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C: Bernard Schäferbarthold; HELLA GmbH & Co. KGaA; CFO
P: Akshat Kacker; JP Morgan; Analyst
P: Ashik Kurian; Jefferies; Analyst
P: Henning Cosman; HSBC; Analyst
P: Julian Radlinger; UBS; Analyst
P: Lello Della Ragione; Intermonte; Analyst
P: Manuel Tanzer; Equinet; Analyst
P: Raghav Gupta-Chaudhary; Citi; Analyst
P: Victoria Greer; Morgan Stanley; Analyst
P: Kai Mueller; Bank of America Merrill Lynch; Analyst
P: Sascha Gommel; Credit Suisse; Analyst
P: Operator

COMPANY EDITED TRANSCRIPT

Operator:

Good morning. Thank you for standing by, and welcome to the HELLA investor update.

(Operator Instructions) I must advise you that the call is being recorded today, on Thursday, the 22nd of March 2018.

I'd like to hand the call over to your presenters today, Dr. Rolf Breidenbach, CEO; and Bernard Schäferbarthold, CFO.

Please go ahead.

Rolf Breidenbach^

Yes, thank you very much for the introduction. Also on behalf of my colleague, Mr. Schäferbarthold, I would like to welcome you to our investor call with regards to our third quarter results.

Overall, there was, as in the quarters before, no tailwinds with regards to the market development as well as the currency development, but this doesn't prevent us from achieving, from our perspective, very good results. And the positive development we have seen in the last quarters of our fiscal year also continue in the third quarter. And we were able, on the one hand, to again

outperform the automotive markets, especially in NSA and Asia. And we did this at the same time by reaching, from our perspective, quite good profitability level.

Starting with the first slide of our presentation, you can see that we have grown on an adjusted basis by 9.3%. The, from our point of view, good news is that this growth is generated by all our 3 segments. So Automotive grew by 8.2%; Aftermarket, with regard to the external sales, by 3.9% and Special Applications, from our perspective quite encouraging, by 13.4%. The adjusted gross margin is at a level of 27.9%, so on a year-on-year basis comparison a plus of 0.4%-points. We are especially satisfied with the gross margin development in Automotive. We see an increase in our production volume and a step-by-step higher utilization of our assets. With regard to the adjusted EBIT, we could see a plus of EUR 35 million compared to the last year. We are now at EUR 408 million, also from our perspective a very good and solid profitability situation. And this leads to adjusted EBIT margin of around 8%, also a plus of 0.1%-points compared to the last fiscal year.

We are very satisfied with the development of our cash situation. So we could increase the cash flow by EUR 60 million now to a level of EUR 166 million, so a very good development, especially compared to the last year. And perhaps you remember that we announced in the last fiscal year a special program to increase the cash flow under the leadership of Mr. Schäferbarthold, and we see now step by step the results out of it. The increase is mainly driven by higher funds from operations and lower net CapEx. Yes, as I said, overall we think this is a good development with regard to the financial stability of our company.

In the next chart, some additional details are given with regards to our adjusted growth rates. You could see, without adjustments, we could generate EUR 444 million more sales. This is reduced by around EUR 90 million currency effects, and with this we come to the reported growth rate of 7.4%. I think there is nothing more to say at this chart. Allow me to comment on the next chart, on the different, let's say growth performances we could show over the last 9 months in the different markets.

Overall, we could see a clear outperformance of the automotive market by 6.9%, so we grew in our automotive area by 8.2%. The global markets, from our perspective, by 1.3% and this results in this 6.9% overperformance. We are especially satisfied that this growth especially took place in 2 markets, North and South America and Asia, because it's our clear company strategy to over-proportional grow our business in these 2 markets. Therefore, this outperformance of more than 20% in NSA; as well as more than 11% in Asia and rest of the world, of course especially in China, I think, is a good sign that our globalization strategy pays off and delivers the expected results.

With regard to Europe, we developed more or less on market level, minus 0.6%. This is nothing which concerns us. A growth rate in line with the European market development is more than fine for us.

Yes, overall from my perspective, again a good quarter. And having said this, allow me to hand over to my colleague, Mr. Schäferbarthold, our CFO, who will now give you much more details about our financial situation.

Bernard Schäferbarthold^

Okay, good morning also from my side, to all participants of this call.

