C: Dr. Rolf Breidenbach; HELLA GmbH & Co. KGaA; CEO and President
C: Bernard Schäferbarthold; HELLA GmbH & Co. KGaA; CFO
P: Akshat Kacker; JP Morgan; Analyst
P: Christian Ludwig; Bankhaus Lampe; Analyst
P: Kai Müller; BofAML; Analyst
P: Christoph Laskawi; Deutsche Bank; Analyst
P: Raghav Gupta-Chaudhary; Citigroup; Analyst
P: Sascha Gommel; Credit Suisse; Analyst
P: Operator

COMPANY EDITED TRANSCRIPT

OPERATOR: This is Conference #: 2638334.

Operator: Ladies and gentlemen, thank you for standing by, and welcome today's Hella Investor Update, with Dr. Rolf Breidenbach, CEO; and Bernard Schäferbarthold, CFO. At this time, all participants are in a listen-only mode.

There will be a presentation followed by a question and answer session, at which time if you wish to ask a question, you will need to press "star" and "1" on your telephone keypad.

I also must advise you that this conference is being recorded today, Thursday, the 25th of July 2019. And I would now like to hand the webcast over to your presenter today, Dr. Rolf Breidenbach, CEO. Thank you. Please go ahead, sir.

Rolf Breidenbach: Yes. Thank you very much. Yes. Good morning to all of you. Thank you for dialing in. This is Rolf Breidenbach speaking. I would like to welcome all of you to our today's investor update. Also on behalf of my colleagues and our CFO; Mr. Schäferbarthold.

There are 3 main reasons for this extraordinary call. First, we want to present our preliminary financial results for the fiscal year 2018/2019. Second, we want to give you further background information on our dividend proposal for the fiscal year 2018/2019. And third, of course, we want to explain the company's outlook for the current fiscal year 2019/2020 in more detail.

And before we come to these 3 items, allow me to make some general remarks. In the last fiscal year, the market environment was very challenging for the entire automotive industry. We saw a significant decline in production volume on the one hand. And on the other hand, we saw an accelerating industry transformation resulting in even higher R&D investments and increasing costs for labor and materials.

Under the given circumstances, we HELLA, from my perspective, can be quite satisfied with our development in the last fiscal year. We were able to largely compensate the mentioned challenges. Thus, we were able to fulfill all our commitments and targets for the fiscal year 2018/2019. And we were again able to outperform the automotive market.

However, and we discussed this since at our last investor call, particularly since the end of 2018, we are confronted with a negative market momentum, which we cannot fully withdraw from. Basically, from week-to-week, the global lighting vehicle production is going further down. The Chinese market is still very weak. Also in other key markets, the situation is quite challenging. Customers postpone ramp-ups. Life cycles of car models are shortened. Many car manufacturers and suppliers announced profit warnings.

In other words, there is an ongoing negative trend, and we do not see any significant recovery in short term. Thus, for the current fiscal year 2019/2020, we expect even stronger headwinds from the market. Particularly in June-July 2019, the market volume expectations have fallen significantly. So the originally expected recovery from the second half of 2019, will from our perspective not come. This negative trend is also reflected in our figures.

Our growth slowed down from quarter-to-quarter. In our last quarter, Q4, of the fiscal year 2018/2019, we only saw a growth rate of around 2.5 percent. This is the main reason why we are more cautious with respect to our outlook of the fiscal year 2019/2020.

Due to the continuous negative market trend and no recovery in 2019, we expect that the first half of our current fiscal year will be weak. For the first quarter, we expect even negative growth. However, in this context, I have to mention that our last Q1 of the fiscal year 2018/2019 was a strong quarter due to the certain pull forward effects related to the introduction of WLTP.

For the second quarter of the current fiscal year, we expect a certain stabilization on low levels. To predict the development in the second half of this fiscal year 2019/2020 is, as of today, quite challenging due to a lot of uncertainties. In total, we might be a little bit better. However, as of today, we do not expect any recovery for the second half of the current fiscal year. All these market insights and assumptions are, of course, reflected in our guidance for the fiscal year 2019/2020.

However, most important, we do not see any structural issues for our company. We rather confirm what we already said in our last call. The market is weak, therefore our growth will be lower, but we have all prerequisites to further outperform the market. We have a strong order book. We have the right strategy along the major automotive market trends like electrification and autonomous driving. And we will further invest in new technologies. Thus, despite reduced sales expectation and higher materials as well as personnel costs, we intend to continue our fundamental approach to strengthen investments in research and development.

