

Strategy

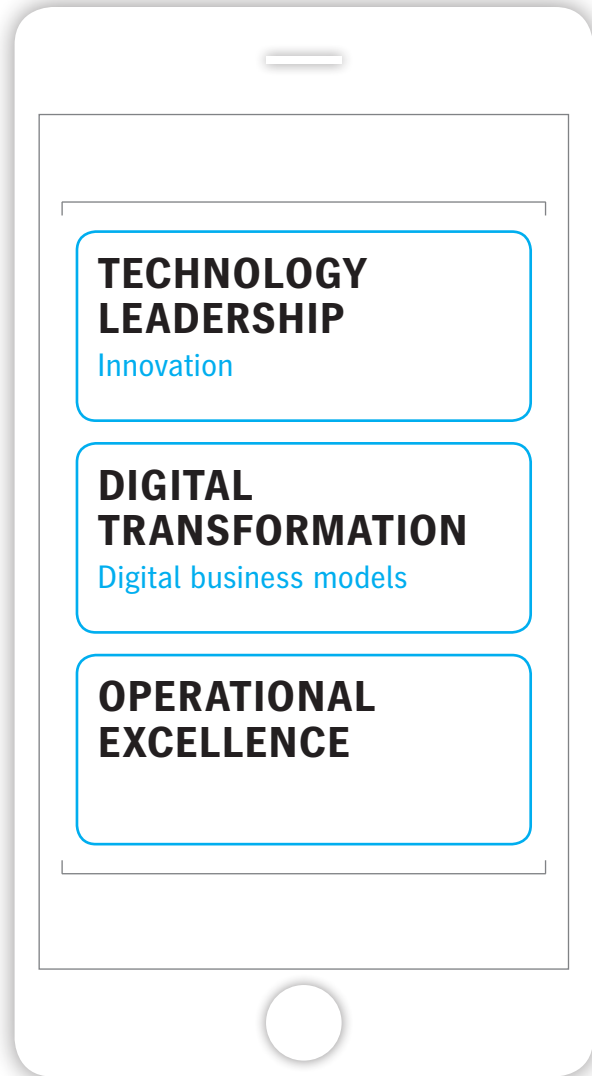
Profitable growth through systematic implementation of digital agenda

In the 2017/2018 reporting year, Heidelberg revealed and documented its path to sustainably profitable growth by publishing a digital agenda. The agenda is systematically built on the corporate strategy presented in the previous year with the slogan “Heidelberg goes digital!”. As an end-to-end system provider of printing presses, consumables, software and services, Heidelberg is actively shaping and pioneering digitization in the industry. The most important component on this path is the smart use of the data already available to Heidelberg through the digital connection and networking of customer equipment. The Company is focused on customer requirements and on generating value added in terms of efficiency, profitability and customer success. Heidelberg has encapsulated the strategic milestones in the three core areas of technology leadership, digital transformation and operational excellence, and it defined clear medium term goals for growth and profitability in the year under review.

Growth potential on our markets

Heidelberg has developed value-based business models for the areas of sheetfed offset equipment, digital printing, service and consumables (see also “Markets and customers”, pages 12 to 15) in order to efficiently tap growth potential. With a market share of more than 40 percent and a potential market volume of around € 2.4 billion, we are already the undisputed market leader in sheetfed offset printing. By contrast, Heidelberg’s share in digital printing – which has a market volume of around € 2.5 billion – is still less than 5 percent. Our market share in consumables (market volume of around € 8 billion per year) is only slightly higher at approximately 5 percent. Heidelberg anticipates major potential for expansion in both areas. This will be leveraged firstly by our positioning as the technology leader and secondly by offering new digital business models as a holistic solution in the life cycle of a printing press. With the acquisition of Fujifilm’s coatings and press-

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room chemicals business for the EMEA region and of the software provider docufy, Heidelberg has already strengthened its position in key growth areas in the 2017/2018 financial year. The new framework for the syndicated credit facility that was agreed with a banking consortium in March 2018 will also allow the Company to shore up its intended growth with further strategic acquisitions moving ahead.