Please let me start with some personal comments. First I'm very pleased about the Q3 development overall. We were able to realize the results we planned. We are absolutely in line with our expectations. We improved in all important financial KPIs, respectively: sales growth, EBIT but especially also our free cash flow improvements. And looking also at full year, we are, out of my perspective, very well on track to realize our full year targets we have set ourselves.

Going more into details for the third quarter, starting with our gross profit development on Page 8, an increase of 8.9% in absolute numbers, EUR 116 million. We were able to increase our gross profit in all 3 segments, which is good, according to our expectations and that we also stated in our Capital Market Days. We improved gross profit by 0.4 percentage points to 27.9%. As Mr. Breidenbach stated, the improvement comes, on one hand side, from Automotive, where we were able to increase our gross profit margin by 0.4%-points to 25.6% despite the fact that we are actually increasing our capacities globally significantly and with that also facing and having ramp-up costs actually, which are reflected in our P&L. Additionally, we have a very decent development in our Special Applications gross profit margin related to the sales growth in that segment.

Coming to Page 9. We increased our R&D expenses by EUR 42 million to EUR 510 million. We continue to invest significantly in our technology leadership position following the respective market trends, as we presented intensively also at our last Capital Market Day. Additionally, we spent here also some money in the ramp-ups, in new launches in different facilities globally, as we also explained in our last conference call. Also we have to bear in mind the FX development, which certainly has also an effect in the relative number of our R&D expenses, bear in mind that we have a 3% adjustment only in Q3 due to FX development on a year-on-year comparison which certainly also has an effect in relative terms.

SG&A developed under-proportionally. We increased SG&A overall by EUR 29.6 million to EUR 545 million. We continue to have a very high cost awareness overall. So that is reflected also in our admin expenses, which stays constant at 3.4%, but on the other hand, we improved in distribution, in our distribution expenses in relative terms, so that overall we have here a good development in our expense ratio, which is at 10.6% after 9 months. As we also presented in our Capital Market Day, going forward, we will continue to invest in the optimization of our processes and systems but continue also to be very sensitive if it comes to the expenses we are doing.

All in all, EBIT improved by EUR 35 million, 9.5%, to EUR 408 million, mainly with the volume increase but also the improvement in gross profit. We were able to compensate the higher investments in R&D and especially the weaker contribution of our JVs. As we explained also, we are seeing actually the stabilization of the results within our JVs in Q3. We were able to have a constant level on a year-on-year comparison, so that we are, I will say, prudently but optimistic also going forward. All in all, as I said, we are well on track to reach our target EBIT-wise also on a full year.

Reported EBIT is at EUR 404 million. We adjusted, due to our restructuring programs in Germany, EUR 4.2 million overall. Our net financial result decreased by EUR 3.8 million on a year-on-year comparison due to higher business activities in countries with higher interest rates such as Mexico. We took action here in a way that we changed our financial concept, especially related to Mexico. We actually closed a USD 200 million loan facility now in the third quarter, which will significantly help to reduce the hedging volumes we have and by that improve the financial result significantly also going forward.

Earnings per share increased by 12% after the third quarter.

Coming to Page 13, Q3 as stand-alone quarter, growth in all 3 segments. And we see here the reported numbers in the bars. On a year-on-year comparison, if you look at the FX impact, it was 3%, very significant. So if you would look at growth in Automotive and having in mind a 3% adjustment in FX, Automotive growth would be at 9.3% only. A very decent development in our growth, Special Applications continues to grow at a level above 10%, actually in Q3 at 14.2% only.

Profits improved, especially in Aftermarket –and in Special Applications. As expected and also commented to you in our last call, in Aftermarket we are now seeing that our investments we are doing in Aftermarket are paying off now in Q3, a very nice development of our profitability. And we expect also a very solid fourth quarter in that segment.

Special application, also with a very good development also in the third quarter, and we stay within our expectation. We also have given to you that we expect all in all, full year, around 10% profitability in that segment, which is a very good development compared to last year. But again, last year, bear in mind that we had also negative effects out of the disposal of our Industries and Airport Lighting business.

Coming to Page 14, free cash flow, with a very strong development in the third quarter, which brings us now to EUR 166 million end of February and a 56% improvement on a year-on-year comparison. Here we see that our efforts and focus on cash are now starting to pay off. We are well on track here also to reach our targets full year. Fourth quarter, we expect a higher net CapEx, but on the other hand side we also see that we will improve in working capital overall.