Against this background, we assume, in total, a lower profitability level in the current fiscal year 2019/2020. However, we have our cost under control. We have a very effective cost control program already in place since 2018. Each cost position is thoroughly checked whether it is really necessary. In addition, we are also continuously working on further structural improvement – cost improvement measures.

For example, further automation or implementation of a fully-fledged shared service organization. The results of these cost improvements and programs are also reflected in the figures of the last fiscal year 2018/2019, where, as I said, we could achieve all our targets and fulfill all our promises.

That said, let me now move to Page 3 of our presentation starting with our preliminary financial results. Our currency and portfolio-adjusted sales increased by 5 percent. Our adjusted EBIT improved by 5.9 percent to EUR 585 million. Thus, our adjusted EBIT margin is at a level of 8.4 percent, which is approximately at the level of the previous year.

These numbers confirm also what we have seen in our Q4, which we expected to be challenging. We have not seen any recovery in the automotive industry, especially in Europe. And as I said, China has been difficult. Therefore, our growth rate in Q4 further slowed down. And as mentioned before, we expect that this lower growth dynamic will spill over to the current fiscal year 2019/2020.

Now coming to the dividend proposal for the fiscal year 2018/2019. The management of HELLA proposed to the Annual General Meeting on September 27, 2019, the payment of a special dividend of EUR 2.30 per share in addition to the dividends of EUR 1.05 per share. Thus, the total dividend for the fiscal year 2018/2019 would be EUR 3.35 per share.

The proposed special dividend is based on a strong balance sheet development in the past year and the disposal of our wholesale business. The dividend amount accounts approximately to the accounting profit of around EUR 255 million that HELLA realized by the selling of the wholesale business or rather around 2/3 of the cash proceeds for this transaction. The proposal also ensures an unchanged strong financial basis to the further invest in future technologies and profitable growth. Mr. Schäferbarthold will give you further details on the dividend proposal later.

Looking forward to the guidance for the fiscal year 2019/2020. Now as already mentioned, the situation is very challenging this year. We do not see any signs of recovery, especially in the first half of our fiscal year. The first half of our fiscal year also is expected to be very challenging due to the high a comparable basis in the previous period after the WLTP introduction.

In addition, at this point in time, we do not expect any recovery of the market in the second half of the fiscal year 2019/2020. At the same time, cost for materials and personnel rose to higher levels. With the lower top line growth, we will not be able to balance all these effects to 100 percent, especially against this background that we will continue to invest in R&D. Due to these headwinds, we are currently expecting for the current fiscal year 2019/2020 the following:

The currency and portfolio-adjusted group sales is expected in the range from EUO 6.5 billion to EUR 7.0 billion and the adjusted EBIT margin, excluding restructuring and portfolio effects, is expected in the range from 6.5 percent to 7.5 percent. Having said this, let me now hand over to Mr. Schäferbarthold, who will provide you with more details.

Bernard Schäferbarthold:

Thank you, Mr. Breidenbach. Good morning also from my side, I will continue in our presentation on Page 4. More details and final numbers will be presented as planned on the 9th of August. So overall, as Dr. Breidenbach was stating, on the basis of the preliminary numbers, we are pleased to be able to confirm overall the guidance given on our fiscal year 2018/2019.

Market as said was weak. Also, as commented in our last call, we have seen no stabilization in the market related to IHS numbers. In our Q4 the market was down 6.2 percent, respectively, 6.6 percent in the second half. We have again seen in our Q4 a reduction of our growth dynamics compared to the earlier quarters.

On a positive note, our outperformance remained on a high level. More details to that will be also presented on the 9th of August. Overall, the 5 percent growth in 2018/2019 was at the lower end what we expected internally when we entered into the fourth quarter, reflecting the high market volatilities we have seen. Profitability was in line with our expectations and the comments, we already have given to you in our last calls. We have seen higher material and personnel expenses compared to the last quarters in our Q4, which impacted partially, especially our gross margin.

On the other hand side, as mentioned, the cost-saving measures could partially compensate these additional burdens. Positively, we closed the sale of our property in Australia and realized by that a gain of EUR 12 million as planned, which is reflected in our numbers. All in all, on preliminary numbers, adjusted EBIT is at EUR 585 million, respectively 8 percent EBIT margin, which is slightly better compared to last fiscal year.

