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COMPANY EDITED TRANSCRIPT

Operator: Good morning, ladies and gentlemen, and welcome to the investor call of HELLA for the preliminary results of the fiscal year 2023.

(Operator Instructions)

Let me now turn the floor over to your host, Bernard Schäferbarthold, CEO of HELLA.

Bernard Schäferbarthold: Yes. Thank you very much. A very warm welcome from my side to our call with regard to our preliminary results. I sit here together with Kerstin Dodel, Head of Investor Relations.

Looking at our preliminary results, overall, I can state that we have met all targets for 2023 we wanted to reach. So first time, we are at EUR8.1 billion of sales. Decent growth, despite the fact that certainly H2 was not at the level we originally expected. I will come to that a little later. Operating income margin was at 6.1% Q4 at a similar level, quite a good improvement in comparison to 2022, an improvement of 2 percentage points.

We are very pleased to say that we were able to generate a significant improvement in net cash flow. We achieved to the end of the year, EUR205 million, a ratio of net cash flow to sales of 2.6 percentage points. Our target was to be around 2%.

Our order intake was, again, at a very strong level. We reached around EUR11 billion, and we won significant high-volume orders with important technologies for the upcoming years, which should secure our growth in the upcoming years.

We had a good development in terms of our synergy achievements together with FORVIA. And at the end, we reached together EUR190 million of synergies. And for 2023, more than half is attributable to HELLA.

If we look a little more in detail on the different business groups, lighting last year showed a decent growth, overall year-on-year 15%. H2, and specifically also the fourth quarter, was not as strong in terms of the growth, specifically on some SOPs. And on the other hand side, some EOPs and a lower number of them SOPs. So we had quite an unfavorable mix. We mentioned that in the prior call before. Despite that, overall, if I look at the year, a good outperformance, a strong growth in China, specifically for lighting and quite a diversified customer base. So overall, we were very satisfied about the development in lighting overall.

We improved our operating income margin significantly in comparison to '22 to a level of 3.4% at the end of 2023. We are still not at the level we want to be. But for 2023, we have fully reached the targets we have set ourselves. Overall, a very good development in terms of the improvements, specifically within our gross margin, R&D was flat with around 8%. On top of that, we won strong and very good orders. Around 50% of our global order intake we reached of EUR11 billion could be allocated to lighting. A very good mix in terms of our product proposition, specifically on SSL/HD. We won some important projects to further implement our technologies. But we were also very pleased to win some orders and strong volume for our interior lighting business with our Smart Light concept.

If we look at electronics, we had a growth in electronics of around 10%. Our growth was lower than expected. Several reasons for that. First of all, we had much lower sales on some of our important programs for electrified cars, specifically for German customers. This was quite a difference in comparison to our internal target. Positively, we had a strong growth within our radar business. We had a strong growth overall within our energy management business. But as I said, lower than we expected. Specifically, H2 was lower than expected. Partially, also we have seen that specifically on the months of November, December, we were below the expectations in terms of our sales. Overall, if I look lighting and electronics in total, the last six weeks were much lower in sales, which, at the end, was also the reason why overall, Q4 was, in terms of total sales, below our expectations.

The operating income margin improved to 6.9%. We had a good development in terms of our gross margin. On the other hand, if we look at the R&D, the overspend in R&D was by far too high. The R&D expense in electronics was overall at 15.4%. And this is, by far, over our internal budget we had. There were some reasons for that, specifically on one program on electric power steering, where the overspending was very significant. We should be over with that, but it had a very strong impact, as I said, to the year of 2023. Overall, this additional R&D spending, which was in comparison to 2022, as a ratio around 1.5% higher in our R&D expense. This was a strong hit looking at our overall 2023 result.

Order intake was also very good for electronics, around half of our overall order intake accounts to electronics. Again, we had a very decent order intake development for our newest radar generation, and we were able to win different programs on high voltage and low voltage as well, and this should contribute to our further growth path, specifically for ADAS and also energy management in the upcoming years.

Life Cycle Solutions had, again, a very strong year overall. We were at 11.9% to the end of the year. Overall, we had a very strong development in the workshop business. The workshop business still at a lower level, but with the growth last year of more than 40%, we reached, first time a level above EUR100 million for that the business. With that, we were at EUR1.1 billion and operating income of EUR128 million, which represents an operating income margin of 11.9%.

