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P: Björn Voss; M.M. Warburg; Analyst
P: Victoria Greer; Morgan Stanley; Analyst
P: Florian Treisch; MainFirst Bank; Analyst
P: Jürgen Pieper; Metzler Capital Markets; Analyst
P: Xavier Caroen, Bryan, Garnier & Co.; Analyst
P: Lello Della Regione; Intermonte; Analyst
P: Rajeev Gupta; Citigroup; Analyst
P: Nikhil Bhat; JPMorgan; Analyst
P: Ashik Kurian; Jefferies; Analyst
P: Michael Punzet; DZ Bank; Analyst
P: Operator

COMPANY EDITED TRANSCRIPT

Operator: This is conference # 961600.

Good afternoon, ladies and gentlemen, and thank you for standing by.
Welcome to today's Hella Investor conference call.

At this time, all participants are in a listen-only mode. There will be a presentation followed by a question-and-answer session, at which time, if you wish to ask a question, you will need to press star one on your telephone and wait for your name to be announced.

I must advise you that this conference is being recorded today, on Thursday the 6th of April 2017.

I would now like to hand the conference over to your speaker today, CEO Dr. Rolf Breidenbach. Please go ahead, sir.

Rolf Breidenbach^ Yes, thank you very much.

A very warm welcome to all the participants of our today's investor call with regard to our third quarter results, also on behalf of my colleague, Mr. Schäferbarthold, our CFO. We really appreciate that you have taken the time for this call.

Overall, we are quite satisfied with the third quarter results. As expected and also discussed in our last telephone call, the growth in the third quarter has accelerated. This means that now after nine months we grew by 3.5% on an adjusted basis. And when we only look at the third quarter, the growth was at a level of 5.5%. Nothing unexpected, but as I said before, the acceleration of growth we also forecasted and discussed three months ago and we think that this trend of the acceleration of growth will continue because additional launches will also take place in the fourth quarter.

We're also quite satisfied with the financial situation after nine months. We can show a gross profit margin of 27.5%, an increase of 0.3%-points on a year-on-year comparison. When we look at the adjusted level, we could increase our EBIT by EUR28 million after nine months; and also in the third quarter on a year-on-year comparison, we are significant stronger.

So we are currently year-to-date at a EBIT margin of 7.8% on an adjusted basis. With regard to the third quarter, we are at 6.5%; 0.7% higher than the third quarter in the last fiscal year. This has especially to do with our lower R&D rate, something which we also expected and discussed in the last call.

Also when we look at the free cash flow, a good development. Compared on a year-on-year comparison, we are EUR30 million stronger, so we have a continuous strong basis for our future growth; no, from our opinion, complaint from the cash side, a strong financial constitution. As I said, overall, the third quarter ran as expected.

When we look at the second slide here again a more detailed explanation with regard to our adjustments. On the one hand, we adjusted the portfolio topic, this means the sale of our industry's activities. And on the other hand, the currency influence. This means we in the end came to a net growth rate of 2.6%, adjusted the already mentioned 3.5%.

The reason for this acceleration of growth is mainly driven by Automotive, which is now step-by-step developing into the right direction. We could show an increase of 2.4% now for the first nine months. On a year-on-year comparison, Automotive has grown by 6.1%, which shows the acceleration I mentioned.

The reason for that is especially, on the one hand, an increasing demand for energy management products and on the other hand significant ramp-ups in Eastern Europe with regard to lighting products. Also the aftermarket segment shows, in our opinion, a quite satisfying growth rate of 5.5% on a year-on-year basis, especially the workshop equipment area has grown significantly, as well as our wholesale business.

With regard to Special Applications, we have this special effect of the sale of our industry business. Adjusting that Special Application slightly grew on a year-on-year comparison by 0.2% and the very difficult situation in the agricultural market is still there, and the business is suffering from this market weakness also in the third quarter.

When we look at our overall growth performance compared to the automotive market, we again see a significant weaker growth in Europe. So on a nine month basis, we underperformed the market by 3.3%, but when we look at the third quarter, we were already able to outperform the market by 1.6% in Europe. When we look at NSA, we could show a significantly higher growth rate year-to-date, but also in the third quarter. On a nine month basis, we could outperform the market by 8.8%. And also in Asia, we grew stronger than the market by 1.6%, which also shows the general tendency of the acceleration of growth in the third quarter.