On Page 5, some more comments to our dividend proposal. The shareholders committee and the management board decided yesterday that the proposal to the AGM would be a dividend payout of EUR 3.35 per share. On one hand side, we maintain our continuous dividend policy on the regular dividend, which is a very important element for us. The proposal is EUR 1.05 per share, which is on a similar level compared to prior year.

On the other hand, we proposed a special dividend of EUR 2.30 per share, reflecting the strong balance sheet improvements we have seen in the last years, but also the successful sale of our wholesale business in the fiscal year 2018/2019. Overall, the special dividend reflects roughly the book gain of the wholesale transaction or 2/3 of the cash proceeds of that transaction we realized.

On Page 6, we have illustrated some relevant key parameters of our balance sheet to show what we mean by a strong balance sheet. The financial basis remains very strong and do not hinder us to invest in future technologies and growth as presented in our last CMD, considering even the proposed dividend payment.

Our leverage ratio remains even after this payout of the dividend at a very low level, so that our fire power and the strong balance sheet remains absolutely intact. Actually, end of May, we are even at net cash positive number, which we will show in detail to you also on the 9th of August.

Coming to Page 7 and our expectation on this fiscal year 2019/2020. As said, we are still seeing a downward trend in the market. Especially in the last weeks, the expected volumes in H2 2019 have significantly being reduced. This leads to our market estimates that we are not building on a market recovery overall in our fiscal year 2019/2020 completely.

That means that we assume most likely further market volume reductions for this fiscal year, and especially on H2 2019/2020. Where at this point in time, IHS based on July numbers, is expecting nearly a flattish market. This, absolutely, we see at risk.

Taking this most likely continuous market decline under consideration, we expect sales, portfolio-adjusted and FX-adjusted in the range of EUR 6.5 billion to EUR 7 billion. It is important to mention as Dr. Breidenbach already said that we still see and anticipate outperforming the market, and we do not see any structural topic on our order book.

We expect, based on lower growth dynamics, higher material and personnel expenses and continuous investments in R&D, that overall adjusted EBIT margin will be in the range of 6.5 percent to 7.5 percent overall.

Last comment to our free cash flow ambition. We stick to our target of a further reduction of working capital, which we will show also on the 9th of August, the improvements we have already realized now, especially also in the last year. And we further plan to be able to reduce working capital. This should support in combination with strict cost controls, CapEx control, a solid free cash flow generation also this year. This remains for us a continuous key topic.

Having said that, we are happy now to take your questions.

Operator: Thank you, sir. Ladies and gentlemen, we will now begin the question-and-answer session. As a reminder, if you wish to ask a question, please press “star” and “1” on your telephone keypad and wait for your name to be taken by an operator. If you wish to cancel your request, you may press the “hash” key. Once again, “star” and “1” if you wish to ask a question.

And we have a question that came through. Sir, please stand by while we take the name. Thank you. Once again, for those who want to ask a question, please press “star” and “1” on your telephone keypad. “Star,” and “1” if you wish to ask a question. And we have questions that came through, sir. Please stand by while we take the names. Thank you.

Thank you for waiting, sir. We now have our first question, and this comes from the line of Raghav Gupta.

Raghav Gupta: If I can just focus on the FY '20 guidance, please. Your outperformance could have been double-digit now for some quarters. And the implication of your guidance is that it's essentially going to evaporate. And at the same time, you talk about a strong order book. Can you just help us reconcile this, please? Let me just kind of give you the three.

Secondly, on margins. You cite raw materials and labor inflation as a headwind. Can you just remind us please of what your exposures are? And in terms of raw materials, we have had some of your peers, kind of talking about raw material and kind of easing pricing, easing. So that would be helpful.

And then finally, on free cash flow. Can you just quantify your expectations for free cash flow in the coming year? I hear what you say about kind of expecting working capital, CapEx discipline to perhaps help in the coming year, but do you expect that to offset the earnings decline that you're suggesting in your kind of revised guidance or new guidance.

Rolf Breidenbach: Yes, starting with regards to our market outperformance. Of course, we still are more than confident to outperform the market. But due to the weak market, of course, we also have to reduce our growth expectations. And so we expect a very weak market for our fiscal year 2019/2020. This means a shrinking market of around 6 percent.

