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C: Bernard Schäferbarthold; HELLA GmbH & Co. KGaA; CFO
P: Christoph Laskawi - Deutsche Bank AG, Research Division – Research Analyst
P: Kai Mueller - BofA Merrill Lynch, Research Division - Associate and Analyst
P: Marc René Tonn - Warburg Research GmbH Senior – Analyst
P: Sascha Gommel - Jefferies LLC, Research Division – Equity Analyst
P: Akshat Kacker - JP Morgan Chase & Co, Research Division – Analyst
P: Gabriel M. Adler - Citigroup Inc., Research Division – Assistant VP & Senior Associate
P: Operator

COMPANY EDITED TRANSCRIPT

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the HELLA investor update for the first quarter 2021 webcast. (Operator Instructions) I must advise you that this webcast is being recorded today on Thursday, the 24th of September 2020. I would now like to hand the webcast over to your first presenter today, Dr. Rolf Breidenbach, CEO. Please go ahead, sir.

Rolf Breidenbach: Yes. Dear, ladies and gentlemen, good morning to all of you. Thanks a lot for dialing in. This is Rolf Breidenbach speaking. Welcome to our HELLA investor call on our first quarter results of the fiscal year 2020/21. Also, of course, on behalf of my colleague and our CFO, Mr. Schäferbarthold.
Before we go through our presentation, let me start with some short comments on the market and our business development. From our perspective, we had a good start into the new fiscal year. Better-than-expected. And achieved a satisfactory result in the first quarter. The utilization of our global production network is continuously growing as our OEMs are increasing their activities. This development is also reflected in the general market figures. Even though global light vehicle production fell by 10.4% in the first quarter compared to the previous year, the market has developed better-than-expected in early summer. China has recorded the strongest positive development. Europe and NSA also saw a slight improvement in the production numbers. Compared to the market, HELLA has developed slightly under-proportionally in the first quarter, which is mainly due to the growth dynamics in China, whereas

Europe and North and South America developed quite well. HELLA has shown a lower growth dynamic in China than the overall market. This is mainly due to an unfavorable ratio of production ends and starts. Due to the numerous ramp-ups in the upcoming months, we expect that we will again outperform the global automotive market for the full fiscal year. The same is true for the selective Chinese market.

On the profitability side, we are quite satisfied. We have continued our stringent cost control program worldwide. This has contributed significantly to our return to profitability at the operating level in the first quarter.

Furthermore, we will now invest again step-by-step in additional measures that will bring us continuous improvements. Our gross margin is negatively affected by the ramp-up of our global production network as our plants are still not fully utilized. We assume that the gross profit margin will improve over the remaining quarters as our capacity utilization continues to rise.

Let me also give you a short update on our long-term improvement program to strengthen our cost competitiveness.

Within the last 2 years, we reduced our global workforce by around 5,400 jobs, especially at our international site in China, Mexico and East Europe.

As already mentioned in our previous calls, our main focus is now on the German side. Our plan is to adjust the overall headcount and lift that by around 900 employees and by 300 to 450 employees at our other German locations until end of calendar year 2023.

The discussions with the Workers' Council have already started. The corresponding provisions of around EUR 170 million were accounted in the first quarter of the fiscal year for the anticipated severance payments that will incur in the coming years.

In addition to the structural improvement measures in Germany, we will, of course, also continue our improvement measures in our global network.

Looking at the expected market development of our current fiscal year, we see that the IHS figures show a certain stability since July 2020. Compared to the market forecast published in our annual report 2019/2020, the global light vehicle production estimates have improved in the meantime. IHS is currently expecting a growth of 6.4% for our fiscal year 2020/21.

This growth comes from a better-than-expected first half with a strong first quarter and assumes further volume increases in the second half of our fiscal year by more than 10%.

We assume, from today's perspective, that the IHS figures are still reflecting a very positive scenario. From our point of view, the stability of the recovery is quite unsecure as there are still many market uncertainties. For example, the development and the further consequences of the COVID-19 pandemic cannot be foreseen. Depending on the development, there is still the risk that regional lockdowns or disruptions in our production network or our supply chain might occur.