So, again, allow me to say that we are very satisfied with the development of our third quarter; no surprises. We are, on the one hand, of course, satisfied that now the growth dynamic has come and that our sales developed as expected and the same is true for our, in our opinion, quite solid financial performance especially when we look at the adjusted EBIT level of 7.8% on a nine month basis.

This is so far from my side with regard to the highlights of our current financial figures, and allow me now to handover to my colleague Mr. Schäferbarthold the CFO of HELLA, who will explain you now in more detail our financial performance.

Bernard Schäferbarthold^ Thank you.

Good afternoon, ladies and gentlemen also from my side, I would continue in our presentation on page eight. As Mr. Breidenbach was stating we are pretty pleased about further development of this fiscal year. All for us important financial metrics have further developed positively and are in line also with our plan, and what we explained also in our last call.

Looking at the gross profit, we have increased the adjusted gross profit by EUR49 million, plus 4% on a year-on-year comparison. On reported numbers, it was even an improvement of EUR76 million, 6% plus, bear in mind here that especially last year we had a significant extraordinary effect with the default of a Chinese supplier, which accounted for EUR27 million.

The increase was on one hand side, due to a higher volume and the pick-up in growth especially in Q3 in Automotive and also in Aftermarket, but in addition to that, we improved also the gross profit margin by 30 basis points, due to a higher utilization in the first nine months, but also a higher efficiency in a year-on-year comparison.

Q3 only improved by EUR23 million especially driven by Automotive. The gross profit margin is unchanged on the year-on-year comparison 27.0, we had an improvement in Automotive, but a slight decline in aftermarket, especially due to the fact that we had a higher share in this quarter with third-party products.

Going to the next page on the R&D expenses in the year-on-year comparison, we had 4% higher expenses EUR19 million. The higher expenses reflect especially our investments in already acquired projects in the past periods, and will certainly also support our further growth in the coming years. In absolute terms, we have spent EUR157 million in Q3 and that is unchanged, compared to the Q3 quarter last year, but also unchanged, compared to our previous quarter in this fiscal year.

The ratio is slightly up this year on a year-on-year comparison, but that is due to the fact that we had a lower growth, especially in H1 of this year. Looking at the nine months, compared to H1 we were able to reduce the higher ratio and our expectation that it should also go slightly down to the end of this fiscal year with also growing business in Q4.

On the SG&A, we increased the expenses moderately by EUR11 million, more or less in line also with the sales growth, ratio is at 10.8%. The increase reflects especially investments we have done in distribution, in Automotive, but also Aftermarket and in the administrative functions also especially in IT infrastructure, but also systems and processes.

In Q3, our adjusted SG&A ratio is more or less also unchanged, and sales distribution is roughly higher, but in line with growth on the administration side slightly above our growth in Q3, but that is purely phasing of projects, we have realized in respective functions.

On page 11 EBIT, in the first nine month increased by EUR28 million and that's an increase of 8%, in that number EUR12 million is included on additional cost we had after having sold our industries and airport business, and that is an impact of 0.4% in EBIT, which is included in that number.

Adjusted EBIT margin is at 7.8%, but again the cost of industries and airport are not adjusted, they are still in that number. The improvement as stated is on one hand side coming out of a better gross profit margin, but also improvement in our joint venture incomes with the 0.2%.

Some more details on our P&L on page 12, our reported EBIT improved by EUR59 million to a level of EUR348 million. We did adjustments in the fiscal year 16/17 of EUR25 million, compared to last year the number was EUR55 million, that is EUR30 million lower. We have roughly similar adjustments of around EUR9 million related to our restructuring measures in Germany. And this year, we had also in H1 our provision we booked on case initiated by the European Cartel Authority of EUR16 million, and there our judgment is unchanged. That should cover the risk we are actually seeing today.

Last year as mentioned EUR47 million was the overall adjustment, due to the default of the Chinese supplier. Together with better financial results on the year-on-year comparison, but also an improvement in our tax ratio we can show an increase in net profit of EUR64 million to overall EUR248 million, and this turns into an increase in earnings per share of EUR0.58 to EUR2.21 per share.

On the cash flow, on page 13, the adjusted free cash flow has further improved in Q3 by EUR19 million, and after three quarters we stand at EUR86 million, and that is a EUR30 million improvement on the year-on-year comparison. This improvement is on one hand side driven by a higher net profit, I just explained, but also by an improvement in working capital in Q3 we were able to realize.

Net CapEx increased by EUR31 million mostly related to acquired projects in the past and should support also further growth in the upcoming periods. Q3 only we have an improvement, which is EUR58 million. We had a negative free cash flow last year of minus EUR39 million. Same reasons as on the first nine months, higher profitability and a reduction in working capital in Q3 of overall EUR33 million supported that improvement.