So minus 6 percent market growth, and this is true for the first half of our fiscal year and also for the second half of our fiscal year. We know that this is not in line with the IHS figures. But we do not see any sign that the market will now again develop positively. Also, IHS is expecting a negative market for the second half of the calendar year 2019. So, I think with our expectations, we are, of course, conservative but quite solid. So, to answer your first question, we will continue – from our perspective, we will continue to outperform the market, but of course the general market development also has significantly influenced our growth potential and profitability.

Raghav Gupta: Can I just quickly follow up on that, please? If you're assuming negative 6 percent growth for the market, roughly kind of at the midpoint of your sales guidance, I guess that implies 600 basis points of outperformance. If the market is better than that, is it fair to say that you'll stick to the 600 basis points of outperformance? And can you guide on out performance. I guess I just need help on that.

Rolf Breidenbach: Yes, we do not – I do not say that, let's say, the 6 percent of market outperformance. Let's see whether we can get this, but of course, your calculation is right. When the market is going down by 6 percent, and we reached, let's say, the midpoint of our guidance, then this is outperformance.

So when the market is developing better, it's very difficult to say whether we can then also show this outperformance on such a quantitative level. Because outperformance on the one hand, of course, is significantly influenced by the general market development. On the other hand, it also depends significantly on our customers' portfolio, on the one hand, on the specific car lines we are in, and the care line which are most important for us with regard to our content. So, as I said, when the market is developing better, the outperformance will be there. Will this outperformance be at 6 percent? I don't know.

With regards to your second. I think with regard to the second question, this was our exposure to raw material costs. It's difficult to calculate that, of course, the burden is there. Currently, the prices are also fluctuating a bit. We are currently in negotiation for a significant part of our resin materials and other raw materials. So, to quantify that at this point of time is quite difficult. But of course, the burden will be there.

With regard to the cash flow and cash conversion topic, allow me to say that, so far, the figures are not fixed, and we will explain them in detail in our next investor call. I think that's the 9th of August. Then you will get all the details.

But as Mr. Schäferbarthold said, we are quite satisfied with this cash development in the last fiscal year, and it's our key expectation to continue this also in the current fiscal year. But details will come at the 9th of August.

Operator: And we will now take our next question and this comes from the line of Akshat Kacker.

Akshat Kacker: Akshat Kacker from JP Morgan. The first question again, getting deeper into your end market assumptions. When you say minus 6 percent for the first and second half, can you broadly talk about what you're seeing across Europe and China? Because over the last 2 weeks, we've already held some positive commentary from a few suppliers into the first half of next year.

That's the first question on end markets. And secondly, for HELLA specifically, when you're looking at your order book for next year. Do you see additional ramp-ups, projects coming online as you move through the year? Or basically, how is the order book developing through FY '20?

Rolf Breidenbach: Yes. In the first half, but also in the second half of this calendar year, a lot of new launches are taking place in both automotive areas, electronics and also lighting. So here, of course, we never know whether this ramp-up is postponed. What is the take rate of our products? But there are a lot of ramp-ups. So we are optimistic to implement them and we are therefore also quite optimistic to develop better than the market.

With regards to the market expectations, we do not see these positive signs also for the first half of the next calendar year 2020. We see no positive signs today. And also when we talk to our customers, when we talk to government people, in different regions, to industry experts, in general, there is still a negative mood from our perspective in the industry.

And also, we see a lot of uncertainty with regards to the mood of the end consumers in all the regions. And therefore, we are not optimistic with regards to the first half of the next calendar year 2020. And the same, of course, is then true for the second half of our financial year.

Akshat Kacker: If I can just sneak in one more question. Looking at your dividend payment, you kept the regular dividend flat. Can you give us an update on your M&A strategy and how you're thinking of using the balance sheet in the next year?

Rolf Breidenbach: Yes. I think your question already implied that there will be no change with regard to our M&A strategy. We do not see a weakening of our balance sheet. We still have a good acquisition, financial power. And therefore, we are in intensive discussions with some companies in the SOE area.

And the same is true with regards to our searching and discussing activities in the area of electronics companies, sensors and actuators, software companies. But yes, so far, the business cases were not so attractive.

We see a decline in prices, which has started in the, let's say, second quarter of this calendar year. So, I'm more optimistic that we can do the one or the other deal, but of course, this is not guaranteed. But our general M&A strategy hasn't changed.