Growth through expansion of technology leadership

By expanding its technology leadership, Heidelberg anticipates additional sales potential of around € 200 million by 2022. To achieve this, we are developing, producing and marketing new technologies, new products and new business models. Around 5 percent of consolidated sales is channeled into research and development to expand our innovation leadership. With automation functions such as push-to-stop and the networking of printing presses, software, consumables and services to create a smart print shop, Heidelberg is a pioneer and digitization driver in off-set printing. The networked presses serve as information providers (big data), which form the basis for digital business and therefore growth opportunities. The expansion of the software range is therefore one of the central pillars of our growth and digitization strategy. With our comprehensive Prinect production workflow, our management information systems for central operations management and the Heidelberg Assistant, which enables digital cooperation with the customer throughout the entire life cycle and assists in productivity enhancement with big data performance analysis, Heidelberg already has a digitization solution that redefines the foundations of the customer-supplier relationship. Heidelberg will further develop its software solutions towards creating a cloud-based subscription model.

We are the clear number one in industrial digital printing, and we will continue to expand this position. The series launch of the first Primefire 106 industrial digital packaging printing press took place as scheduled in early 2018. Demand is huge, and current production capacity is already fully booked for two years. For digitally printed packaging and labels as well, demand remains at a high level. We are forecasting annual growth of 4 percent in the global printing volume for self-adhesive labels, with only 6 percent printed digitally to date. As this share is growing at double-digit rates, we are excellently positioned with Gallus digital label printing presses ("Labelfire").

Digital transformation – participating in customer performance enhancement with subscription models

The digital transformation is also focused on achieving the greatest possible efficiency and productivity by means of intelligent systems and autonomous processes, because we asked ourselves: "What are our customers really looking for? 'Just' a printing press to print premium products, or an entire powerful and reliable system that helps them concentrate on their own customers – such as brand manufacturers – to give their products a unique identity with its label?" The foundation for this is once again Heidelberg's smart print shop, i. e. Heidelberg's unique strategic positioning as an end-to-end system across the customer's entire value chain and utilization phase. Heidelberg is the only provider in the industry that can offer its customers a full range of printing presses, services, consumables, consulting and software in an all-in contract. The customer's value added comes from the data-based, optimal interaction of all coordinated individual components, as this leads to a substantial enhancement in overall system effectiveness. Put simply, we deliver results and not individual products. Under digital business models, the objective for our sales and marketing work is therefore not individual deals, but rather the long-term success of our customers – because this benefits both us and our customers.

Accordingly, unlike under transactional business models, under a subscription contract the customer no longer pays for the individual components, but rather for the use of the performance product, as measured by the number of printed sheets. This is a logical consequence when products are offered as services. The first customer signed up for such a pay-per-use model at the end of 2017; five printing presses were already under contract by the end of March 2018. The new business format guarantees constant revenue streams over a long period, independently of volatile new machinery business and instead with a direct link to rising global print production volumes. Under this model, the greatest growth potential for Heidelberg mainly arises from additional sales of consumables, on which print shops spend around € 8 billion per year. Over a five-year contract, the potential project sales can be increased by up to 70 percent compared to a one-time transaction. Thus, improved

purchasing benefits and rising economies of scale can also lead to higher margins. The goal is to have at least 30 contracts by the end of 2019 and then, after a soft ramp-up, as many as 100 contracts the following year.

But we also want to create value added for customers that do not take part in the subscription model. Using data from printing presses we can build an automated e-shop, which means networking our smart product to create a “product system” and at the same time switching from purely product sales to a service business. The printing press therefore automatically reorders depleted consumables and automates its own resupply. With this new revenue model, we intend to create a digital platform for the printing industry because we know exactly what our customers need and can deliver everything via our platform. Naturally, being able to always know how a product is being used also shifts the focus of the customer relationship, because rather than a sale – usually a one-time transaction – the crucial factor is maximizing value for the customer over a longer period. This likewise gives rise to new requirements and opportunities for sales and marketing. Heidelberg has therefore launched the Heidelberg Digital Unit, a new center of competence for digital marketing and e-commerce, which should, among other things, virtually triple e-commerce sales to around € 300 million over the next few years. This will also be helped by our new digital customer interface, into which the Heidelberg e-shop has been integrated. To this end, the series launch of the “Heidelberg Assistant” took place in December, initially in Germany, the US, Canada and Switzerland. This enables us to serve customers digitally throughout the entire life cycle of their products. In total, Heidelberg expects these measures to generate an additional sales volume of at least € 250 million by 2022.

