

CeramTec TopCo GmbH
Plochingen

Operating and Financial Review
for the period ended
31 March 2020

As of 8 March 2018, the former owner Cinven closed the acquisition of CeramTec Group by a Consortium led by Funds advised by leading private equity firm BC Partners (“BC Partners”). The Public Sector Pension Investment Board (PSP Investments) and Ontario Teachers’ Pension Plan („Ontario Teachers’”) are part of the consortium. The transaction was announced in October 2017. On 22 February 2018, anti-trust authorities approved the takeover. As a result, CeramTec AcquiCo GmbH (“CeramTec AcquiCo”) acquired the shares in CeramTec Holding GmbH (“CeramTec Holding”). CeramTec AcquiCo GmbH is a 100% subsidiary of CeramTec BondCo GmbH (in the following “CeramTec BondCo”), which is itself a 100% subsidiary of CeramTec TopCo. Based on the described acquisition, CeramTec TopCo indirectly obtained control of the operating Advanced Ceramics Business as from the acquisition date 8 March 2018. CeramTec TopCo is the ultimate parent and prepares the interim condensed consolidated financial statements.

The purpose of this Operational and Financial Review is to show the development of the financial results of the operating advanced ceramics business for the three-month period ended March 31, 2020 in comparison to the three month-period ended March 31, 2019. The financial data for both periods has been derived from the interim condensed consolidated financial statements.

The following discussion should be read in conjunction with the information contained in our interim condensed consolidated financial statements for the three-month period ended March 31, 2020 including the notes thereto. In the following, we discuss certain financial quantities on an adjusted basis, before giving effect to depreciation and amortization and certain extraordinary, non-recurring items.

The figures in this review are presented in Euro. The amounts are in millions of Euros (EUR m). All amounts are rounded using standard commercial principles. In some cases, adding single values to the total values may therefore lead to differences. Due to rounding differences, figures in tables and cross-references may differ slightly from the actual figures (units of currency, percentages, etc.).

Business Overview

We are a leading global developer, manufacturer and supplier of high performance ceramic (“HPC”) solutions for various end markets including medical, automotive, industrial, consumer and electronics. Our HPC solutions are made of advanced ceramics, which are highly specialized materials with superior biological/chemical, mechanical, thermal, electric, magnetic or optical properties compared to competing products made from metal or polymers (plastics). We have been engaged in the HPC industry for over 100 years, with operational expertise and experience in creating innovative system solutions for longstanding customers at an industrial scale. We currently offer a wide range of HPC solutions including among others, hip joint prosthesis components, actuators in engine valves for fuel injection systems, electronic substrates for chip resistors and electrical vehicles, high speed cutting tools, and piezo components critical for many different sensors in for example medical equipment or the metering industry. The versatility of HPC products and resulting wide range of applications provides us with a highly diversified end market and customer base.

Our operations can be divided into two businesses, Medical Products and Industrial.

Medical Products

Our Medical Products business focuses on developing and manufacturing ceramic components for hip joint prostheses, such as ball heads and cup inserts used in total hip replacement (“THR”) procedures. In the three-month period ended March 31, 2020, it generated 44.5% of our revenue.

Ceramic materials are replacing traditional materials for hip joint prosthetic components such as metal which can trigger negative patient reactions, for example due to allergic reactions resulting from metal sensitivity. Our HPC medical solutions are biologically inert and have high wear resistance and excellent friction behavior, making them one of the few materials that are durable and stable enough to withstand the corrosive effects of bodily fluids. More than 18 million of our BIOLOX® ceramic components have been implanted in patients globally to date. We estimate that nearly one in two hip joint implant systems sold worldwide includes at least one ceramic component and we estimate our BIOLOX® products represented more than 95% of the ceramic components used for these hip joint implant systems. We believe that our BIOLOX® brand has come to symbolize high quality and innovation and is increasingly preferred by surgeons and other medical professionals. We anticipate that our HPC solutions will be increasingly used for various other joint replacements, such as knee, dental and shoulder implants in the future.

Industrial

Our Industrial business develops, manufactures and supplies a broad range of highly specialized, performance critical HPC solutions for customers spanning a wide range of industries including

automotive, defense, electronics, industrial machinery and medical equipment. In the three-month period ended March 31, 2020, 55.5% of our revenue was generated by our Industrial business.