Therefore, as of today, our full year outlook is unchanged from what we communicated in our last call. We expect, for the adjusted sales a range from EUR 5.6 billion to EUR 6.1 billion. In terms of adjusted EBIT, we expect a range of 4% to 6%.

Going forward into our fiscal year and with more visibility on the development in the second half, we will provide a more detailed outlook if needed.

Having said this, let me now move to Page 4 of our presentation, starting with our financial results for the first quarter of the fiscal year 2020/21.

Our currency and portfolio-adjusted sales decreased by 10.6%. Our adjusted EBIT declined by around 50% to EUR 56 million. Thus, our adjusted EBIT margin is at a level of 4.2%. This is a decline of 3.1 percentage points compared to the previous year.

Our reported EBIT margin is at a level of minus 8.6% due to the restructuring costs for the improvement program in Germany.

Our adjusted free cash flow declined by EUR 308 million to minus EUR 240 million. We already comment in our last call that we will see a normalization of our working capital with a reversal of the receivables that lead to a significant negative cash flow in this quarter. More details will be given by Mr. Schäferbarthold.

On Page 5, we give you an overview of our automotive performance in the single regions. You can see that we were able to outperform the market in Europe and North and South America. Our outperformance in Europe was

quite solid. We outgrew the market by around 3 percentage points due to the ongoing project ramp-ups and higher volumes in East Europe.
In North and South America, we outperformed the market by around 2 percentage points. In Asia and the rest of the world, we underperformed slightly by 0.6 percentage points. This is mainly due to China, where the underperformance by around 12 percentage points for the reasons I mentioned already.
So all in all, on a global level, our automotive business underperformed the market by 2.4 percentage points in the first quarter. However, as mentioned earlier, this will change during the current fiscal year. And we will, from our perspective, outperformed the market for the entire 12 months.
Having said this, let me hand over to my colleague, Mr. Schäferbarthold, who will explain you the financial figures in more detail.

Bernard Schäferbarthold: Thank you, Mr. Breidenbach. Good morning, ladies and gentlemen, also from my side. I would continue on our presentation on page t Page, 7. Sales, FX and portfolio-adjusted is at EUR 1.37 billion in the first quarter. This is a decline of 10.6%. The portfolio adjustments, which are shown in the chart are related to the sale of our thermal business in the last fiscal year. The disposal of our relay business is not adjusted, as we also mentioned in our last call. In previous year, the sales number related to that business was EUR 10 million. In Q1, as Dr. Breidenbach has mentioned, ramp down of car lines due to upcoming and running EOPs, especially in Europe, but also in China, were significant. We expect due to several SOPs, which are actually ongoing and more SOPs, which will happen in the upcoming months, a stronger sales performance in automotive in the upcoming quarters. From today's perspective, we should, for that reason, as already said, see an outperformance in automotive on the full year numbers.
Going to Page 8. Our gross profit decreased by EUR 84 million. All 3 business segments were negative. Main reason are lower sales. In addition, inefficiencies related to the ramp-up of all production plants globally were unavoidable, despite high and very extensive cost-saving measures we have taken within that last 3 months.

Another important factor was the lower sales out of reimbursements for tooling and D&D in comparison to previous year. Which, to a large extent, is related to COVID. And due to that, we occurred delays in some of our running projects. Positively, the gross profit margin in aftermarket improved with a better product mix. Going forward, we expect the gross profit margin to improve with increasing sales, lower inefficiencies and higher sales related to reimbursements we expect.

On Page 9, R&D expenses are lower on the year-on-year comparison. We focused clearly on projects within our backlog and on projects which are actually in acquisitions. In doing that we were able to maintain the R&D ratio on a stable level compared to prior year. With the expected increase in sales we expect full year to come back to an R&D ratio, which is around 10%.

Going to Page 10. The SG&A expenses level further improved in that last quarter. With our strict cost reduction measures, we were able, again, to maintain the SG&A ratio on a very low level, which is closely to last year. The reduction within the other income is related to a higher income from subsidies in China we got in the last year.