Our independent aftermarket had also developed quite decently. Overall, we continue to invest in that business to let it grow. We invested in some new sales organization globally where we invested in addition, also in new products. Our R&D increased slightly to around 5% in that business, specifically for workshop business, but also our special application business. We were also very happy to win important orders in our special application business, specifically for LED work packages and also headlamp business as well.

If we look a little bit more in detail in terms of order intakes so electronics, some highlights here, we are mentioning. Importantly, on our radar 77Ghz, we won a record size package in the last year. We have further won in Q4, additional programs on that technology. I mentioned also on battery management, on our battery management system, some successful acquisitions we were able to win in high voltage as well also in low voltage. What also is a success for us is that the orders we won were quite balanced in terms of the regional split. A lot of projects we won are on the -- for the Americas as well as for China, which should contribute to our target that we get more balanced towards our sales development in the upcoming years.

Lighting, I mentioned our most recent SSL/HD technology on headlamps where it was, for us, a big success to win further business on that technology to further introduce it to the market. Importantly, also on the on the rear lamps side, we were quite successful, and I mentioned also on interior light. So overall, with all our solutions to the market, we were quite high happy about the success. And also in lighting, I can say we were quite balanced regionally.

Coming to the outlook, so overall, we are expecting very similar to what the S&P actually has as an estimate, a quite flattish market development this year. We would assume around 90 million vehicles for 2024. We see that specifically on Europe; we could see a decline in the market. We have already seen to the start into 2024 that specifically also with the cut on subsidies in Germany, the sale of electric cars is at a very low volume. So that should also impact the development specifically in Europe overall. Americas, China should be more stable. In Americas, we would also expect a slight growth. China, we will see how the market will develop. Here, also, the expectation is more flattish. But overall, we can certainly say that the visibility remains quite low in terms of a clearer view to the full year. But overall, I think we assume at the end, no big volume increase and a more challenging situation for Europe.

With that, we would come to our outlook overall. We are expecting sales in the range of EUR8.1 billion to EUR8.6 billion, taking into account the flattish market and also the uncertainty on the visibility going forward. Also, for 2024, on volumes on electrified cars, specifically for Europe. On the operating income margin, we assume a range between 6% and 7%.

We continue on working on the different improvement initiatives we already have started, and which are in implementation. On top of that, and I will come to that in a minute, we have initiated our competitiveness program for Europe, which also should contribute already in 2024, but specifically also in the years to come to the improvement of our profitability. And we also assume that specifically on further synergies, we would see additional contribution to the development of our operating income. On the synergies, we are seeing that there are a lot of additional measures we can, and we will work on so that we feel confident also to increase our synergy target overall for FORVIA and HELLA to above EUR350 million from a level of EUR300 million, of which around 50% in 2025 should be attributable to HELLA.

In terms of net cash flow, we are looking and assuming an improvement to 3% of net cash flow. We are working on further improvements on CapEx, also on working capital besides the improvement in operating income we are targeting.

With that, I would like to come to our performance program for Europe we have communicated this morning. It is obvious for us and also quite clear that the market situation in Europe, specifically since COVID has significantly changed. The assumptions on volumes are very different to prior crisis, so that we need to continue on the further adaption on overcapacities we actually see in Europe for the automotive industry at all and also for HELLA specifically. In addition, we are seeing that we have increased competitive pressure, specifically with Chinese OEMs entering the European market, the cost pressure is increasing, and we already can see that significant cost cutting measures also on our customer side are happening, which means that to maintain our competitiveness in Europe and also to increase our competitiveness in Europe, we will further work on adapting ourselves. This is not new for us. So you are aware that we have continuously adapted our structure in Lippstadt. We have, in 2020, implemented Phoenix program with a significant reduction and shift of development and administrative resources already. And also in terms of capacities, we have continuously reduced. But there are additional measures on our side, which will now and are already in the phase of being implemented and which will be initiated also in the upcoming months.

The focus will be, first of all, on production. We will continue to adapt and to reduce our capacity. But overall, this program should also include operational improvements we will continue to work on. For the production, we have already started to implement our new excellence system, which is basically taking the best out of FORVIA and HELLA. And we are assuming that this deployment of this new adapted excellence system should contribute to a much more efficient flow within our whole value chain, but also specifically in the efficiency and productivity of all our different plants. On top of that, we will continue to work on our flexibilization. So we have new concepts in terms of universal assembly lines, we already mentioned before. We will continue to deploy these within all our different plants. At the end, the target is that all our plants need to be competitive and profitable.

