recurring revenue was up 23.3%, but also nonrecurring revenue grew 18.8%, boosted by direct sales.

The segment's EBITDA increased to EUR 5.26 million from EUR 2.969 million in last year's quarter.

And EBITDA margin increased to a record of 41.5%, that's compared to 29.6% in Q4 2018. And that despite the continued expansion of our software sales and marketing capacity.

Moving now to Slide 9. You will see that total revenue in our Materialise Medical segment grew 14% for the quarter to EUR 17.2 million.

Revenue from Medical Device Solutions rose 16.9%, accounting for 70% of the total segment's revenue. This includes the results of the Engimplan acquisition that we consolidated since August 1, 2019.

As Engimplan manufactures and sells orthopedic and cranio-maxillofacial implants and instruments, its revenues are reported on a Medical Device solutions.

Engimplan's revenues amounted in the aggregate to EUR 1.4 million. Medical software sales, which were not impacted by Engimplan's acquisition grew 25.4%. This quarter's deferred revenue from license and maintenance fees of EUR 1.3 million, tempered revenue growth to 8%.

Revenue from our Medical Software accounted for 30% of the segment revenue. EBITDA for the Medical segment was EUR 3.5 million compared to EUR 3.6 million. The EBITDA margin was 20% as compared to 24%.

Now let's turn to Slide 10 for an overview of the Q4 performance of our Materialise Manufacturing segment. The revenue was down by 11% or EUR 2.6 million, reflecting a decrease in both a traditional manufacturing and [hectic] businesses. But particularly, we're affected by the softened macroeconomic environment in Q4.

EBITDA decreased EUR 222,000 to EUR 1.8 million, while the EBITDA margin remained flat at 8.3%. Gross profit was affected negatively because of the fixed cost of capacity, but partly offset by slightly decreased operating expenses and increased net operating income.

Slide 11 provides the highlights of our income statement for the fourth quarter. Revenue rose 3.5% and gross profit rose 4.8% compared to last year's period.

The EUR 1.3 million gross profit improvement was realized by our Software and Medical segments, partly offset by Manufacturing's cost of capacity.

In total, sales and marketing, G&A and R&D spending rose by less than 1% over the prior year period. Sales and marketing rose by 13%, mainly by continued capacity expansion in our Software and Medical segments, G&A decreased 22%, and R&D costs rose 11%. This R&D cost increase -- excludes expenditures in Q4 2019 of EUR 306,000 that were capitalized as intangible assets from our tracheal splint initiative.

In total, the intangible assets related to the development initiatives amounted to EUR 1.759 million on our balance sheet at the end of the fourth quarter 2019. Net other operating income increased by EUR 700,000 to EUR 1.5 million compared to EUR 800,000, mainly as a result of higher rent income and an improvement of our bad debt position.

As a result of these 3 elements, improved gross profit as well in amount as in margin, the low increase of operating expenses and higher net operating income. The group's operating profit increased by EUR 1.8 million or 232%, to EUR 2.589 million compared to EUR 781,000.

Net financial result was negative EUR 558,000, in line with the negative result of EUR 420,000 in last year's period.

Income tax expense amounted to EUR 558,000 as well, compared to an income tax income of EUR 348,000 in the fourth quarter of 2018, that at that moment, reflected positive deferred tax results.

Net profit for the fourth quarter was EUR 1.327 million compared to EUR 525,000 for the same period in 2018.

Now please turn to Slide 12 for the recap of balance sheet and cash flow highlights. Our balance sheet remains strong, with cash of EUR 128.9 million compared to EUR 115.5 million as of end 2018. The increase of cash reflects the strong EBITDA performance, a focus on reducing accounts receivable and the joining of the second tranche of EUR 25 million from our credits facility with the European Investment Bank, partly offset by the Engimplan acquisition and other capital expenditures and the payment of EUR 2.5 million convertible loan that we extended in Q1 to Fluidda and that we referred to in the previous earnings call.

Total debt rose EUR 21.9 million from year-end 2018 to EUR 127.9 million. Besides the new EUR 25 million tranche drawn by the European Investment Bank, this debt includes EUR 5 million of total lease liabilities from the new accounting standard, IFRS 16, and EUR 1.3 million debt from the Engimplan acquisition.

Capital expenditures for the quarter amounted to EUR 3.8 million, of which less than 10% was financed. The EUR 3.8 million includes the EUR 306,000, capitalized development costs for the tracheal splint project explained earlier.

Cash flow from operating activities for the quarter was EUR 5.7 million and amounted to EUR 28.4 million for the full year as compared to EUR 28.3 million last year.

Total deferred revenue amounted to EUR 22.7 million as compared to EUR 27.8 million as of end 2018. Of the EUR 32.7 million, EUR 27.6 million were related to annual software sales and maintenance contracts versus EUR 22.6 million as of end 2018.