On Page 11, we show the structural adaption. We already have realized globally on a year-on-year comparison. As Mr. Breidenbach already said, we have reduced the number of headcounts by 7.2% compared to previous year. As you can see, all regions, all functions are working continuously on improving their cost position going forward. And by that, increasing competitiveness for our business going forward. Special focus will now be on Germany, and the restructuring in D&D and admin, where especially we will relocate resources from Germany and D&D towards Eastern Europe, what we described in our previous call.

Page 12. We see our adjusted EBIT development in Q1, EUR 56 million. This is an adjusted EBIT margin of 4.2%. As said, main reason for the decline is the lower gross profit. And in addition, the lower incomes out of our joint ventures. Our joint venture companies globally were affected very similar from the COVID pandemic. Going forward, we also expect results from our JVs improving with better and improving market volumes.

Page 13. We are showing further important financial KPIs. Most important are the expected severance costs, I've already mentioned, related to the planned structural measures in Germany, which now we have provisioned. The cash outflows related to these provisions should come within the next 3 years. Taking the accrued restructuring expenses into account, reported EBIT in the first quarter is negative at minus EUR 115 million. And the net loss for the period is minus EUR 87 million.

On Page 14, adjusted free cash flow is at minus EUR 240 million as expected and also commented in earlier calls. The increase in working capital plus CapEx shifts we also had from previous quarter were the main reasons for that development. We expect now in the upcoming quarters to be positive in now each individual next quarter to come. Our actual outlook is that we would get positive again on a full year perspective.

Looking at the different segments on Page 15, starting with automotive. Overall, as I already mentioned, sales in the first quarter was impacted on the one hand by negative FX effect. And on the other side, also with more EOPs of car lines and lower sales from SOPs. On a positive note, to a large extent, our business related to electrified cars was growing. EBIT margin in automotive is at 3.5% due to the decrease in gross profit margins for the reasons I already mentioned and lower JV income. This should now improve within the next quarters to come.

On Page 16, starting with aftermarket. Aftermarket has decently recovered in the first quarter. We have seen a strong demand on our workshop products with the growth in comparison to previous year of around 5%. From our perspective, it is good to see that after the disposal of our wholesale and thermal management business and with the structural changes within our organization we have done, we are able to slightly improve our EBIT margin even in such difficult market conditions. Looking forward, on a full year perspective, we anticipate to be around 10% in EBIT margin for the full year.

In Special Application, top line was also negative despite the strong demand on the customer segment agriculture. The gross profit margin was significantly down, also due to some positive one-off effects in the previous year. EBIT margin is down at 9%. On a full year perspective, for Special Application we also expect to be around 10% in EBIT margin within the full

year, and we should see an improvement and normalization of the gross profit margin in the upcoming quarters.
Having said that, I would like to hand back to Dr. Breidenbach with the outlook.

Rolf Breidenbach: Yes. Thank you very much. With regard to the market outlook, I already commented that the global light vehicle production estimates from IHS improved compared to the forecast published in our annual report of the fiscal year 2019/2020, mainly due to an improvement in the first half of the fiscal year 2021. And so this positive trend we already have seen in July with regard to the IHS figures continues now in September. When you look at different volumes in our quarters, the jump now from this EUR 12.2 million in the fourth quarter of our last fiscal year to this EUR 18.6 million in the first quarter of 2021 has occurred. And now of course, the question is, can this further growth happen, especially when we look at the third and fourth quarter.
We, as I also already commented, we see here some significant risks, especially due to the COVID-19 pandemic. What does it mean for our fiscal year? We now see that IHS expects a growth rate of 6.4%, supported by all the different regions, especially from the Americas. But also in Europe and also with the contribution from Asia. So a quite positive outlook.
With regard to our financial figures, also, let me again point out that we stay with our guidance with regard to the currency and portfolio-adjusted sales in the range of around EUR 5.6 billion to EUR 6.1 billion. With regard to the adjusted EBIT margin, excluding restructuring measures and portfolio effects in the range of around 4.0% to 6%. This guidance reflects the continuing high level of market uncertainties. We see a risk that further volume increases, especially in the last 2 quarters our fiscal years, so from September onwards, will not happen to the full extent.
Yes. Having said this, the presentation part is finished, and we now can start with the Q&A.