Coming to the segments on Page 15. In Automotive we continuously see a very strong demand for our products in lighting but also in electronics. Overall a 7.1% growth reported in electronics and a 9% growth reported in lighting shows that and underlines that, which is significantly above the market growth, which Dr. Breidenbach commented. Profits improved by 4.4%, but this is under-proportionally to our sales growth due to the investments we are doing in our further growth, on one hand side, in R&D but also in the capacities, we commented. And additionally, the lower JV income is reflected in that segment.

Aftermarket, with a very decent external sales growth of 3.9% and an over proportional profit increase of 9.3% to EUR 56.7 million after 3 quarters. A very solid development, as I mentioned, in Q3, where we have seen strong growth at our workshop products which is contributing to that improvement with the launch of our new mega macs product.

Special application, with a very solid growth, as I commented. The important segments within special application, agriculture and construction, continue to grow with a double digit number. And on top of that, we actually benefit this year from the over-proportional demand in Australia on our products, and that leads to that very decent profit increase I commented.

So all in all, we are well on track and within our expectations. With that, I hand back to Mr. Breidenbach for the outlook. And I'm happy to take also your questions later on.

Rolf Breidenbach^

Yes, Mr. Schäferbarthold, thank you very much.

Coming to the short outlook. With regards to the development of the different markets, we see, let's say, no change compared to the situation 3 months ago, where we also commented on that. So Europe shows a significant growth also, from our perspective, in the months to come. NSA is more stable. And China is on a moderate growth path. This leads to our assessment of a 1.6% global growth of the automotive market. So no special effects are here, of course, considered.

With regards to our guidance, Mr. Schäferbarthold already comment on that. We feel very optimistic that we will meet the guidance we have given to the market 9 months ago and repeated after the first and the second quarter. So we expect a growth rate between 5% to 10%. The same is true for our adjusted EBIT growth. And we see a margin around 8%. And of course, we cannot in the end precisely assess the future market development, but as I said, today we see no reason why this moderate growth in the automotive markets worldwide should not continue. Of course, we also cannot assess the currency development, but also here we feel so far quite comfortable that we have no, surprisingly, negative effect on our growth rate or on our profitability situation. And this is also reflected in the guidance, and Mr. Schäferbarthold also comment on that. Of course, we will continue with regards to the investments in R&D because this secures also a good future perspective, especially in Automotive and Special Applications.

Having said that, I'm, as Mr. Schäferbarthold, very happy to answer your question now.

Q&A

Operator^

(Operator Instructions) Your first question today comes from the line of Henning Cosman.

Henning Cosman^

Please, can I ask just one question on the gross margin development? I think you said you're quite pleased with the continuing progress. And it's obviously a function of a better asset utilization, so I was just wondering what your visibility is on further improvements there and what sort of target range you want to get to, where you stand in terms of utilizing those assets. Or have we maybe already reached a certain plateau because obviously you're also adding more assets then which will be underutilized in the ramp-up phase? If you could just talk around that a little bit. That's my first question. And then secondly, I was hoping you could maybe remind me. We

might have very well talked about it at the time, but in terms of the deceleration in growth, what had happened in the second quarter last year? What was the reason again for the deceleration in the growth, especially in lighting? And my point is more, seeing the very positive development now, if this could at all happen again in the next maybe 4 quarters or so. Or if you could remind us what your visibility is like and why that might not be happening again as compared to last year. That's my 2 questions.

Rolf Breidenbach^

Yes, with regard to the gross margin, of course, we are always targeting to improve the gross margin, but it's very difficult to assess how the gross margin now will develop in the months to come because, as you already mentioned, we have this launch of the many plants. We managed that in the last months very well, but we have so many new launches. Of course, we have underutilized assets. So of course we intend to improve the gross margin, but let's see how this will develop because launching so many plants, of course, is a burden. And this underutilization, at least for the months to come, will remain. With regard to the second quarter of the last year, if I got it correctly, this was an, how should I call it, interesting happening of many, many products which came to end of production, on the one hand; and very, very few launches in this period of 3 months, which was a little bit unusual for our lighting business. Will this happen in the future again? This is very difficult to assess because we see a lot of volatility in the markets with regards to the postponement of SOPs, on the one hand; the demand of different models, on the other hand. So we currently do not see this on the horizon, to be more precise, but of course we cannot say that this will not happen again in the future.

Henning Cosman^

So what's your visibility? And I mean I understand it's difficult to say that, but what could be the risk? How long before would you know? Because I think, last time this happened, we didn't really have enough visibility to realize that maybe a quarter before, right?