Our dedicated teams of scientists and engineers collaborate closely with customers to develop tailor made solutions and production processes to fulfil distinct functionality and performance requirements. We believe that we are one of the few advanced ceramics manufacturers with a full range of HPC materials and manufacturing processes with a global reach. Our HPC solutions are often used in performance-critical components. For example, our piezo components are widely used in highly specialized sensors for medical equipment and in numerous metering devices and our material and process know how allows us to develop tailor made solutions to the specific requirements of our customers. Our cutting tools have a longer life and faster cutting speeds compared to non-HPC cutting tools, allowing our customers to save costs and reduce downtime. In automotive engineering, HPC products, including our piezo ceramic components, play a vital role in increasing safety, improving cost-effectiveness and enhancing comfort in vehicles for combustion as well electric vehicles. Our ceramic substrates are used for a variety of purposes in the electronics and telecommunications sector, including measurement and control technology and entertainment electronics. We believe that the specialized, mission-critical nature of our solutions, our long-standing customer relationships and our highly diversified portfolio of solutions and customer base, reduces the exposure of our Industrial business to any single industry or product.

Results of Operations

The following table sets forth amounts from our income statement along with the percentage change for the three-month period ended March 31, 2020 compared to the three-month period ended March 31, 2019.

	Three months Ended March 31,		
	2020	2019	Change
	<i>(in EUR m)</i>		<i>(%)</i>
Revenue	158.1	165.5	-4.4
Cost of sales	89.2	92.0	-3.0
Gross profit	68.9	73.4	-6.2
Selling costs	23.8	24.8	-3.8
Research and development costs	5.8	6.0	-3.2
General administrative costs	6.0	6.1	-1.6
Other income and expenses (-), net	-1.8	0.8	N/A
Operating income	35.1	35.8	-1.9
Interest income and other finance income	0.4	15.2	-97.5
Interest expenses and other finance costs	49.4	25.7	92.5
Financial result	-49.0	-10.4	370.2
Profit/(Loss) before income tax	-13.9	25.4	N/A
Income tax expense	2.7	-11.3	N/A
Net profit/(loss) for the period	-11.1	14.1	N/A

Our Management considers the results of operations on the adjusted basis, before giving effect to depreciation and amortization as well as certain extraordinary, non-recurring items, with Management adjusted EBITDA as an important indicator of business performance. Management adjusted EBITDA, its main components and its reconciliation to Operating Income as reported are shown in the following table.

	Three months Ended March 31,		
	2020	2019	Change
	<i>(in EUR m)</i>		<i>(%)</i>
Revenue	158.1	165.5	-4.4
Cost of sales*	74.4	77.3	-3.8
Gross profit*	83.7	88.1	-5.0
Selling costs*	11.2	11.7	-4.9
Research and development costs*	5.3	5.3	-0.5
General administrative costs*	4.9	4.7	4.2
Other income and expenses (-), net*	1.3	0.0	>1k
Management Adjusted EBITDA	63.7	66.4	-4.2
- Exceptional Items	1.7	3.6	-51.1
EBITDA	61.9	62.9	-1.5
- Amortization, Depreciation and impairment charges on non-current assets	26.8	26.8	0.0
Operating income	35.1	35.8	-1.9

* Excluding depreciation, amortization and exceptional items

The following table provides a breakdown of the Exceptional Items for the three months ended March 31, 2020, compared to the three months ended March 31, 2019.

	Three months Ended March 31,	
	2020	2019
	<i>(in EUR m)</i>	
Exceptional items	1.7	3.6
Restructuring costs	0.3	2.0
Other non-recurring costs	2.2	1.1
Foreign exchange conversion effects	-1.5	0.2
Acquisition costs	0.1	0.3
Start-up losses	0.3	-
Discontinued operations	0.3	-

Restructuring costs in 2019 and 2020 mainly comprise severance payments for the reduction of staff at CeramTec GmbH and CeramTec-ETEC GmbH for restructuring initiatives undertaken in our Industrial business.

Other non-recurring costs in 2020 mainly comprise non-recurring consulting and litigation expenses, Covid-19 costs for measures to safeguard employees' health, IT environment, plant shutdown related sales loss, severance payments, short time working impacts while 2019 mainly comprise non-recurring consulting and litigation expenses.

Foreign exchange conversion effects reflect certain impacts related to currency conversions of intercompany receivables that are accounted for in our Operating income.