Operator: (Operator Instructions)

Your first question comes from the line of Sascha Gommel.

Sascha Gommel: It's Sascha from Jefferies. My first question would be on the guidance, just that I understand it correctly. So you said in the presentation that your gross margin is going to get higher for the rest of the year. And at the same time, we were structuring below the gross margin by an R&D and admin expenses. So that should improve as well. And now in Q1, we are already at 4% EBIT margin. Why are you so cautious not to upgrade your margin range for the rest of the year? Is it just limited visibility? Or are you actually having indications that things will turn out weaker than IHS thinks? That will be my first question.

Rolf Breidenbach: It's a limited visibility. We do not really know what will come in our third and fourth quarter. And therefore, we are a little bit cautious.

Sascha Gommel: Okay. But you still -- you said you're expecting a higher gross margin. So -- but you're still confident that you can achieve that?

Rolf Breidenbach: Yes. When -- of course, when the volumes will come, then we are confident that we can achieve this.

Sascha Gommel: Okay. Okay. Understood. And then my second question would be on the ramp-ups and a bit the trend in your order intake. I think you said in China, you had more EOPs versus SOPs. How should we think about ramp-ups in the regions now in Q2 and Q3? And then also, how is your order intake trending right now? Especially with respect to kind of key products for the future like PowerPack and Dual Voltage System and Battery Management Systems?

Rolf Breidenbach: With regard to the ramp-ups, we especially see a significant number of new ramp-ups in China. But at a, let's say, reduced level, this is also true for NSA and Europe. So a lot of new business is currently in the SOP phase. And with regard to the order intake, we are very satisfied with the start into the fiscal year, we see both our lighting products, especially our new headlamp technology is really generating a good demand in the market. We are currently launching the first let's say, world headlamp. This means only one variant for all the different regions. And also other new LED technologies are currently close to the ramp-up phase. And so for both for the ramp-ups, but also for the new orders, we see that our LED, especially the headlamp LED strategy is really paying off. But we are also very satisfied with the rear lamp and interior lighting, car body lighting demand in the market.

With regard to electronics, we see an increasing demand for both 48-volt systems like the DCDC convertor, but also high-voltage applications like Battery Management Systems. We already got some quite encouraging orders. And we expect that, especially in the energy management area, we will acquire a significant business in this fiscal year.

With regard to Dual Voltage, we are in 2 very promising predevelopment projects, but we haven't acquired a serious order from the customer, and the same is true for PowerPack.

Sascha Gommel: Okay. Great. And then my last question would be on your software business. I think there has been some confusion what the reorganization of your software business means. Maybe you can clarify that today?

Rolf Breidenbach: So we are continuing counting on software and software development. Therefore, we just started to build up a new software house at our Berlin location in our company, Aglaia. This company is especially focused on setting methods and standards with regard to the testing and developing of our software, but also generating and carrying out new software, let's say, business cases, software as a product. So we, of course, significantly have and will invest into the software area.

Operator: And your next question comes from the line of Gabriel Adler.

Gabriel Adler: My first question is on outperformance, which, as you mentioned, was a little bit disappointing in Asia, but also somewhat weak in Europe and Americas. If I look at the top end of your guidance, it implies essentially no outperformance versus the latest IHS forecast of 6% growth. I understand that you're being more cautious than IHS on your outlook production. But even on the previous forecast, the top end of your guidance implies only about 4 percentage points outperformance in a best case scenario. So you mentioned outperformance should be positive this year. But could you quantify this for us? And also explain what will drive an improvement in our performance across each of the region?

Rolf Breidenbach: Of course, this is per region, this is always very difficult to assess. But we expect our outperformance at more or less the same level of the last fiscal year. And with regard to the regions, yes, I will not now speculate. So this is very difficult to say because there are so many uncertainties with regard to how our new products are now perceived by the market, how the possible setbacks in the one or the other market will occur. So it's, currently for us, a bit too difficult now to specifically comment on the different markets. But we are quite sure with regards to the general outperformance in this fiscal year.