Rolf Breidenbach^

That's correct, but you can imagine our customers inform us, for example, as late as possible with regard to SOP postponement because, when the customers do this, of course, the suppliers are not so motivated to get all their parts and components ready for a specific point of time. So this comes on short notice. This is clear. And with regards to EOPs, here also this is not

something we are aware of, let's say, when it's changing unusually, aware of, let's say, 6 or 9 months before this will happen. So these kind of fluctuation with regards to our demands can happen, but when you look at our growth in the different quarters, it was really so far very seldom a coming together of these very few launches on the one hand and many EOPs on the other hand.

Operator^

Your next question comes from the line of Raghav Gupta-Chaudhary.

Raghav Gupta-Chaudhary^

Two questions from me. And first is on top line growth, asked it slightly differently of Henning. Clearly, for the last few quarters, you're seeing very strong development, you are towards the top end of your 5% to 10% range. I was wondering if you could just help us understand how much of that strong development is market share gains versus higher pricing or better mix, and that will be my first one. Secondly, on working capital you've outlined your working capital as being a lever of improving your free cash flow generation. And if I looked at the numbers correctly, there's a slight deterioration in the third quarter and both versus the Q2 and the third quarter last year. I appreciate there might be a degree of seasonality to this, but I was just wondering how much progress you're making towards your stated goal of reducing working capital as a percentage of sales by 300 basis points. Those will be my 2.

Rolf Breidenbach^

Yes. Thank you for your questions. With regard to the top line growth, when you look at the growth, it's mainly happened in China and in NSA. Therefore, an over-proportional part is due to market share increase, so it's volume driven, not price driven. Of course, there are some price effects, but mainly volume driven.

Raghav Gupta-Chaudhary^

Can I just ask a quick follow-up on that? I mean you made a point about NSA and China. On Slide 15, you talk about demand being driven by NSA, China and Europe ex Germany. What's the market dynamic in Germany and that kind of makes you call out Europe ex Germany? Are you losing share there? Or what's happening there?

Rolf Breidenbach^

No, when we're now talking about 0-point-X percentage, it's difficult to assess whether we are losing market share or not. So we don't think that we are losing market share but that we are growing more or less with the market, but with regard to Germany, I think one has to take into account that the German car manufacturers more and more localize their products especially in China but also in NSA. And this is true for the premium car manufacturers, from my perspective. And this, from our perspective, leads to the situation that we are reducing our figures in Germany.

Bernard Schäferbarthold^

On your question related to free cash flow. So first of all, we are well on track, if it comes to the working capital program to get to the 3%. Second we are actually, as I said, end of the third quarter, we are higher, especially on our inventory level. And that is, on one hand side, related to a lot of ramp-ups we are preparing, where we are in preparation; and also on the new plants we actually are building. And both is increasing the inventory level significantly end of Q3. We expect, and that was my comment towards working capital development in the fourth quarter, we expect working capital to go down end of Q4, but overall, as I said, we are managing that in that way, that we are looking overall at free cash flow. And then we also take the business decisions, what's best also for the company, but overall, 3% stays as a target. And I would say I'm personally convinced that we can get to that result.

Operator^

Your next question comes from the line of Akshat Kacker.

Akshat Kacker^

Akshat, JPMorgan. My first question would be a follow-up on Raghav's question. I see that account receivables were high as well at the end of 9 months. And what happened there? And where does the 3% improvement come from exactly as you continue to grow strongly? And secondly, a different way to put Henning's question on gross margins. Despite the underutilization of resources, capacity expansions, I see higher depreciation as well in the third quarter. Are you still seeing strong improvement in gross margins? I understand that there are higher costs over the coming months, but going out to FY '19, can we expect higher gross margins and further improvement from these levels? And my final question would be your profitability FY '18 targets for Aftermarket and Special Applications. From

what I remember, for Aftermarket it was close to 7% for the full year, and for Special Applications around 10%.

Rolf Breidenbach^

Yes, perhaps allow me to answer your third question, first. I think we also said this in the second quarter. So 10% is the level for Special Applications we intend to achieve. With regards to the gross margin, currently difficult to assess. As you said, we improved in the last years in this area. We again now, also compared to the last year, could show a good improvement, but there are so many influence factors. And of course, we have the clear target. And we are working very intensively on cost reductions, like material costs, productivity increases. Of course, due to our investments, as you said, the depreciation has increased. Overall, we feel quite optimistic to run the company at this very high gross margin level. Whether it's really possible to increase, it's difficult to assess currently, especially in this very challenging situation of launching of these many, many plants. And I cannot say more because we have no clear picture about it. So this high gross margin level, we are quite optimistic to at least maintain it, but an improvement is our target, but difficult to assess whether we will achieve it or not.