Operator: And we'll now take our next question and this comes from the line of Christoph Laskawi.

Christoph Laskawi: The first one would also be on the outperformance and market assumptions for next year. If I understood it correctly, and as I said before, you are now looking for production down fix for your fiscal year and at the midpoint of the guidance is 600 basis outperformance.

Considering that you had a quite strong outperformance this fiscal year that just ended, 600 basis points looks a bit high to me. So my question would be, what would be the key drivers behind that? Just new launches or do you think you can really deliver above, let's say, the long-term average that you've seen?

Second question will be, you highlighted that you don't have any structural issues in the business. So what would it need to get back to 8 percent margin? And do you think it's a thing that you could do in one to 2 years? Or will it be a longer period? Is it just volumes needed to come back or more than that? And yes, these will be my 2.

Rolf Breidenbach: Starting with the second one. I think we need a at least reasonable developing market, a slight growing market to achieve this 8 percent profitability. So we continue to significantly invest into R&D. We also spent a lot of money into our infrastructure like plants, IT systems and so on. And to do this and reach a profit margin of 8 percent at the same time, we need at least a slow-growing automotive market is my assumption and my thinking.

Christoph Laskawi: And then you could snap back quite quickly? Or will it take several quarters to work up there again?

Rolf Breidenbach: When the volumes are there also, the margin will be very quickly there. Because we can generate additional gross margin and this additional gross margin, we'll put us into the position to increase our growth. Will it be 8 percent from one quarter to the other. I don't know, but we are quite optimistic when the volumes are coming back, then the margin can also be improved. But we do not expect it.

With regard to the market. Can you repeat your first question with regard to the market development?

Christoph Laskawi: Yes, sure. I was just wondering. To me, at the midpoint, when you really assume production being down 6 percent, and at this point, you are outperforming the market by 600 basis points. Considering that you had a very strong outperformance with the fiscal year that just ended, I would have expected you to point to a lower outperformance to be honest. So I was wondering what is driving this up to 600 basis outperformance? Is this new ramp-ups? Or is there might be lower – also lower (basis) than the long-term average.

Rolf Breidenbach: For us, it's very difficult to have this market outperformance 100 percent transparent, because it's a mixture, of course, new launches and also products which come to an end of production. And it's a mixture of different customer performance and different car line performances.

Therefore, our current estimation at least around 6 percent, but of course, there is no guarantee there could be an upside, but there also could be a downside. Because in the past, the outperformance and the success of different customers and different product lines for us were in a way forecastable. But this has changed. So the market is so volatile, the success of different car lines, the success of different brands in different regions is changing so fast.

So for us, it's very, as I said, very difficult to calculate this in an exact way. We only can make assumptions, assessments. And based on that, we came out with this 6 percent. But again, due to the fact that we also will launch a lot of new products in the months to come, we see a good chance to, again, outperform the market on the level we discussed.

Christoph Laskawi: And if I may sneak in one last one on the working capital. Which you've mentioned improved over the last years. And I was wondering, given the very high volatility currently, where do you see room for improvement on the working capital? I think inventory is quite tough to manage. Will it be rather on the payable side or on the receivable side? If you can ....

Bernard Schäferbarthold: Most will be on the payable side, but still I would also see on the inventory side that there's still room for improvement even in these times. We have reached basically the targets end of the year.

So if we look at the 3 percent we are targeting, 2 percent roughly we have now reached, and we see that we have especially on the payables side, successfully negotiated a lot of payment term extensions, which will now kick in, in the next months to come.

So there is already a lot, I would say, negotiated and then realized, which will come, certainly. You are right that on the receivables side and inventory side in these volatile markets, especially also looking at China, it gets more difficult to further come down. But I think the measures are defined. We are working on them. We see the potential to get to this additional 1 percent reduction this year.

Operator: And we'll now take our next question, and this comes from the line of Sascha Gommel.

Sascha Gommel: The first one would again be on your market guidance. It sounds quite negative, minus 6 percent. And when we listen to what OEMs are saying, most of them basically assume that the market is at least bottoming out. So I was wondering if you have a particular region or particular clients that are very negative. So any color on that would be quite helpful.

Then related to the growth. Yes, you probably have a few products like DC/DC convertors, radars, electronic power steering that should be growing quite strongly going forward. So I was wondering if you could also highlight some products where you see kind of below average growth rates in the coming quarters? Then my next question would be on your margin guidance, which looks shockingly low, I have to say.