Sales potential from new high-tech industrial applications

Another key component of the digital transformation is the smart use of technologies that already exist within the Group for new business areas and product offerings. In this way, we intend to achieve additional sales of around € 50 million per year by 2022 – by offering new digital platforms that will establish IT solutions for design, production and services for all aspects of high-tech applications for industrial customers. In the Heidelberg Industry area, for instance, we have extensive expertise in control and power electronics for industrial and e-mobility applications, for example as a supplier of high-performance Wallboxes and smart charging cables for electric vehicles or as an entry-level product for consumers. Together with the Berlin tech start-up Big Rep, we have also developed an innovative large-format 3D printing solution that has been in series production since October 2017.

Operational excellence at all levels to increase productivity

However, Heidelberg’s strategic development does not end with the generation of additional sales potential; it is also concentrating on leveraging efficiency and cost-cutting potential of € 50 million in total by no later than 2022. This comprises improvements in our logistics, the site and space consolidation and the standardization of printing press platforms. In order to adapt our corporate culture, and thus our management culture, to the challenges of modern, globalized and digital business, after determining our new strategic alignment, the Company’s management structure was converted into a leaner, more efficient and more agile organization. The new management organization began at the start of the new financial year on April 1, 2018.

New organizational structure

The new organization is more customer-centric, which means it is intended to create value added for customers. It was designed according to holistic solutions for customers, rather than individual products. Our smart products require continuous coordination across segment boundaries, as the customer journey extends from product development to cloud operation and the improvement of services to after-sales customer contact. Administrative functions in the sales and marketing units have been centralized and globally aligned, at the same time reducing the number of levels. Moving ahead, the different customer segments will be addressed with their own strategies and offers, and with one central face to the customer for all Heidelberg products and services. The businesses bundled in the previous segments Heidelberg Digital Technology (HDT) and Digital Business & Services (HDB) are being restructured into the Heidelberg Digital Technology and Heidelberg Lifecycle Solutions segments. The Heidelberg Financial Services segment will continue to exist unchanged.

Heidelberg Digital Technology:

Global product portfolio and supply chain management

The Heidelberg Digital Technology segment now comprises sheetfed offset business, label printing, print processing and digital printing. In addition to the responsibility this entails for the global product portfolio, including the strategic product roadmap, the core functions for the entire value process – i. e. research and development, procurement and production – are still located within this segment and given global mandates in their respective areas of responsibility.

Heidelberg Lifecycle Solutions:

Value added over the entire life cycle

The Heidelberg Lifecycle Solutions segment bundles life cycle business (Service, Consumables), Software Solutions and Heidelberg Platforms (offerings outside the print media industry). We create value added for customers here by addressing our customers' entire value chain with bespoke solutions and new business models.

The restructuring of the segments will affect both the organization and reporting of key performance indicators from April 1, 2018.

Focus still on medium-term targets

In line with planning, the incipient series start-up of digital products and the establishment of the installed printing press base for the subscription model will at first deliver only small contributions to sales and earnings, before rising to tangible and significant increases in the medium term. Overall, we expect these strategic pillars to generate additional sales potential of at least € 500 million by 2022. As a result, operating EBITDA is set to increase by approximately € 100 million. We therefore defined new medium-term targets for the next five years in 2017. Consolidated sales are to improve to around € 3 billion with EBITDA rising to between € 250 million and € 300 million. With our financial result continuing to improve at the same time, we are aiming to pass the threshold of € 100 million in post-tax earnings by 2022.