Akshat Kacker^

And for the Aftermarket profitability.

Bernard Schäferbarthold^

It's around 7% is a statement we did. And we still, I will say, expect that, that is what we will achieve. And that is how my comments went also towards that, that we expect also a stronger fourth quarter with an improvement of profitability in Aftermarket, looking at where we are today.

Akshat Kacker^

Okay. And the last one, on working capital.

Bernard Schäferbarthold^

And on the working capital, if I got your question correctly, where do we see the improvement? So certainly, as I said, in the inventories the level is pretty high today. On the receivables, we see an increase, on one hand side, volume driven. On the other hand side, that is due to invoicing of toolings related to

the projects which are in preparations now for the ramp-ups also. That is why we're also investing so much globally and in new capacities, where we have a significant higher amount also actually in the receivables yet. If we only look at what we have reached, if it comes really to reduction of overdues, if it comes to getting also improvements in our payment terms related to our customers, if it comes to the measures also in inventories but especially in payables, we are well on track within the targets in the program. But the most significant impact also going forward in the next 3 years will come out of the payables. If we look at the DPO in days, certainly there the potential is significant. And that's where we want to reach the highest improvements going forward.

Akshat Kacker^

Just a quick follow-up. Do you see any material impact from IFRS 15 on working capital?

Bernard Schäferbarthold^

We will probably see, I would say, in the allocation of the different positions, changes, but overall working capital will stay the same. It will only be allocation in different lines, but overall I would say no change in working capital because overall, the aggregation of the positions, the net sum will remain the same.

Operator^

Your next question comes from the line of Ashik Kurian.

Ashik Kurian^

I've got a few. First is just trying to understand your margin progression for next year and especially on the auto side. Maybe if you can help us, give us a bit of colors on, as you see now, are the numbers of launches you expect next year higher or lower than what you had this fiscal year. And also, you are expecting an acceleration of growth in electronics versus lighting. Does that have any impact on margins? Then the second question is I know you don't report it, but any commentary on how the order intake is developing, especially on the electronics side? I know you have a few products and the DC/DC converter and also on the ADAS side. And then recently you've talked about the fact that you are looking at a strategic review of certain parts of the Aftermarket business. Whether we have any update on that?

Rolf Breidenbach^

Yes. Thank you very much for your question. With regard to the gross margin development in Automotive, it's too early to say, of course, we will give you an answer in perhaps 3 months when we talk about our guidance for the next fiscal year, but today please understand it's too early to say. With regard to the acceleration in growth in Electronics and the effect on the gross margin, I have to give the same answer. Currently, we are putting together our budget planning figures. And I will now not start to speculate about our guidance, our performance in the next fiscal year. I hope you understand this. And the same is true for our order intake. We are not commenting on that.

Ashik Kurian^

And the Aftermarket.

Rolf Breidenbach^

Aftermarket. We continue to discuss and to assess what our best strategy is, but of course it's currently, with regard to our strategic activities, a clear focus.

Ashik Kurian^

Yes. Maybe again to just have a follow-up question on the free cash conversion. So this year, you should see a decent improvement in your free cash conversion maybe in the range of 7% to 8%. And like previously discussed, not much of the benefit from your planned working capital reduction has come through yet, so is it fair to assume that we should see another step-up in free cash flow in the coming years when you do put through the improvements on working capital?

Bernard Schäferbarthold^

Yes. So that is the clear target and that we want to further improve cash conversion.

Operator^

Your next question comes from the line of Victoria Greer.

Viktoria Greer^

Just two, please. Firstly, on the joint ventures, that number looks to have been stabilizing at this lower level in Q3, about 9 million, 10 million. That's the level that you reached already in H2 of last year. Should we think about that as now the sort of more normal level, about 9 million or 10 million of contribution per quarter? Or should we think about ongoing pressures on that line? The second question more broadly is just on European production. We've seen the European production estimates come up quite a bit for Q1; and then Volkswagen commenting also that, ahead of the WLTP emissions change in September, they will build some inventory ahead of that. What changes are you seeing, if any, in European production for calendar Q1? And then what's the outlook for Q2 from your side?