Coming to the segments on page 14, the Automotive segment, the reported growth in the first nine-months is at 2.4%. We see here the acceleration of growth, especially in the Automotive as also expected and told to you in our

last call, that this has taken place and we have been able to grow the business in Q3 at a level of 6.1% with several project ramp-ups, which happened.

And we see also in Q4 that this dynamic is continuing, so that we are quite optimistic here as stated also before. On group level FX here is at negative 0.6%, but which is not now counted in this 6.1% stated reported growth in Q3.

Growth as Dr. Breidenbach was stating is especially coming out of NSA and Asia, but also we had a good pick-up in Europe in Q3 with the growth of 3.1%. EBIT increased by EUR35 million and ended at a level of EUR314 million in the first nine months. EBIT margin 8.6%, no adjustments in 16/17 booked and the improvements, especially coming out of a better gross profit margin, but also a better JV income result and ratio of 0.2, and this compensates slightly higher R&D we have also in Automotive.

On page 15 Aftermarket / Special Application. Aftermarket continues the growth also in Q3. In the first nine months 4.5% growth year-on-year. All areas contributed to that growth, independent aftermarket, wholesales, but also our business in workshop products continues to grow. EBIT improved overall by 2.5 million to 51 million. EBIT margin is unchanged compared to last year and the first nine months.

Special Application is impacted by the disposal of our assets in industries and airport lighting end of last year. The additional cost we have overall in that fiscal year now at EUR12 million. On top of that, we have one relocation of a production facility to Eastern Europe, we also commented in the first-half call with EUR3 million. Adjusted to the disposal of the industries and airport lighting business, sales grew at a very low level of 0.2% in the first nine months and the EBIT was at EUR2.3 million only. But taking into account the EUR15 million extraordinary costs this year, certainly also we see still an impact of the quite difficult agriculture sector, Dr. Breidenbach was also mentioning.

Page 16, an overview on some selected financial metrics on Q3 only, the most of them I already commented, so I will very shortly only give an overview. Adjusted growth at 5.7%, light vehicle production on this single quarter 4.2%, comparing that with our Automotive growth of reported 6.1%. So we are around 50% above market growth, which we are pleased about overall.

Adjusted EBIT margin is at 6.6% as commented in absolute terms EUR105 million EBIT versus EUR89 million adjusted last year, which is a 17%

increase. Q3 only we had adjustments of EUR2 million related to restructuring measures in Germany.

On the segments on page 17, you see here growth in Automotive and Aftermarket with quite decent rates. You see that Special Application is negative, but excluding Airport Lighting and Industries, we would have a slight growth of 1.3% in that segment. So here you can see the acceleration of growth compared to H1 as we stated also in the last call.

We see adjusted EBIT margins in Q3 only improvements in Automotive and especially Aftermarket with a decline, as mentioned because of product mix and a higher share of third-party products. SOE is at 2.4% including Airport Lighting and Industries, 6.1% excluding extra costs we had also in Q3.

That's all from my side on more details on our financial performance. And with that, I hand back to Mr. Breidenbach for the outlook.

Rolf Breidenbach^ Yes, thank you very much.

With regard to the outlook, let's say nothing has really changed compared to our first half year outlook. So with regard to the latest IHS light vehicle production expectations, we see let's say a moderate growth globally by 1.9%. The growth in Europe of around 1.7% to around 22 million vehicles. We also see a moderate growth in China by 2.5%, and a very flat market development in North and South America for the calendar year 2017.

So to sum it up, overall let's say a moderate positive growth expectation, but no, let's say, noticeable tailwind from the market.

With regards to our guidance, our current outlook is 100% in line with the guidance we have given mid-August, and also in our Q1 and first-half year calls, so we expected sales growth excluding the exchange rate and the portfolio effect in a mid-single-digit percentage range. As I already said in Q3, the acceleration of growth which we expected has started. It will continue in the last quarter of our fiscal year. There are, of course, two more months now to come in which we are facing launches in lighting and electronics, but so far there is, let's say no development visible which in our opinion could influence our guidance. So nothing which concerns us, HELLA internally or with regard to the external influence on sector.

With regard to our adjusted EBIT margin, we see this EBIT margin according also to our latest guidance at a level of the previous year, compared to the first half of our fiscal year, we see in Q3 a temporary dilution of the gross profit margin, which as we already discussed has to do

with the many, many launches we are currently facing. On the other hand, of course, Q3 is one of the more weaker quarters and contrary to that Q4 is in general a very strong quarter. So we can expect that the profitability for the full year will be, let's say, more on top, so on the very high level of our guidance.