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

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

Thank you, Johan. Before we conclude our prepared remarks this morning, I would like to go over our financial guidance for this year.

For fiscal 2020, we expect to report consolidated revenue between EUR 202 million and EUR 215 million, with the growth, like in 2019, coming primarily from our Software and Medical segments.

We expect our adjusted EBITDA to come in between EUR 27.5 million and EUR 30 million, and our deferred revenue from software licenses and maintenance to grow by an additional EUR 3 million to EUR 5 million as compared to December 31, 2019.

The financial year has started with some unexpected headwinds in connection with the COVID-19 virus.

As Fried already explained, our Software and Medical segments are active in Asia, which is currently most impacted by the event, and our Manufacturing segment is exclusively active in Europe, where the impact of the crisis on the economy may be higher than initially anticipated. As a result of this unfortunate event, we have built in some extra prudence into our guidance by widening the ranges we are providing. We also believe that the business impact that we will likely feel in the first half of the year, may, to some extent, be compensated by a stronger second half of the year.

And with this, I would like to conclude our prepared remarks. So operator, we are now ready to open the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Troy Jensen with Piper.

Troy Donavon Jensen - *Piper Sandler & Co., Research Division - MD and Senior Research Analyst*

Congrats on good results here in a tough environment.

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

Thank you, Troy.

Johan Albrecht - *Materialise NV - Executive VP & CFO*

Thanks.

Wilfried Vancraen - *Materialise NV - Founder, CEO & Director*

Thank you.

Troy Donavon Jensen - *Piper Sandler & Co., Research Division - MD and Senior Research Analyst*

So for me guys, this Software segment was pretty impressive, as Johan had mentioned, we saw acceleration here in the fourth quarter. Just curious to know what you think is driving that?

Is it traction with metals? Is it just more end part production applications? Just any more insight would be helpful.

Wilfried Vancraen - *Materialise NV - Founder, CEO & Director*

Well, I think there are 2 elements. On one hand, we saw a stronger performance of the OEMs by the end of the year. But on the other hand, we do believe that some of the newer system types, like the HP printers are getting more and more adopted in end parts applications in manufacturing applications. And this, together with the continuous growth of metal will have -- yes, we recuperated some of the (inaudible) opportunities that (inaudible) behind (inaudible) you to the (inaudible) an economic (inaudible) in the (inaudible) of 2019, by the end of 2019.

Troy Donavon Jensen - *Piper Sandler & Co., Research Division - MD and Senior Research Analyst*

Okay. Is it so -- am I hearing you right saying that OEM sales are growing faster than maybe Magics and Streamics?

Wilfried Vancraen - *Materialise NV - Founder, CEO & Director*

Well, build processes are definitely performing strong. I would, however, say that, you mentioned Mimics, that's part of our Medical segment, and Mimics has been performing extremely strong as well. Especially, we see -- we have seen an uptake in the hospital market segment of Mimics. It has long been slower. But now at the end of last year, we have seen several major deals coming through.

Troy Donavon Jensen - *Piper Sandler & Co., Research Division - MD and Senior Research Analyst*

Sure. And then Magics, guys, but we can move on to the next one. So the Brazilian acquisition, Engimplan. Just curious if that was in line with your expectations?

Wilfried Vancraen - *Materialise NV - Founder, CEO & Director*

Well, yes, those results were in line with the expectations.

Troy Donavon Jensen - *Piper Sandler & Co., Research Division - MD and Senior Research Analyst*

So if we exclude that, I think the chart show that you only had 3% growth in medical sales. Just thoughts on what's going on there? Is CMF still kind of the biggest driver for that segment?

Johan Albrecht - *Materialise NV - Executive VP & CFO*

Yes. In the first place, we have a strong growth in the medical software, as I mentioned, the sales themselves were up 25% that were then tempered by the deferred revenue aspects, so that it was limited to 8%. And in the Medical Devices, there we see -- was 14% of increase. And it includes -- that includes the growth of Engimplan. Excluding Engimplan, we are also up in the single-digit growth. And there we see effectively, a growth of production sales, where, in the past year, we still have the current services as well, that we see now, that they are in a good, sustainable growth of production sales. This is bit how we move on and that we can grow in the future.

Wilfried Vancraen - *Materialise NV - Founder, CEO & Director*

Yes, we had a couple of research contracts that -- in 2018 that we didn't have in 2019. So the -- especially the implant business in CMF has been growing very steadily.

Troy Donavon Jensen - *Piper Sandler & Co., Research Division - MD and Senior Research Analyst*

Okay. And then maybe last question for me. Just an update on the BASF partnership.