Rolf Breidenbach^

With regard to the joint venture contribution, currently we see, let's say, a going back to the normal level. One important reason for the reduction of the joint venture income were these, let's say, unfavorable developments in the Korean and Chinese market and activities. So currently we see a step-by-step coming back to normal level. Whether this will continue, of course, we do not know because these things are depending on economic, political questions, but so far we've seen, as I said, an improvement and we are quite optimistic that this, let's say, as you described, normal level will be achieved. With regards to the demand of our customers Q1, Q2, currently they are very stable, so nothing which currently concerns us. Also when we see the fluctuation over the weeks, currently a very stable situation; nothing surprisingly, so far.

Operator^

Your next question comes from the line of Lello Della Ragione.

Lello Della Ragione^

I have three left. The first one relates to FX. And I wanted to be sure that no hedging effect impacted the line from gross profit margin to EBIT. The second one relates again on the trend by region. You mentioned before that in Europe the performance is related to something that is happening at the German OEM level, but if we do the math for on a quarterly basis, the third quarter was a little bit weaker. And I mean, on that side, especially in Europe, since the performance is stabilizing and you're actually

underperforming in some quarters, what's happening? I mean, apart from the trend on the German, are you losing market shares there outside Germany? Is there some issue on the take rate of your products? Or is that any issue alike on European level? The third and last is on the trend in the fourth quarter, your fourth quarter of the fiscal year, you are mentioning a lot of ramp-ups. I mean, should we see some new products starting in your fourth quarter, meaning that we might see an acceleration in some of your lighting or electronic revenues on the fourth quarter?

Bernard Schäferbarthold^

On the FX, there is no effect on the gross margin. On your last question, on the growth, certainly I would say we stay within our guidance we have given in the Capital Market Day, that we want to further grow in the range of 5% to 10%. So basically this additional capacity supports then that growth going forward. So certainly the products we were also talking about also will contribute to that further growth. And that's, we talked about the additional capacities globally, so that is in Europe but also in the Americas and also in Asia.

Rolf Breidenbach^

And the ramp-ups which are now taking place step by step in the different plants are already reflected in the growth performance we have shown so far. And hopefully, we also can show it in the fourth quarter, which we of course also expect. With regard to Europe, as I said, on the one hand it's our clear strategy to over-proportionally grow in Asia, especially in China; and NSA. And with regard to Europe, we feel quite comfortable to at least grow mid- and long term with the market, so we are not concerned with regard to take rates or losing market share.

Operator^

Your next question comes from the line of Manuel Tanzer.

Manuel Tanzer^

Just 2 questions left from my side. The first one will be you mentioned the investments in the Aftermarket. Can you shed some more light on the taken measures and, or how exactly you plan to achieve that 7% profitability level. And the second one is on R&D. What is your localization rate with respect to R&D? As you mentioned that there's a significant negative FX effect, I would assume that it's strongly centered in Europe. That will be it.

Rolf Breidenbach^

Coming to your second question. On the one hand, of course, we have a very strong, indeed, R&D base in Europe, but we have also many, many engineers in the U.S., especially also in China, in Mexico. So not all our R&D people are in Europe. And therefore, we see that negative effect with regard to exchange rate in R&D. With regard to the independent aftermarkets, there are, for example, investments into new branches in our wholesale business. We have invested into our IT system in the months ago and years ago. And this step by step now will pay off in efficiency improvement. And of course, we are always working on our product mix, trying of course to develop it into the right direction. And all this, from our perspective, is resulting in the mentioned improvement in the margin in the Aftermarket area. For example, also we are currently launching our new diagnose system at Hella Gutmann, which is selling very well and is also contributing to this margin improvement.

Operator^

The next question comes from the line of Julian Radlinger.

Julian Radlinger^

Three from my side, the first one on free cash flow and then yet another one on gross margin. So on free cash flow, first of all, net CapEx was surprisingly low again this quarter, same as it was last quarter. Now you indicated that, in Q4, the net CapEx-to-sales ratio should go up again, but to reach your, you've been telling us net CapEx-to-sales, full year target of around or expectation of around 8%, the ratio would have to go all the way up to essentially 12% or something like that in Q4. Is that what we should expect? And will that be driven by the planned openings or the plant constructions happening in the fourth quarter? That's number one. And then the second one on free cash flow, this is regarding the customer reimbursement. Mr. Schäferbarthold, you told us back in November or December that you expect a significant amount of customer reimbursements this year, maybe even as many as or as much as EUR 300 million worth. Year-to-date, first 9 months of the year, we've only had slightly over EUR 100 million. Can we expect accordingly a very substantial increase in the amount of customer reimbursements in Q4? And then my last question, on gross margin, let me rephrase what I guess everybody else has been asking in one way or another. You've been cautioning us about the negative impact on the gross margin from all these planned openings that started essentially back