With regard to our guidance to the fiscal years to come, we see and the third quarter in our opinion was the first proof for that acceleration of our growth dynamic, so that we are quite confident that we step-by-step will come back to a growth level which significantly outperforms the automotive market.

Okay, this was it from Mr. Schäferbarthold and my side with regard to the details of the financial figures and the outlook. And now, we are looking forward to answer your questions.

Q&A

Operator^ Thank you very much. Ladies and gentleman if you wish to ask a question at this time please press star one on your telephone key pad and wait for your name to be announced.

And your first question comes from Christian Ludwig. Christian, your line is open.

Christian Ludwig^ Yes. Good afternoon, gentleman.

First question is on the slide six you presented, where you compare your Automotive sales growth with the global light vehicle production. I had a look at it and just can't make ends meet base, you are saying that you underperformed Europe by 3.3%, and outperformed all the other regions to different degrees, but still on a global basis, you've underperformed by even 3.6%. Maybe you can help me out to get that math together. That was number one.

The second question, basically almost answered, because the seasonality would always imply that your Q4 at the Automotive margin goes up versus Q3. Now, I think you said basically with the profitability at the high-end that that is the usual pattern we should also expect for the full year. Just want to get that confirmed.

And the last question is on your Special Applications margin. At the Q2 call, you kind of indicated that we should expect roughly EUR12 million of EBIT for the second-half, which implies a EUR6 million run rate. Now, we're well

below that in Q3. What is going on there? Why is the margin so disappointing? Maybe you could shed some light on that. Thank you.

Rolf Breidenbach^ Okay.

With regard to the outperformance and underperformance of the markets, that's again the numbers. So an underperformance of 3.3 in Europe, in NSA plus 8.8%, in China the single figure is minus 1.4 and in Asia plus 1.6; as you said, globally an underperformance of 3.6. So, to get you more details, I would recommend that Ms. Dodel send you our Excel sheet, if that's okay for you.

Christian Ludwig^ Okay.

But you see where I'm getting, right? Europe is only minus 3.3, the rest is better than the market and still on a global basis, you're minus 3.6 even worse than Europe, that just doesn't make sense to me?

Rolf Breidenbach^ Yes.

I think it depends on the rest of the world figure. So as I said Ms. Dodel will give you the details, is that okay?

Christian Ludwig^ Okay. Thank you. Yes.

Rolf Breidenbach^ Okay. What was your second question?

Christian Ludwig^ Well.

The usual seasonal pattern for you is that your Q4 margin especially in Automotive is significantly better than Q3. And I just wanted to get confirmation that despite the more product launches, we will see a similar pattern this year?

Rolf Breidenbach^ That is correct.

Christian Ludwig^ Yes, okay.

Rolf Breidenbach^ And the third one? Sorry that you have to repeat it again.

Christian Ludwig^ And that was on your Special Applications.

You had guided initially that we should be looking for EUR12 million

EBIT contribution in the second half, which will make a run rate of roughly EUR6 million. Again, we are well below that in Q3. So what additional costs were occurred? Why is this business not able to return to margin we have seen before?

Bernard Schäferbarthold^

What we have to admit that we had to take extra costs on the disposal of the assets in Industries and Airport Lighting, which we have assessed differently in our H1 call, but this was basically a EUR3.5 million, roughly EUR4 million additional cost we have not, I would say given as a guidance to you.

If you would take out these EUR12 million, our EBIT margin was roughly 6%, slightly above 6%. So that, if you would take these costs out and you would look also at Q4, we would, I would say, come to that level despite the fact that still agricultural market is not really picking up and supporting that, but the business is continuing and from a low level, we think that we should develop it further and it should improve further in the, hopefully, in the next periods.

Christian Ludwig^

But is there a risk that we will see another impairment or asset write-down in Q4 as well?

Bernard Schäferbarthold^ Hopefully not.

I think that we have now seen the vast majority, I would say most of it is closed of the projects we had still, I would say, to negotiate, but still there is, I would say, a minimum risk, but which will not really have a significant impact, if we really look at the overall numbers. I can ensure you that we are also not really happy about that, but we had to take it now.

Operator^ Thank you, sir.

Your next question comes from Bjorn Voss. Bjorn, your line is open.