The second focus will be R&D. We are and have been in 2023 at 11%. We want to reach our targeted level of 9% to 10% in the upcoming years. For that, we will further work on increasing our best cost share. We will reduce the level also specifically of external service providers we have in high cost. We will bundle activities. We will continue to work on our portfolio management as well as we have done it in the past. We have to focus and work on technologies where we are competitive and where we can differentiate also in comparison to our competitors. Overall, the target is to reduce our gross costs in an amount of EUR400 million in 2028. We expect thereof a gross saving already by the end of 2025 of EUR150 million with all these different measures. We have counted now with an overall investments and restructuring costs of around EUR200 million until 2028 with the majority of these spendings until end of 2025.

All structural adjustments will be detailed and worked out within the upcoming months, and we will communicate also as soon as we are ready to give more detail. And for sure, we will work with all structural adjustments in a way that we will do it with the social responsibility we also showed in the last year. This, from our perspective, will be a major initiative and program to increase our competitiveness, specifically for Europe. And at the end, this should make us much stronger also for the future and also more balanced, specifically looking at all three regions where, as of today, Europe is certainly the region with the lowest profitability today.

So summing up, a solid performance last year. We met our targets. Sales was a little lower, specifically in Q4. That had some impact on our profitability in Q4. In addition, with the overspend in R&D, we also had until the end of the year. This should improve now for 2024. Good progress in terms of the cooperation with FORVIA, a good synergy realization, and we feel confident to improve the synergy run rate to more than EUR350 million for end of 2025.

And the performance program to increase our competitiveness for us is an important pillar now to make HELLA even stronger for the midterm.
Having said that, thank you very much for listening. I'm happy to take your questions now.

Operator: (Operator Instructions) So the first question is from Michael Jacks, Bank of America.

Michael Jacks: The first one is just on cost pass-throughs. Where did you land on pass-through in 2023? And what do you think is required or expected for 2024? My second question is in relation to lighting. Polymer prices have declined quite significantly in the past quarters. So to what extent should this reflect in your cost of goods sold in 2024? And how much of this will need to be passed to the customers and with what sort of time lag? And then finally, just on the R&D spend. Should we expect a reduction in absolute terms in 2024? Thank you.

Bernard Schäferbarthold: So pass-through was strong in 2023. So we were very close to a full compensation of inflation comparing to our reference point, May 2021. So taking into account material, energy, and logistics. And on one hand side, we think it should be a little lower in terms of the compensation overall. But on the other hand side, we also see that we can improve in terms of our material cost initiatives we have initiated. So that overall, we wouldn't see a very big difference in 2024 to 2023.
On R&D, we will come down in terms of the relative R&D ratio. Specifically, this very big overspend we had on this one program, this only was more than EUR50 million overall in 2023. That should be not there in 2024. So on the other hand side, we will invest some money in addition also into the new programs and also the strong order intake we had in the last two years. So some increase, but very selectively, specifically for radar and also energy management where we would be higher, but very little. So overall, to your concrete question, will it grow? Absolutely. Only slightly.
And your second question, was it related to lighting?

Michael Jacks: Yes, in lighting. Yes, just in terms of the raw material tailwinds from polymers, is that something that should reflect in your cost of goods sold this year?

Bernard Schäferbarthold: No, not significantly. So overall, in lighting, it is more, let's say, the development because of the higher electronic content in the new lighting systems, this is, let's say, more important for us in terms of cost development. So we actually do not see -- or overall, we would see that within our material cost assumptions, taking all in all, we should see a reduction in comparison to 2023 so that we should see a slight improvement in lighting overall in cost of goods sold.

Michael Jacks: Very clear. Thank you very much.

Operator: The next question comes from Sanjay Bhagwani, Citi.

Sanjay Bhagwani: Hello. Thank you very much for taking my question also. I have got three questions as well. So my first one is on organic growth outperformance. So if you look at the organic growth outperformance for '23, this comes somewhere around 200 basis points. So could you please maybe provide some color how much of this 200 basis points is actually the pricing pass-through? And then when we think of the organic growth outperformance that is implied for '24, it is somewhere around 500 basis points for the midpoint. So if you could provide some color on what will drive or accelerate the organic growth outperformance in '24? That is my first question.