in October last year on the gross margin due to the lower capacity utilization while these plants ramp up. However, in Q1, Q2 and now in Q3, we haven't really seen the gross margin decline at all. It's either been stable or even increased. And so my question is that in line with your expectations? Did it surprise you that the gross margin has actually been holding steady or even been better year-on-year despite of these planned openings? Or is it because the really big planned openings are yet to come now in Lithuania, in China and so forth throughout the rest of calendar 2018?

Rolf Breidenbach^

Yes, allow me to start with the third question. And then I will hand over to Mr. Schäferbarthold. With regard to the gross margin development, we see this negative impact with regard to the utilization, but on the other hand, of course there are other elements which are influencing the gross margin, material costs and productivity. And so far, we were able to compensate this underutilization, but you mentioned now these plant openings, for example, with regard to our huge, huge electronic plant in China and also in Mexico. And whether this compensation from other sectors will also be possible in the future, we do not know. So far, we are very satisfied with this development, but as you already mentioned, the big plant openings now will come. And therefore, we are a little bit cautious with regard to the further improvement of the gross margin.

Bernard Schäferbarthold^

To your 2 remaining questions. One is the reimbursements. Yes, we still expect around EUR 300 million of reimbursements overall, but my comment, I did, partially you see these reimbursements in the net CapEx number and partially you see it within the receivables, respectively in the inventories. And this depends from an accounting perspective who at the end is the owner of these toolings. Remember one of the questions was why are the receivables higher? Because also we invoiced some of these toolings to the customers. And one reason why the inventories are also higher is still we have a lot of, I would say, project-related toolings still in the inventories in preparations to the ramp-ups where the owner afterwards will be the customers. So that, again you talk about the EUR 300 million, it's then the aggregation of both. To the net CapEx, the 7.5% overall is like, yes, I would say, an orientation point. Yes, we will see a higher number at the end in Q4, if you compare it now to the first 3 quarters, but I don't assume that we will really reach that overall number that year. So we will be lower than the 7.5% at the end of the year.

Operator^

The next question comes from the line of Kai Mueller.

Kai Mueller^

Just three, if I may. The first one, on your takeup rates in the LED space, you've already mentioned there are sometimes quarters where project ramp-ups are slower than expected, but generally how have you been seeing those rates developing versus what have been initially booked as an order? And then how this amount is actually shaping up. That's the first one. Second one, on the WLTP, we obviously spoke about possible impact on the production shape in Europe over the next couple of quarters. What's your implication actually in terms of the model variety? Does that have any implications on possibly the types of headlamps that you're shipping into those vehicles that could have consequences on possibly actually reducing a number of varieties? And then thirdly, just to come back on that, I know it's been a while, but Conti started that JV obviously with Osram, competing also in the field of lighting. How do you see that shaping up and also in terms of your relationship obviously to Osram given they're delivering quite a lot of your chips that you put into the headlamp systems?

Rolf Breidenbach^

Perhaps starting with your third question. Our relationship to Osram is one of our important, but only one LED chip supplier, will not change. Osram is a very professional company. And we are sure they will separate these 2 businesses and will act, as I said, very professionally. And we will do the same. So from our perspective, the supplier-customer relationship between Osram and HELLA will not change, and Osram will remain an important supplier for us. Of course, this joint venture, let's see how it will be now positioned in the market when 2 companies like Osram and Conti are building a joint venture. We have to take this very seriously. The competition can increase, but so far, we are not concerned. With regards to the take rates, on the one hand, we see continuing trends to these LED, full-LED headlamps. It depends a little bit on the segment, whether our customers order only 100% LED headlamps, sometimes a low-end and sometimes a high version; or whether they still want to have a halogen version. Of course, especially in the mid- and low segment halogen is the cost-competitive technology, and therefore it will remain. But overall the take rate and the demand of LED headlamps is still increasing. And when we now look at the new vehicles, we see that this will again from our perspective lead to an increase of the importance of the LED technology because the front end, the whole front end is or let's say it's the other way around. We see the headlamps, for example, more and more integrating into the front end. So integrated solutions are demanded. The same is true for

currently smaller, more compact solutions. And all this will support the continuing increasing demand of LED technology.