Björn Voss^ Yes, good afternoon, it's Björn Voss of M.M. Warburg.

Mr. Breidenbach, and I think at the beginning of the call you said or you highlighted the acceleration in top line growth. And I think you also said that

this will develop even more pronounced from next fiscal year. So should we assume next year, at least in the Automotive business to show a higher than 6% topline development? This is my first question.

And second one, what about ramp-up charges in the fourth quarter, and also in the next year? I think, Q3 had been impacted by these and what's your expectation for the fourth quarter and then also for the next year. And then a little bit of housekeeping one, one question with regard to the interest income, I think interest income in the third quarter dropped to just EUR1 million, in the first quarter it was EUR12 million, second quarter it was EUR4 million, so quite a low interest income. Maybe you can help me to understand what happened there. Thank you.

Rolf Breidenbach^

Yes, with regard to the topline growth, as I said, we see an acceleration in the fourth quarter, compared to the third quarter. In the third quarter, we have grown by 5.5% as you also mentioned. So for the fourth quarter, we are quite sure that this acceleration will take place, because we can see the development of the markets and we of course can combine them with our launches and the running and products.

With regard to the fiscal year to come, it is a little bit early to say, but I only can, let's say, again repeat our guidance. We are very, very sure that our growth dynamic will increase. And therefore, we see a growth rate higher in the next fiscal year than we will show this fiscal year, but, let's say, more I cannot say. Perhaps, we can give more guidance at our Capital Markets Day, but today in my opinion, it's too early to say more than I now said.

With regard to the ramp-up charges, we were quite satisfied with the ramp-up costs in Q3. And therefore, we are also quite optimistic that now our ramp-up performance will continue to improve. And this is not only true for the fourth quarter, but also for the next fiscal year. When we talk about these ramp-up charges, they are mainly occurring in the lighting area due to the very complex, and from a technology standpoint, quite challenging LED products, and we get more and more experience in that, so that step by step these charges and these special costs should go down.

Bernard Schäferbarthold^

The financial results, Q3 this year is more a normalized level, I would say. You could also, basically assume some volatilities depend on hedging, but going forward Q3 last year was certainly negatively impacted by valuation of

some securities we had, and which had on this single quarter, a negative hit to take. So it's basically a two negative Q3 15/16 we are comparing with.

Björn Voss^ So you were referring to the financial result in time, right?

Rolf Breidenbach^ Yes.

Bernard Schäferbarthold^ Yes.

Björn Voss^ Yes. Okay. Alright. Thank you.

Operator^ Thank you.

Your next question comes from Victoria Greer. Victoria, your line is open.

Victoria Greer^ Good afternoon and one longer-term one from me, please.

We've seen an increasing amount of changes from the OEMs around their whole powertrain strategies. Firstly, obviously with diesel volumes continuing to fall, but then things like, Daimler for example, bringing forward their EQ range plans. Could you talk a little about, firstly, where you're seeing the major interest in future products for now, and how that's changing as the OEMs trying to think about being flexible around their powertrain requirements?

Rolf Breidenbach^

So, overall, we see a lot of, let's say, new growth opportunities with regard to the general trends you also described, e-vehicle digitalization, also due to the fact that perhaps the diesel demand will go down, the pressure on the other technologies, on the one hand the conventional, let's say, gasoline engine and on the other hand the fast penetration of hybrid and e-vehicles all this is currently in favor for us. This means that the introduction of these new technologies at least in China and in Europe will be accelerated, and this means that for example for our energy management product like Battery Management Systems or DC/DC converters, products in the area of driver systems, systems like our radar components or our camera software, all of them will be supported by these general market trends.

There is also this tendency of digitalization of the lighting products, these high definition headlamps, which now will be step-by-step introduced into the market. So, on the one hand of course, it's very challenging, I think not

only for us as a supplier, but also for our customers to exactly calculate the impact of these different technologies to the market demands.

But all these trends in our opinion are much more chances for HELLA than risks or threats and in our opinion one thing is clear, due to the legislation discussions, which are going on especially in Europe and also in China, due to the real concerns the people have in both regions with regard to air pollution, fuel efficiency, environmental aspects, electrification, the introduction of hybrid vehicles will be pushed not only from the OEM side, but also from the demand side. And therefore, we see, as I said, an acceleration in both electrification and digitalization and those tendencies will be huge chances for HELLA to continue the growth story we have shown in the past.

Victoria Greer^ Thank you.

Operator^ Thank you.

Your next question comes from Florian Treisch. Florian, your line is open.