Wilfried Vancraen - *Materialise NV - Founder, CEO & Director*

Well, there, we continue the collaboration. We have several new Materialise -- new materials launched together with BASF in -- at formnext and especially the TPU had been quite successful in uptake.

Operator

And our next question comes from the line of Jason Celino with KeyBanc.

Jason Vincent Celino - *KeyBanc Capital Markets Inc., Research Division - Associate*

Following up on kind of the last question. The software was very strong. But was that impacted at all by disruption in Asia that you mentioned or

Wilfried Vancraen - *Materialise NV - Founder, CEO & Director*

No. Coronavirus really started to happen in January. So our results of last year were not negatively impacted, and yes, they were also [asset] like -- good level in Asia.

Jason Vincent Celino - *KeyBanc Capital Markets Inc., Research Division - Associate*

Okay. And then relative to the guidance for -- or the commentary of the impact for your Asia business, does it skew more towards medical versus software? Or is it more of an even kind of impact?

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

Well, it impacts on an even basis. The software sales from the Software segment and the software sales from the Medical segment. But as you know, Jason, software sales within the Medical segment only roughly represents 30% of total sales within medical. So overall, the Software segment will be more impacted by this temporary situation in Asia than our overall Medical segment will be impacted.

Operator

(Operator Instructions) And our next question from the line of Greg Ramirez with Bryan Garnier.

Gregory K. Ramirez - *Bryan Garnier & Co Ltd, Research Division - Analyst*

I wonder, go back to the growth which is expected on EBITDA for 2020, it's something around -- yes, it requires an OpEx increase of 2% to 9% which means that it will expect to grow in line with the revenues. Maybe could you explain a little bit how you will manage your operating costs this year, depending on the obviously the revenue mix? As I can assume that if the software division will be -- I don't know if it will be in decline, is it a credible scenario that it will be in decline, whatever it is the software division or medical software, at least for H1? But how you will manage the OpEx, depending on the revenue mix, but also on the sales commissions, as well as managing G&A costs?

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

Yes. Thank you, Gregory. Maybe one clarification. We do not expect a decline within the Software or Medical segments. As a matter of fact, like in 2019, we expect the bulk of the growth of our overall revenues in 2020 to come from those 2 segments. Now with respect to your question on how we're going to further manage OpEx, as you have noticed, we have significantly invested in sales and marketing in 2019. These investments typically do not immediately generate a return as sales people need to be trained, need to be introduced to the market and the like. So we do expect to be able to benefit from the investments in sales and marketing that we have done in 2019 throughout 2020. And so that is definitely one way that we will manage our OpEx. As you have also noticed, we have -- we believe our G&A expense is under control in 2019. That does not mean that G&A as should be the case in any organization remains under scrutiny also within Materialise. So we will also continue to manage those expenses tightly. And as we are a high tech company, you can expect continued investments in R&D in 2020 in line with the efforts that we have undertaken in 2019.

Gregory K. Ramirez - *Bryan Garnier & Co Ltd, Research Division - Analyst*

Okay. Right. And just on the -- yes, to come back, you mentioned on the -- that no software activity will be in decline for the full year. I understand it but is it impossible scenario in H1? Only in H1?

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

Well, H1 is, as we explained, with the current situation with the coronavirus, we're constantly assessing, and definitely software sales and this growth of software sales, both in software and in medical will be impacted by the situation, in particular, in Asia. Now whether that will result in a stabilization of those sales or a negative growth is an assessment that we make on a day-to-day basis, Greg, it's, it's difficult to assess, but H1 would definitely be impacted, and hopefully, the virus will not survive the summer, be able to recover some of the loss in software in the second half of the year, it remains to be seen, and we will keep you updated during the course of the quarter.

Wilfried Vancraen - *Materialise NV - Founder, CEO & Director*

Maybe just for (inaudible) Gregory, mentioned in Fried's comment (inaudible), our introduction. We have also a lot of recurrent revenue from maintenance and renewals of license fees. We don't expect that these revenues will be impacted even immediately in the -- in this virus season, and so people continue and companies continue to renew business. And as you know, from previous calls, that represents roughly 50% of the software revenue as well. So there will be an effect. There will be an impact. It will be in the first place in this Asian region, but the effect you can make an estimate based on what we said that we are looking it up day-to-day.

Operator

And that concludes today's question-and-answer session. I would now like to turn the call back to Peter Leys for closing remarks.

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

Thank you, Chris. And thank you all again for joining. Today's environment is very fluid -- so we look forward giving you an update on the (inaudible) on our quarter also, for your information will be in (inaudible) in April, and I plan to be in Boston for the financial conference in June. So we look forward to seeing some of you at these upcoming events. Thank you again for dialing in, and we look forward to continuing the dialogue. Goodbye.

Wilfried Vancraen - *Materialise NV - Founder, CEO & Director*

Bye.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.