Kai Mueller^

And on the WLTP and how that impacts the offer that you have for cars or the number of models possibly.

Rolf Breidenbach^

So far, we do not see a big influence. So we feel well prepared with regards to our platform and module strategy. So an interesting, new field but nothing which will significantly change our product or technology road map.

Operator^

The next question comes from the line of Sascha Gommel.

Sascha Gommel^

The first one would be a follow-up on your comments regarding the European market and that you expect to grow in line with the market. Now looking back at the Capital Market Day, you showed a lot of slides where you showed your potential to increase content per car, so maybe you can help me understand how to reconcile those slides with your statements that you only expect to grow in line with the market. And then secondly, can you just update us about your M&A strategy because I had the impression you're very eager to do deals. And then lastly, considering that there's a lot of pressure on CapEx budgets in the whole car industry, do you see some of your competitors in areas where they're small that they are actually leaving the market in order to focus their budgets on products where they're stronger? And would you consider something similar with product areas? And maybe you can, if so, highlight what product areas that would be.

Rolf Breidenbach^

Yes, coming to your first question: Again, I have to point out the huge growth rates in NSA and NAFTA. And therefore, we try to here continue an over-proportional growth and with regards to the market development in Europe, as I said, we always try to overperform the market, but when I look to the demands, especially also in the next quarter, I assess that we will grow with the market. Mid- and long term, of course, we have the clear ambition

to also overperform the European market, referring also to the product road maps we have shown at the capital market day. Will this happen? This, of course, depends on our performance, on our acquisition performance and on the quality of our products, but we are quite optimistic in this regard. With regard to M&A, yes, we still remain interested in doing acquisitions. And we are talking to a lot of companies and potential partners, but I again have to say that the targets are currently very, very expensive. And when the business case does not pay off for us, we will not do it. And this is currently the challenge we have to handle. And with regards to CapEx, of course, we as an automotive supplier have to look on our CapEx. This was one of the reasons why we started this cash improvement program, due to the fact, and I think this was included in your question, that so many investments now have to be made in new technologies. And this is not only software. This is of course, in the end also hardware, new tools, new facilities, new equipments and devices. We have to optimize these topics, but we are working hard on that. With regard to the trend that some of our competitors are now focusing more on the one or the other product or technology area, currently we have no signs that this is taking place, let's say, on a larger scale. Because, to be open, many, many of our competitors are the big, for example, electronics suppliers, which from our perspective follow more a full portfolio strategy than focusing currently on a specific area.

Operator^

Your next question comes from the line of Akshat Kacker.

Akshat Kacker^

Just a quick follow-up. I recently heard from Audi that rear sensors that were earlier used for lane changing and maneuvering or Level 2 autonomy are not really required and not essential going forward. So how are you seeing the demand for the 24 GHz radar sensor currently? And how is the launch of the 77 GHz?

Rolf Breidenbach^

So the use of radar for autonomous driving cars is assessed differently from different OEMs. When you look at some new OEMs, they are realizing most of their autonomous driving functionalities, for example, with camera. There are others who are using combined systems of lidar, radar and camera. So the strategies are different. Which strategy will be the most successful, nobody knows, from my perspective, because currently all our customers are trying out their different business cases. They are improving the performance of

their systems. Therefore, this technology race is not at an end. And therefore, the scenario you described is possible. Will this be the dominant scenario? I don't know. Because we currently see a huge demand of 77 GHz radar systems, on the other hand. But of course, radar sensors can be substituted by other sensors or by camera functions. And this is, of course, true. So the demand of radar sensors is currently, from our perspective, rather increasing than going down. And 24 GHz, of course, is currently, with regard to the cost position, a very important technology for us, but due to the fact that we need the higher performance of the 77 GHz sensors in the mid- and near field, we are currently developing this technology. The first offers are out. This is the current status.

Operator^

Thank you. There are no further questions. Please continue.

Rolf Breidenbach^

Okay, then from Mr. Schäferbarthold and my side, again thank you very much for taking the time for listening to our overview, for asking the questions, discussing with us and overall for the interest in our company. Thank you for that, and have a good time. Bye.

Operator^

Thank you. That does conclude the conference for today. Thank you all for participating. You may now disconnect. Speakers, please stand by.

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