Then my second question is a follow-up to Mike's question on the cost bucket. So if you could provide some color on key cost buckets for '24. That is how should we think of electronic cost, labor, energy, and all other costs. Overall, what should be the gross or net impact?

And finally, thank you very much for sharing this new efficiency improvement program. So when we actually look at the 2025 targets, the previously announced, they were somewhere around EUR9.4 billion of sales and greater than 8% of margin. Do they still stand intact? Or would this require a further review and you'll update us in the near future on that one? Those are my questions. Thank you.

Bernard Schäferbarthold: Thank you, Sanjay. So on the outperformance, there is no big impact in terms of inflation if we compare '23 to '22 because the percentage of inflation is quite comparable. The outperformance overall in lighting was good. So if I look overall in lighting, we were above 5%.

As I said, we had a very strong growth in China. We had some programs with some specifically electric car OEMs, which were, volume-wise, very good. And this was major reason also for a good outperformance in lighting. We had, as I said, a change specifically in Q4 in lighting with some important programs which were in EOP. So that was why lighting was, to the end of the year, much slower. And even with a negative outperformance and some new SOPs, were slower or a little delayed. So this is why the trend in lighting was negative to the end of the year.

Electronics was quite a disappointment if I look overall to the outperformance last year. So we were, in electronics, only, more or less, at a very little outperformance overall in the year and even significantly negative to the end of the year. So the overall trend last year was a weakness, specifically on all German OEMs in terms of their electrified car programs, where the numbers of sales were low and many delays we have seen, and this was a big impact for us in electronics.

A second was that still there was with the offer the OEMs had, take rates were impacted for some of our products. And this was a second element. Despite that, the growth, as I said, for radar, but also for energy management was quite significant in terms of percentage, but overall, lower than expected. And in 2024, we would assume that lighting should be a little lower than last year in comparison to the 5%. But we are assuming that electronics would be and should be much better so that we would assume electronics to have a higher outperformance to the market slightly around 5%, a little higher perhaps. As I said, visibility is not so good overall, so it's very difficult to predict. So I would say it's today's view, I would have overall.

The second question, if I look at material costs, so if I look mechanical parts, costs are going down, specifically on electronics. Overall, raw materials are also going down. Active electronic parts, semis, it's still very challenging, and we do not reach really price reductions as of today or more significant price reductions in comparison also to prior crisis. So this level stays quite flat. But if I take it in, let's say, the full scope, so we are assuming, let's say, a reduction overall in materials between 1% and 2%.

On the energy, we are not fully benefiting today. If I look at 2024 expectations, from the prices you see spot for energy. Also, because we hedged already a time ago, partially step-by-step our volumes to be also in a, let's say, secured bandwidth. So we have a decrease in terms of our energy costs overall, but not in full comparison to the spot price you have.

Logistics was coming down, and now with the crisis we have -- prices have increased, but I wouldn't see as of today, looking at 2024, overall, a big impact. This would not be my assumption. So I would assume quite flattish. So all in all, a material, we would expect and also logistics, energy overall, a decrease. And in addition, as well for some improvement programs in efficiency we are working on, but on the other hand side, we also have wage inflation, which goes against but which we assume with productivity and efficiency to compensate.

To your third question regarding our competitiveness program and looking ahead to 2025. So it's still a little early to now, let's say, fully confirm. I think the biggest topic, or one big topic is the uncertainty about volumes. So we would assume that specifically on electric cars, we think 2024 will be very slow in terms of growth. We have already seen that to the beginning of the year. But 2025 should again with a significant increase for electric cars. But overall, volumes still are an uncertainty and specifically also on the different programs. So there is an uncertainty about the sales level overall, we could reach. The order book is strong. But the mix is certainly from utmost importance.

We see and we remain, let's say, with the ambition in terms of our operating income margin, the initiatives we have started and we will also now further implement, but also work on, as I stated, will contribute also to come to that target. So that, in that regard, I feel confident that we have all in our hands despite the fact how volumes would be and they, for sure, have then a significant impact.

Sanjay Bhagwani: Thank you. That's very helpful.

Operator: And the next question comes from Akshat Kacker, JPMorgan.

Akshat Kacker: Mr. Schäferbarthold, Akshat from JPMorgan. Three from my side as well, please. The first one is on the weaker margin development within Life Cycle Solutions in Q4 specifically. Could you just share more details on business trends in that division and what drove that decline sequentially?