Gabriel Adler: But in terms of the unfavorable, I mean, end of production dates in China, should we -- is it right to assume that, that should begin to improve from next quarter? Or could that impact drag on a little bit longer?

Rolf Breidenbach: Perhaps we would see it latest in the third quarter.

Gabriel Adler: Okay. Okay. And then my second question is on capacity utilization because you mentioned underutilization of capacity impacting gross margins. What capacity roughly are your plants currently running at? And when do you expect to return to a more healthy level of utilization?

Rolf Breidenbach: No, we expect that the utilization now in the weeks to come will continue to improve. Therefore, the months of October and November should be at a very good and high level. Then, of course, our third quarter will become a little bit weaker, holiday season and so on and so on. And then the big question mark is, how the fourth quarter will look like? But the second quarter looks as if our utilization will come very close to the normal level.

Operator: And your next question comes from the line of Kai Mueller.

Kai Müller: The first one is really if you could give us a bit of color near term. We've obviously spoken about in this quarter, actually coming in fine, you have ramp-ups. Can you give us some comments really around the first 2, 3 weeks of September? And how that's been boding maybe also by region and product, whether it's lighting or electronics? And then the second point is, we've heard from some of your competitors. And you had mentioned that, obviously, quite early, one of the reasons also for the negative free cash flow in this quarter is that some OEMs are possibly trying to stretch a little bit the payment terms. Is that something that you are seeing as well? And what are you doing against it? Because I understand, obviously, you've been trying to improve your working capital position yourself.

Rolf Breidenbach: Yes with regard to the September development. As I said, now the volumes are increasing, and this is true for lighting as well as electronics in all the regions. So yes, September, October, November are traditionally strong months in the auto industry, especially for HELLA, and we had a good start into this second quarter.

With regard to our cash management and payment terms, of course, it's now a big fight in all the different dimensions, be it receivables, payables. As Mr. Schäferbarthold already said, we are quite satisfied that now step-by-step, we would see from the second quarter on a positive cash flow development. And overall, at least 0, a balanced cash flow for the whole fiscal year. Of course, our customers try to do everything they can also to improve their cash management, but this is also true for our suppliers and all the other stakeholders. But we had under the leadership of Mr. Schäferbarthold set up, from our perspective, a very efficient cash improvement program 2.5 years ago. And all the processes and activities are now paying off. And therefore, of course, we -- you know, we already mentioned our program to improve the stability of our supply chain by offering them good financing conditions. So this is one lever, for example. And yes, we have many others so that we are, as I said, quite efficient in this area. But, and perhaps here, your question is going to, of course, the whole environment is challenging, but nothing which concerns us currently.

Kai Müller: Okay. That means basically, even if the OEMs are trying to push harder on those terms, you already have countermeasures in place with your own supplier base?

Rolf Breidenbach: Yes. And of course, we are also negotiating this kind of wishes or topics also with our OEMs. But we, as I said, we are quite optimistic that we have the right countermeasures.

Operator: (Operator Instructions) Your next question comes from the line of Marc Tonn.

Marc René Tonn: My first question would be regarding the restructuring expenses for the improvement program, which at EUR 170 million or more than EUR 170 million were already very significant in the first quarter. Perhaps you could give us some insight whether you are, let's say, perhaps quicker or more successful in implementing the saving measures or at least deciding the saving measures? And whether this could have some implication already on perhaps it's a savings or also, let's say, turning up a bit quicker than you had originally planned? And perhaps an update whether you may need the full EUR 240 million in terms of cost here? That would be the first question.

Rolf Breidenbach: We are, let's say, totally in our timeline. So as I said, discussions with the Workers' Council have started, the different business cases, have been calculated. And now we are implementing according to our time plan. So it's everything as planned, but not faster. And with regard to this EUR 240 million, of course, there are so many, let's say, parameters, which are influencing these figures. Starting with the negotiations, which are currently going on with the Workers' Council and the unions. So this is difficult to now assess. But we see this EUR 240 million as a maximum.