Florian Treisch^ Yes. Hello, gentlemen.

Florian Treisch speaking from MainFirst Bank. I have two questions. The first is on the R&D spending side. If you look at the last couple of years, we have in two or three cases seen a strong rise in R&D spending in the fourth quarter and only one flat spending here. What is your assumption for the fourth quarter? Are we seeing again a step up in R&D spending?

And the second question is around, as you've highlighted and given your very solid financial position, are you kind of having a changing approach going more proactively for M&A, I was mentioning your Aftermarket business or diversifying your electronical business for example, any comments here from your side?

Rolf Breidenbach^

I think with regard to the R&D spending percentage-wise, we expect in the fourth quarter a reduction: At absolute level, a slight increase, but this is only an estimation. Could you again repeat your second question?

Florian Treisch^

More general question, when it comes to your M&A strategy given your solid financial position currently, are you now more proactively going for, for example, a move into Aftermarket segment for whatever regional expansion or if you're going for new product technologies and for example electronical space, if you can give an update here?

Rolf Breidenbach^

Yes, we will continue significantly investing into our electronic division with regard to especially software products like camera software and also in the driver assistance system area, and here especially radar and perhaps other technologies. But also we will continue investing in our energy management area, battery management system as a key word.

So we will continue to invest significantly in D&D, and as you said of course, we have quite a good financial situation. Therefore, when we look at our M&A activities, as we discussed also in the last calls, we are interested in doing the one or the other move in the Aftermarket or in the Special Application area, but the same is true for Automotive. But, we are a little bit careful with regard to the current prices we have to pay.

So, currently we are involved in intensive discussions in all areas with potential targets, but we do not exactly know whether we are really successful to acquire the one or the other interesting company. As I said, the prices in our opinion are here and there very, very high, and therefore we are careful when we think that mid and long term of business case will not pay off with these kind of acquisitions, but we are, as I said, in intensive discussions with regard to M&A activities.

Florian Treisch^ Thank you very much.

Operator^ Thank you.

Your next question comes from Jürgen Pieper. Jürgen, your line is open.

Jürgen Pieper^ Yes. Hi, gentleman.

Good afternoon. My first question is on the reasons for this acceleration, the background. Is it firstly new customers, is it regional expanding or is it real innovation in the end as a primary driver?

And secondly, just a simple one, the tax rate has more or less fallen consistently over the past years and now at 22%. Is it something to work with for the future or this 25% a better figure to expect?

Rolf Breidenbach^ Yes, allow me to answer the first question.

This growth is a combination of some developments. On the one hand, of course, innovation, especially our products in energy management are very well received by the market, and the same is true with regard to the LED lighting products, of course innovation also plays here an important role. When we look at the regional contribution, as you could see, on the slides, currently our growth is significantly in Asia and in NSA, in Europe, compared to the market we are hanging a little bit behind, but I think in Europe, we will step-by-step growing faster hopefully.

Therefore, I see no, let's say, regional pattern, but two let's say main reasons for our acceleration of growth and this is on the one hand innovation, and on the other hand a much better penetration of existing customers.

Jürgen Pieper^ Thank you.

Bernard Schäferbarthold^

On the tax ratio, I would calculate with a 25%; it could be lower. So you have seen, for example, the 22%, it can be. But what we also observe on the other hand side is quite an aggressive approach partially in some countries, from authorities if it comes to tax audits. And that you have also seen in the last years, where we had to accept also tax payments regarding last year.

So that's something which can happen if, for example, transfer pricing is questioned in some countries, and we have then to accept a correction. So that overall, we will be in a bandwidth between 22 and 25 with some kind of volatility, depending on outcomes of audits we can have in different countries. So if you want to be on the safe side, 25% is certainly a good number overall.

Jürgen Pieper^ Okay, thank you.

Operator^ Thank you.

Your next question comes from Xavier Caroen. Xavier, your line is open.

Xavier Caroen^ Hi, Xavier Caroen from Bryan Garnier.

Actually I've one last question, which is on the profitability level for Q4 and for the full year. You mentioned that basically you could easily achieve the guidance of being in line with the adjusted EBIT margin of last year. So the question was more on what kind of granularity you can give on that, given that you could do a simple calculation having a 7.5% EBIT margin for the full year would imply a margin decline of 100 basis point compared with last year on the last quarter or Q4, which is quite there.

So I wanted to be sure that basically it is clear that another day, you will easily beat this guidance and that consensus is not too high at 7.7%, 7.8% EBIT margin for the full year?