The second one is on the restructuring plan that you announced. Is it possible to give us a broad split for the targeted savings? What portion of it comes from plant consolidation? How much of it is optimization in R&D and CapEx? And finally, how much of it is overhead reduction to whatever extent possible as of now, please.

And the last one, a bit of a maintenance question. Could you just tell us about your CapEx plans for 2024 and the cash restructuring that you have assumed for 2024 and '25, please? Thank you.

Bernard Schäferbarthold: Yes, thank you for the questions, Akshat. So the Life Cycle, we have seen somehow a weakening specifically on special application where volumes and sales, especially on agriculture, but also on construction where this positive trend were somehow not fully broken, but it was not as strong as in the last two years, I would say. So this was one element where the growth trajectory was much slower. And the second was on the workshop products. So we had with the emission tester, which was by law from the regulation. It was a very strong business in the first three quarters. And basically, in the fourth quarter, it was much smaller because this business was then made. So this was the second major topic, which was more related to workshop products. Independent aftermarket was quite stable.

So that, overall, we had a very strong operating income margin. If I would look ahead and now 2024 Life Cycle, it will remain a very good business. This emission tester, specifically on Germany, this was more or less a one-timer which we will not see in 2024. But on the other hand side, there are new products we have launched. There is an increase in our sales in specifically independent aftermarket where we have invested. So we will compensate to a large extent, but the growth will be slower, and we will continue to invest. So that overall margin should be slightly lower in '24 in comparison to '23. But still, it's a very good business. And it will remain a very strong pillar for us going forward.

In terms of the savings potential, so EUR400 million gross. We assume 2028, it should be a net saving of EUR200 million. Restructuring, I mentioned it will be around EUR200 million. This EUR200 million, we are not, let's say to the level that I can detail it out now fully. | can give you my rough view. It will be partially restructuring cost to adapt to the capacities in the different plants. This certainly would be one larger part, but it could be around one-third of the costs related to that.

Then a part of it would also be with some relocations we will also do. So we will consolidate some of the program to - and move some of the programs to low-cost plants where we have more capacity so that we can improve utilization of the different plants. So some of the relocations will be a part of these costs. There is then with that, some additional depreciation we would then also consider if we reduce the capacities.

And then there is a part which is more related then to investments we will do if we think about also artificial intelligence, if we think about some standardization, universal assembly lines, so some modernizations, but which will be overall the smaller part. But I would ask you to wait a little bit so that we can detail it out in the next calls we would then have.

CapEx for this year in terms of tangible, if | relate to tangible CapEx, it will be quite similar to last year, even taking into account what we consider now for the European investment plan in terms of cash out.

Akshat Kacker: Understood. Thank you so much.

Operator: And the next question comes from Michael Jacks from the Bank of America.

Michael Jacks: Hi. Thank you. Just one follow-up question. With regards to your exposures in China at the moment, could you please just give us an update on what your current exposure is to domestic OEMs and how that looks in terms of your order book development? Thank you.

Bernard Schäferbarthold: So around one-third of our business we are making in China is towards Chinese OEMs or a little less, so around 30%. And this is basically what we have now booked, or it is what we have booked within the order intake. The sales level is still a little lower. I'm not counting with the Chinese OEMs. So if we are working with the German OEMs in partnership with the Chinese, so also to all joint ventures, this is more for me, counted as not as Chinese OEMs. So we are growing. We have some of the customers, Chinese, strong Chinese customers where we have already quite strong positions, and there are some where we are still working on to get a higher importance. I think, specifically in electronics, I see quite a significant opportunity with the different programs actually we are working on with some customers. So it should continue to increase now in the upcoming years.

Michael Jacks: Thanks very much. And perhaps just one brief follow-up. Do you see any opportunities to work together with some of these Chinese customers that are looking to establish plants outside of China?

Bernard Schäferbarthold: Sure. This is a big opportunity for us. And all different customers, and we are, let's say, working together with, I would say, all important relevant Chinese customers and all which have plans to go outside of China are talking with us about how we are and how we could support them. This is a big opportunity for us.

Michael Jacks: Great. Thank you very much.

Bernard Schäferbarthold: Thank you.

Operator: So as there are no further questions at this point, I'd like to hand back to you, Mr. Schäferbarthold, for some closing remarks.

Bernard Schäferbarthold: So thank you very much for joining this call, and I wish you a very good day. And hear you, see you soon. Bye-bye.

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