Acquisition costs in 2020 and 2019 comprise costs related to the acquisition of CeramTec by BC Partners.

Start-up losses reflect the ramp up cost of our knee and dental businesses in Medical.

Discontinued operations mainly comprise the exit / discontinuation of some product groups in our Industrial business.

Revenue

The following table provides a breakdown of our revenue for the three months ended March 31, 2020, compared to the three months ended March 31, 2019, by business:

	Three months Ended March 31,		
	2020	2019	Change
	<i>(in EUR m)</i>		<i>(%)</i>
Medical Products	70.4	68.1	3.3
Industrial	87.7	97.3	-9.9
Total revenue	158.1	165.5	-4.4

Total revenue for the three months ended March 31, 2020 was €158.1 million, a decrease of €-7.3 million or -4.4%, as compared to €165.5 million for the three months ended March 31, 2019.

Revenue in our Medical Products business was €70.4 million for the three months ended March 31, 2020, an increase of €2.3 million or 3.3%, as compared to €68.1 million for the three months ended March 31, 2019. Growth was slower than in previous quarters as certain Chinese customers reduced their orders in the context of Covid-19; there was no meaningful impact on volumes from orders outside of China in Q1.

Revenue in our Industrial business was €87.7 million for the three months ended March 31, 2020, a decrease of €-9.6 million or -9.9%, as compared to €97.3 million for the three months ended March 31, 2019. This decrease was mainly due overall lower volumes for electronics and automotive market, in line with the macro trend that has been observed in the previous quarters and sales additionally

impacted by Covid-19. These impacts were partly compensated by good volume growth for piezo ceramics for sensors for different end markets, especially for medical equipment.

The following table provides a breakdown of our revenue for the three months ended March 31, 2020, compared to the three months ended March 31, 2019, by region.

	Three months Ended March 31		
	2020	2019	Change
	<i>(in EUR m)</i>		<i>(%)</i>
Europe (excluding Germany)	74.0	73.6	0.5
Germany	34.0	38.8	-12.4
North America	25.1	24.2	3.7
Asia	21.9	24.5	-10.6
Other regions	3.2	4.4	-27.3
Total net sales	158.1	165.5	-4.4

Cost of Sales and Gross Profit

The following table provides a breakdown of our cost of sales for the three months ended March 31, 2020, compared to the three months ended March 31, 2019,

	Three months Ended March 31			
	2020		2019	
	<i>(in EUR m)</i>	<i>(% of net sales)</i>	<i>(in EUR m)</i>	<i>(% of net sales)</i>
Personnel expenses	33.7	21.3	34.0	20.5
Material and packing costs	26.8	17.0	33.4	20.2
Amortization and depreciation	14.0	8.9	14.0	8.5
Other cost of sales	14.8	9.4	10.6	6.4
Cost of sales	89.2	56.4	92.0	55.6

Cost of sales was €89.2 million (56.4% of revenue) for the three months ended March 31, 2020, a decrease of €-2.8 million or -3.0%, compared to €92.0 million (55.6% of revenue) for the three months ended March 31, 2019. Excluding amortization and depreciation and non-recurring items, our adjusted cost of sales decreased by -3.8% from €77.3 million or 46.7% of revenue for the three months ended March 31, 2019 to €74.4 million or 47.0% of revenue for the three months ended March 31, 2020.

Gross profit was €68.9 million for the three months ended March 31, 2020, a decrease of €-4.5 million or -6.2%, as compared to €73.4 million for the three months ended March 31, 2019.

Adjusted gross profit margin, before giving effect to depreciation and amortization and non-recurring items, was 53.0% for the three months ended March 31, 2020 compared to 53.3% for the three months ended March 31, 2019, suffering from a lower fixed cost absorption and a lower productivity due to various Covid-19 impacts.

Selling Cost

Selling costs were €23.8 million (15.1% of revenue) for the three months ended March 31, 2020, a decrease of €-1.0 million or -3.8%, as compared to €24.8 million (15.0% of revenue) for the three months ended March 31, 2019. Excluding amortization and depreciation and non-recurring items, our adjusted selling costs decreased by €-0.6 million to €11.2 million or 7.1% of revenue for the three months ended March 31, 2020, compared to €11.7 million or 7.1% of revenue for the three months ended March 31, 2019.