Rolf Breidenbach^

Unfortunately, I can only repeat what I have said. We are quite confident that in the end we'll end at the more higher level of our, let's say, guidance window, more I cannot say. We have still two months to go, we have these many launches and we are quite careful not, let's say, now to over-commit statements to you with regard to our financial performance.

So we are quite sure that we will end at the upper range of our guidance when we talk about profitability, but as I said, we are careful, launches are ahead of us. Allow me to state that we as of today cannot say more.

Xavier Caroen^ Okay.

And on the Aftermarket business, it's frustrating that the margin you've realized over the Q3, which was quite low, will further increase or we will come back to a more traditional level of 7% to 7.5% over the last quarter?

Rolf Breidenbach^

Difficult to assess, because the margin significantly depends on the product mix and we sold a lot of, let's say, external products.

Xavier Caroen^ Margins are lower, yes?

Rolf Breidenbach^

Yes. Technically, margins are lower. And how this product mix exactly will look like in the fourth quarter is, for us, very difficult to forecast.

Xavier Caroen^ Okay. Okay, clear. Thank you.

Operator^ Thank you.

Your next question comes from Lello Della Ragione. Your line is open.

Lello Della Ragione^ Hi. Thank you for taking my question.

Just first a clarification on the answer before on R&D, when you referred on the overall figure, you said it should increase were you're referring compared to this quarter or fourth quarter last year?

Another question on gross profit margin in fourth quarter and launch costs, you stated that you're working hard to do improvement on that term, yes these are headwinds on the other hand you're gaining efficiencies.

I was wondering if it is correct to assume that level closer to the one that you're reaching third quarter, so let's say the 27% is a reasonable one for the fourth quarter or the launches that you're going to have are going to depress this level? Thank you.

Rolf Breidenbach^

Yes. Thank you for your question. So with regard to the R&D ratio, I referred to the third quarter, so in the third quarter, we were at this EUR156.7 million.

Lello Della Ragione^ Okay, okay.

Rolf Breidenbach^

We will be a little bit higher percentage wise of course.

Lello Della Ragione^

No, that's fair, that's fair, because the fourth quarter last year was a very huge figure, so I was just double-checking it.
Okay?

Rolf Breidenbach^

Okay. With regard to the gross margin, as I said this is of course one key, let's say, element also with regard to our financial performance. Therefore, it depends, of course, on the launch cost, but I do not expect, let's say, a gross profit margin lower than in the third quarter. Hopefully, a little bit better.

Lello Della Ragione^ Great, Thank you.

Operator^ Thank you very much.

Your next question comes from Rajeev Gupta. Your line is open.

Rajeev Gupta^ Hi. Thank you. It's Rajeev Gupta from Citigroup.

And just two questions, if I may; first one was on the other income and expenses line. I see it was EUR25 million in 4Q '16, EUR12 million in 4Q '15. What can we expect in the fourth quarter of this year and what's the best way to think about the magnitude of this on an annual basis, just going forward think about how to model it going forward?

And secondly, I guess slightly more kind of medium to long term question on the cash flow and free cash flow opportunity and in fact may come about from working capital improvement. What do you think and will it be possible from a better management of payables for working capital and the improvement, that could have. And over what timeframe do you expect that to be realized? Thank you.

Rolf Breidenbach^

So perhaps I start with answering your second question. With regard to the, let's say, cash flow or cash conversion rate, we stated also three months ago

that we are not happy with our current conversion rate and you already mentioned we see significantly potential with regard to our accounts receivable management. So we expect a significant improvement in our cash conversion rate in the next fiscal year, of course without using any kind of program.

So no factoring, no reverse factoring at the supplier side, pure performance improvement with a special focus on the accounting management. Allow me not to say more, but we are not satisfied with our cash performance so far and we see an improvement in the cash conversion rate in the next fiscal year.

Rajeev Gupta^ And specifically on receivables, not payables is that right?

Rolf Breidenbach^ Both, both.

Rajeev Gupta^ Both. Okay. Thank you.

Bernard Schäferbarthold^

On the others, in the fiscal year 15/16 we had also impacts by the booking of provisions, which had a negative impact. This we hadn't in this fiscal year, that's the main reason, I would say for the improvement. On the other hand side or on top of that, we were able to release, especially in the first half an amount which supported the increase this year.