Marc René Tonn: Perfect. Second question would be, I think we've seen, let's say, price a bit quicker now, let's say, increase in the penetration for hybrid as well as particularly also battery electric vehicles. And I think on your Capital Markets

Day in February, I know that the market now looks different to what it has been the case since February when you mentioned this expectation of tripling the sales with e-mobility products from this '18/19 to '23/24 -- sorry, '24/25. Do you also see there that you may plays a bit quicker in terms of growth in this area than what you had seen before? Or was it already part of your expectation back then?

Rolf Breidenbach: We are not quicker, but we are quite satisfied to reach this, from our perspective, quite good growth figure.

Marc René Tonn: Even at -- perhaps, let's say, a lower market than what you might have been, let's say, been expected in February?

Rolf Breidenbach: Yes. But when we are now talking about '23/24, when step by step especially for our products, the market should have come back in the area of energy management, and we now see again a push for this product, for example, having in mind the now started initiative of the EU with regard to the new CO2 targets already for '2030. So yes, we are optimistic that here we can really triple our sales.

Operator: (Operator Instructions) Your next question comes from the line of Akshat Kacker

Akshat Kacker: Akshat from JP Morgan. Three from my side, please. The first one a follow-up on end markets. You mentioned that the outlook for the coming months is positive. Can you just give us more details on what regions drive this optimism? And what regions have turned out to be better in the last few months? And how much visibility do you have at this point maybe until November? And can you also confirm if September is already back to growth? That is the first one.

The second one, again, on automotive gross margins. I can understand the impact from low capacity utilization and ramp up from low activity levels. But as we look into Q2 can we already think about comparable levels to last year? Or should we be mindful of any special COVID-related costs or startup costs for the number of ramp-ups that you're talking that are still remaining for the rest of the year?

The third one is the dividend income from JVs. You generally get, I think, around EUR 25 million in the first quarter from those JVs. What are your expectations for the year? Or is it just a timing impact? And do you expect some inflow in the second quarter?

Bernard Schäferbarthold: So on current trading, if it comes to volumes now. September, as Mr. Breidenbach said, was, from our perspective, very strong. Close, I would say, to previous year's levels. So perhaps the slight growth we will see. We also see a strong demand now in the especially upcoming 2 months. So this is basically visibility until end of November, is from our perspective, now good and on high levels. It starts from our perspective, from December onwards to be more at risk and at least where we see still -- I would say, where we are not absolutely clear now how OEMs now would -- when they would start to go into Christmas break. So let's see. This is at least where we now see risks starting and visibility being, by far, lower.

Regionally, I think all 3 regions are improving. We can say that if we look now at September and also the next 2 upcoming months. So from our perspective, good demand on all customers. So German OEMs, but also our U.S. and Chinese customers show at least a quite high demand now within our system.

Gross margin with higher sales should improve. So if really we can then be also at previous year level, also depends a little bit on product mix the end also of the quarter. So this is difficult really to foresee, but we should from my perspective, see an improvement also to the first quarter.

On the dividend, we had already one larger dividend payment in the last quarter. So in the fourth quarter of the last fiscal year. So for HBPO, this dividend was paid out earlier in comparison to last year where it was in first quarter. So that is already realized. And on top of that, we also had some difficult, I would say, also difficult business situations, also within our joint ventures. So decisions on dividends have not all been taken yet. So we do not expect any big dividend payment now in second quarter.

Akshat Kacker: Okay. If I could just put one follow-up. Do you still expect free cash flow to be positive for the full year? And can you confirm that you still expect to receive payable factoring to be around EUR 40 million.

Bernard Schäferbarthold: This is what we actually would still foresee as of today's perspective. Somewhere between EUR 30 million.

Operator: We currently have no further questions. Please continue.

Rolf Breidenbach: Okay. Then thank you very much again to all of you. Stay healthy and have a good day. Bye.

Operator: That does conclude our webcast for today. Thank you for participating. You may all disconnect.

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