Research and Development Cost

Research and development costs were €5.8 million (3.7% of revenue) for the three months ended March 31, 2020, a decrease of €-0.2 million or -3.2%, as compared to €6.0 million (3.6% of revenue) for the three months ended March 31, 2019. Excluding amortization and depreciation and non-recurring items, our adjusted research and development costs remained unchanged at €5.3 million or 3.4% of revenue for the three months ended March 31, 2020 compared to €5.3 million or 3.2% of revenue for the three months ended March 31, 2019.

General Administrative Cost

General administrative costs were €6.0 million (3.8% of revenue) for the three months ended March 31, 2020, a decrease of €-0.1 million or -1.6%, as compared to €6.1 million (3.7% of revenue) for the three months ended March 31, 2019. Excluding amortization and depreciation and non-recurring items, our adjusted general administrative costs slightly increased to €4.9 million or 3.1% of revenue for the three months ended March 31, 2020 compared to €4.7 million or 2.8% of revenue for the three months ended March 31, 2019.

Other Income and Expenses

Other income was €1.8 million for the three months ended March 31, 2020, an increase of €2.6 million compared to other expense of €0.8 million for the three months ended March 31, 2019. This increase was mainly due to foreign exchange effects related to currency conversions that are accounted in our operating result. Excluding non-recurring items, our adjusted other income, net, increased to €1.3 million or 0.8% of revenue for the three months ended March 31, 2020 compared to €0.0 million or 0.0% of revenue for the three months ended March 31, 2019.

Interest Income and Other Financial Income

Interest income and other finance income was €0.4 million for the three months ended March 31, 2020, a decrease of €14.9 million as compared to €15.2 million for the three months ended March 31, 2019. This decrease was mainly due to a lack of income resulting from the fair value measurement of derivatives.

Interest Expenses and Other Finance Costs

Interest expenses and other finance costs were €49.4 million for the three months ended March 31, 2020, an increase of €23.7 million as compared to €25.7 million for the three months ended March 31, 2019. The financial expenses of €49.4 million include €27.1 million losses resulting from the fair value measurement of derivatives, €12.8 million of interest expenses from syndicated loan, revolving credit line and bond, €4.8 million of interest expenses from a shareholder loan, €3.2 million exchange rate losses, €1.1 million of expenses from the effective interest rate method and €0.4 million of other interest expenses.

Income Tax Expenses

Income tax expense were €2.7 million for the three months ended March 31, 2020, a change of €14.0 million as compared to €11.3 million income tax expenses for the three months ended March 31, 2019. This was mainly due to higher deferred tax income resulting from the valuation of derivatives.

Net Profit / Loss

As a result of the developments described above, net loss for the period was €11.1 million for the three months ended March 31, 2020, compared to a net income of €14.1 million for the three months ended March 31, 2019.

Financial Condition, Liquidity and Capital Resources

As of March 31, 2020, the gross financial debt, the cash balance as well as the Revolving Credit Facility and Ancillary Line were as follows:

	As of March 31, 2020 <i>(in EUR m)</i>
Gross financial debt (without accrued transaction costs)	1,515.6
<i>thereof bond</i>	406.0
<i>thereof term loans</i>	1,030.0
<i>thereof revolving credit facility</i>	67.0
<i>thereof ancillary line</i>	7.3
<i>thereof accrued interest</i>	5.3
Cash	78.8
Net debt	1,436.8
Undrawn Revolving Credit Facility.....	0.0
Undrawn Ancillary Line.....	0.7

The Management adjusted EBITDA for the last twelve months ended March 31, 2020 was €241.6 million leading to the net debt leverage ratio of 5.9x, compared to the management adjusted EBITDA for the last twelve months ended March 31, 2019 of €231.2 million and the net debt leverage ratio of 6.3x, respectively. The business has continually reduced the net debt leverage ratio over the past quarters.

In January 2020, a distribution of €55 million has been made from the group as a repayment on the shareholder loan. In February 2020, €18 million and further a €49 million in March 2020 were drawn from the revolving credit facility. In March, €7.3 million was drawn from the ancillary line.

Cash Flow Statement

The following table shows the cash flow statement for the three months period ended March 31, 2020 and 2019.