Is that only driven by the low top line and the implied cost inflation? Or do you also see some deterioration from, for example, product mix going forward? And then very lastly, the fact that you pay out EUR 255 million to shareholders, does that imply M&A targets should be considered much smaller? And you find anything price-wise, as you mentioned, you want to become conscious about that? It would be helpful if you could shed some color on that?

Rolf Breidenbach: Yes, starting with the first question on market guidance. When you look at the comments on the market development and then the real market development, here and there you could see some differences in the past. And as I said, we talked to many customers, to other industry experts, and there's not a specific customer or market, which from our perspective gave this very, let's say, cautious feedback. It's worldwide. And also coming from a lot of customers.

Therefore, yes, it's not positive. It's our market expectation. But it's based on the market feedback on the one hand and the experience we have made in the last months and on the other hand. With regard to the different products. Yes, of course, the energy management products like DC/DC are now growing.

Battery management system is another area, but also our radar components currently are running very well, because the take rates are quite high. But also lighting products like the LED headlamps, we also see growth and is not a specific, let's say, product which is performing above an average. It's more underperformance of car lines in specific regions and customers. Which also, of course, can be seen in the current market figures.

Bernard Schäferbarthold: To your aspect of the margin. In general, you are right. So lower volumes, and especially has an impact, especially on the gross margin. If you look at the possibility of flexibilization has certain limits. And on top, cost inflation is there.

We made the comment, Dr. Breidenbach had stated that we see some easing. And as we are in the process of renegotiating. This happens, still I would see especially on the electronic component side that compared to previous year's levels, so in average, still we see an increase. But we are coming back from the absolute high levels we have partially seen the beginning of 2019 or end of 2019 in the market. But in comparison, really, to our numbers last year, it is still an increase. So for sure, we are, as mentioned, working on the structural cost measures to compensate it as much as possible.

And then depending on volumes, our bandwidth is quite high, EUR 6.5 billion to EUR 7 billion. Basically reflects also the high uncertainty, we actually see in the market. But as of today, as said, we can only build on what we see. And as of today, we see more risks than chances on the market upside. On your comment towards M&A.

We have actually EUR 1.4 billion of cash. Considering the payout and the positive free cash flow even in that year that we will generate, we will be further above the EUR 1 billion of cash and a leverage of 0.2.

So I would say the situation is unchanged, that we have all possibilities to do any move which we feel is contributing to our overall strategy. So there is no change from that perspective.

Sascha Gommel: Understood. A quick follow-up, so with regard to the cost question. And if my understanding is right, that this is really more a top line issue. And there's no underlying product/mix change, that is also impacting the margin regulation.

Rolf Breidenbach: Yes, that is right.

Operator: We have 2 more questions, sir. And we'll take our next question. This comes from the line of Christian Ludwig.

Christian Ludwig: This is Christian Ludwig from Bankhaus Lampe. Two quick ones from my side. First of all, on the margin guidance. Do you assume, right, that basically, the margin guidance range of 6.5 percent to 7.5 percent is linked to your sales guidance or at the lower end of the sales guidance, which would expect the lower end of the margin? That will be question number one.

And question number two. Could you give us a kind of an understand or breakdown at the low end of your guidance below the 2 percentage points below last year's adjusted EBIT guidance. Where are you losing these percentage points in your P&L? And is R&D going up that much because you are just not cutting it?

And the rest of gross margin, how should I kind of put that together? And the final question would be on the longer-term outlook. You mentioned, I think, at the last Capital Markets Day, that you believe that your electronics division will surpass the lighting division, revenue-wise by potentially as early as next fiscal year. Is that still the case? Or has something changed there?

Rolf Breidenbach: Thank you for your questions. I think the first question and the last question, I can answer very quickly. Because you are right with your assumptions. And so yes, electronics step by step will grow faster than lighting and will become the biggest area.

And with regards to the guidance, yes, both the high area of our guidance and the lower level, of course, are linked together and when the volumes will come, we will also, from our perspective, reach the higher level of our profitability.

And this also perhaps answers your second question. The reduction in profitability is significantly and mostly influenced by the reduction of top line. And this has to do with the let's say, limited possibility to flexibilize all the costs above the gross margin like depreciation. And of course, we try to flexibilize as much as possible, but there are some limitations.