	Three months ended March 31, 2020	Three months ended March 31, 2019
	<i>(in € million)</i>	<i>(in € million)</i>
Net profit / (loss) for the period	-11.1	14.1
Income tax expenses / benefit (-)	-2.7	11.3
Interest result	18.7	25.0
Amortization, depreciation and impairment changes of non-current assets.....	26.8	27.0
Gain (-) / Loss on disposal of fixed assets.....	-0.1	0.0
Increase / decrease (-) in provisions (excluding deferred taxes)	1.3	1.4
Income tax refund / (payment).....	-8.1	-5.0
Other non-cash expenses / income (-), net.....	28.3	-15.1
Increase (-) / decrease in inventories	-3.5	-0.7
Increase (-) / decrease in trade receivables	-19.1	-19.5
Increase (-) / decrease in other receivables and (financial) assets.....	0.1	-0.8
Increase / decrease (-) in trade payables.....	-2.7	-6.4
Increase / decrease (-) in other (financial) liabilities.....	-1.5	7.7
Cash flow from operating activities	26.5	39.1
Cash received from disposals of property, plant and equipment	0.1	0.0
Cash paid (-) for investments in property, plant and equipment.....	-9.9	-9.5
Cash received from grants	0.0	0.0
Cash paid (-) for investments in intangible assets.....	-0.7	-0.1
Cash paid (-) for the acquisition of entities	0.0	0.0
Cash flow from investing activities	-10.5	-9.6
Cash received from / repayment (-) of syndicated loan	7.3	0.0
Interest paid (-)	-55.4	-19.4
Cash received from drawing / repayment (-) of revolver loan	67.0	0.0
Cash received from / repayment (-) of shareholder loan.....	-19.6	0.0
Cash paid for capitalized leases (right-of-use assets)	-0.7	-0.8
Cash flow from financing activities.....	-1.4	-20.2
Change in cash and cash equivalents.....	14.6	9.3
Net foreign exchange difference	-0.2	0.4
Cash and cash equivalents at the beginning of the period.....	64.4	21.1
Cash and cash equivalents at the end of the period.....	78.8	30.7

Cash flows from operating activities decreased from €39.1 million for the three months ended March 31, 2019 to €26.5 million for the three months ended March 31, 2020. The decrease is driven by a lower overall profit partly compensated by solid operative working capital management.

Cash flows used in investing activities for property, plant and equipment and intangible assets increased from €9.6 million for the three months ended March 31, 2019 to €10.5 million for the three months ended March 31, 2020 which is in line with previous year. Due to Covid-19 outbreak investing outflows are reduced or postponed.

Cash flows used in financing activities decreased from an outflow of €20.2 million for the three months ended March 31, 2019 to an outflow of €1.4 million for the three months ended March 31, 2020. This is mainly due to inflows from drawing the revolving credit facility of €18m in February and €49 million in March as well as the usage of €7.3 million ancillary line compensating a distribution of €55 million made from the group as a repayment on the shareholder loan.

Capital Expenditures

The following table provides an overview of our capital expenditures (w/o right-of-use assets) for the three months ended March 31, 2020 and 2019:

	Three months ended March 31, 2020	Three months ended March 31, 2019
Additions to intangible assets.....	0.7	0.1
Additions to property, plant and equipment.....	4.9	5.9
Capital expenditures (gross)	5.6	6.0
Government grants.....	0.0	0.0
Capital expenditures (net).....	5.6	6.0
Additions from business acquisitions.....	0.0	0.0

In general, our capital investment is split evenly between maintenance and growth projects. Cash outflow for the three months ended March 31, 2020 for intangible assets amounts to €0.7 million and for tangible assets amounts to €9.9 million.

Employees

As of March 31, 2020, the CeramTec Group employed a workforce of 3,528 people, a decrease of -3.4% compared to the previous year.

Headcount	March 31, 2020	March 31, 2019
Employees by region		
Europe (w/o Germany)	630	648
Germany	2.061	2.161
North and South America	334	350
Asia	503	492
	3.528	3.651
Employees by function		
Manufacturing	2.793	2.869
Sales	305	331
Research and development	179	194
Administration	251	257
	3.528	3.651

Recent Developments

The economic impact of Covid-19 is still difficult to assess. We currently assume that the earnings situation (EBITDA) in 2020 will be significantly negatively affected. Regarding the financial position in 2020, cash flow from operating activities is likely to be significantly below the previous year's level but should remain clearly positive.

Plochingen, 15 May 2020

CeramTec TopCo GmbH

The management

Dr. Hadi Saleh