And therefore, we will lose gross margin. With regard to R&D investment, it will stay at high level you know, but there is no significant increased planned above this level and all the other cost positions are so far under control. And we expect to have them under control also in the months to come in the whole fiscal year. So it's – from our perspective, a pure volume question.

Christian Ludwig: Is it fair to say that your gross margin will stay stable?

Rolf Breidenbach: No, no, no, exactly. This is the one which will not go stable because of the possibility to flexibilize, when the volume is going down, is limited. Therefore the gross margin will get worse.

Operator: And we'll now take our last question, and this comes from the line of Kai Mueller.

Kai Mueller: Just to come back again on your margin. Obviously you did an 8.4 percent last year, which was a very strong print in light of the environment we've been seeing. In terms of the step-down into next year. Can you outline a little bit how much cost you took out last year because you were very quick to respond as the market turned? And maybe is that one of the reasons why you see the step-down now a year later, because those costs have been taken out, and you can't cut further? That's the first one.

Bernhard Schäferbarthold: Certainly, we started the cost control measures already very early in the last fiscal year. So a lot of what we would call quick wins are already realized. But still, as mentioned, we see now also the possibility, or this also has already started some months ago, even further with a structural change which, at the end, should lower the cost base more, I would say, mid-term. So as we said with the automation topics in some of our plants, especially now in lighting Where for example in electronics, we are further in automation than in lighting. This – we are consequently working on, and we will be able to be that by far more flexible also and more effective also going forward. Or the examples Dr. Breidenbach did also on shared service.

Still we are working in too many different shared services globally. This now we are concentrating and consolidating in a smaller and more effective structure, which also should support us going forward. But it's certainly somehow right that some of the quick savings are now realized.

And now, I would say that the efforts are more important now to take to really realize it, but if we do that, I think then we have also, by far a better set up also going forward midterm.

Kai Mueller: Perfect. And then when you mentioned raw materials as one of the headwinds, and remember, R&D, labor and raw materials. You mentioned something about resins. What exactly is that? Because we've heard, actually, from some of your peers, almost the opposite that raw mats are turning into more a tailwind in the second half of this calendar year.

Rolf Breidenbach: The comment was made, – and I tried also to say this that we are seeing quite, I would say, a volatile development over the last 12 months. So we had seen especially 1-year ago year basically, a significant increase. And now prices are coming down.

So there, we see some kind of easing, which I would say could support us, and this, we are now trying to realize also. On the other hand side, and this I mentioned, by the electronic components, we were able to push price increases. And this now is something where also prices are somehow coming down, but the comparable prices are still by far higher and mentioning that the electronic content is also increasing overall in our products also in lighting products. This is certainly something which has an impact, but also there, I would say, we see also due to market situations that also here the market is somehow – or negotiations are possible again, so that our negotiation power increases somehow. And this now we are trying to realize. But too early now to say how much we are able to realize. All our troops basically now are working on this.

Kai Mueller: Which actually brings me to my last point on that. Are you able to – price increases you've been facing, are you able to pass them on to the end customer? Or have you seen now actually as the raw materials have come down, that the customer wants to get some of that benefit?

So you don't actually benefit from the weaker raw mats. And can you make a comment if the – obviously, as you outlined, if you see the market down 6 percent, how is the pricing environment developing with your customers and also versus your peers?

Rolf Breidenbach: It's of course difficult to answer this in a general way because it's always a question of negotiation, but with regard to our customers, we have fixed prices for the lifetime of the product. So of course, when there are very unusual disruptive market developments here and there, of course, we try to develop also prices at the customers.

But usually, the prices are fixed. And with regards to the material prices, as Mr. Schäferbarthold said, we were faced with a lot of price increases, especially in the last fiscal year. Now the level is very high. The price increases are now fully impacting our P&L, and we are now working against this.

So currently, of course, we negotiated a lot of the customers, but also on the supply side, but there is no general tendency. Also with regard to the material prices, you mentioned resins and here and there also the prices are going down, but we have bottleneck pricing in electronics, the prices are still at a very, very high level. So it's a mixture of different effects.

Operator: And no further questions over the phone. Sir, please continue.

Rolf Breidenbach: OK. So thank you very much, and we look forward to – let's continue the discussion at the 9th of August. All the best. Thank you.

Operator: Thank you. And that concludes our webcast for today. Thank you all for participating. You may now disconnect.

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