So, that's overall, if you would say what is the good run rate, so if you would basically reduce a little bit the amount we realized in the first three quarters, you would have a more normalized level. On the other hand side, it's difficult really to predict, because it can be that there is something which we have to recognize or we have to book something as a provision, on the other hand side we are getting some government grants as one example sometimes so that, all-in-all, I would say the amount we had this year is not so bad perhaps a little bit too high for a run rate.

Rajeev Gupta^

So, Q1 and Q3 of this year is perhaps more representative than the second quarter? Is that the right way?

Bernard Schäferbarthold^ So Q3 is, I would say, pretty okay.

Rajeev Gupta^ Okay, thank you very much.

Operator^ Thank you very much.

Your next question comes from Nikhil Bhat. Nikhil, your line is open.

Nikhil Bhat^ Good afternoon. This is Nikhil Bhat from JPMorgan.

I actually have just one question remaining. You made a comment on CapEx going into the fourth quarter of this year and next year. I didn't catch that fully. Could you please repeat how should we think about CapEx going into fourth quarter of this year and into next year?

Bernard Schäferbarthold^

CapEx, I'm not sure if I got your question, right. But CapEx, if you look at gross CapEx, we expect, if you compare now with Q3, that we should see in absolute terms that it should go up slightly, and due to the investments we are doing now for upcoming projects. So that is basically our view yet.

Nikhil Bhat^ And into next year?

Bernard Schäferbarthold^

Next year, we see also an increase, but not as huge as we have seen now if you would compare the increase last year and the year before.

Nikhil Bhat^ Understood. Thank you.

Operator^ Thank you very much.

Your next question comes from Ashik Kurian. Ashik, your line is open.

Ashik Kurian^ Hi, thanks for taking my questions.

I've got three, maybe I can take one by one. The first is just a clarification on your comment on acceleration of growth in Q4. I presume you expect organic growth higher than the roughly 6% that you delivered in Q3. Just wondering what is your underlying expectation for market growth in Q4, that

you're basing your guidance on, because the order production was up 4% for your Q3. So do you have a similar, if not a stronger underlying production baked into your guidance? And also is there any particular region that is driving the acceleration of growth that you see in Q4? I'll ask my next questions after this.

Rolf Breidenbach^

We grow in the third quarter at 5.5%. So we see an acceleration, so it's above 5.5%; a more concrete figure, I really cannot give you. And when we look where these launches are now taking place and when we look at the general market development, all the markets will contribute, but I think a special push should come from Europe.

Ashik Kurian^ Thank you.

Just to clarify, you do expect higher outperformance in Q4 than in Q3?

Rolf Breidenbach^

No, we expect a higher growth rate, so a higher rate than 5.5%. The outperformance of course not only depends on our performance, but also how the markets will run and then it's the question how is Europe's, let's say, product contribution to the different car lines. So allow me not to be more specific, but as I said, the external sales growth, we expect it to be higher in the fourth quarter than in the third quarter.

Ashik Kurian^ Okay.

The next question is we have seen your margins improved significantly or better than what you've done in the past years and this fiscal year which coincidentally was a year of lower growth.

Now, once growth resumes as you've expected during the upcoming fiscal years, should we expect the margin improvement to stall, because so far margins and growth have been fairly mutually exclusive for HELLA? So I'm just wondering whether we can continue this improvement on margins in the upcoming years even when the growth resumes.

Rolf Breidenbach^

Allow me now not to, let's say, widen our guidance for the next fiscal year, but of course it's our clear target to do both, to improve our margin on the one hand and to again come back to real outperforming growth rate in the years to come.

And the only thing what I can do is to again confirm our mid-term target to reach an adjusted EBIT margin above 8%, of course, now your next question could be what is mid-term. Here, I cannot be more specific, but of course what you said is right; a higher growth rate, let's say, supports better EBIT margins this is clear.

Ashik Kurian^ Okay.

The last question is probably one for the upcoming Capital Markets Day, but with the evolution of the LED headlights, is there a shift in the value-add between you versus the LED providers? I think, we've also heard some news that maybe OSRAM's become a Tier 1 on a particular model and stuff. So, is there any changing dynamics in the lighting industry and maybe a scramble for the value-add between you and the likes of OSRAM.

Rolf Breidenbach^

Of course, I will not now comment on the specific light source supplier, but overall there is the strategy of the one or the other light source supplier to do this forward integration. And so this is nothing new for us and has happened in the past and will happen today and in the future. So this is not a concern for us. When we now look at the new generation of high-definition headlamps, we see from the value-add side very good opportunities, because the control units for this headlamps are in our opinion quite complex. We can deliver these units, so additional sales potential for us. And also when we look at the number of suppliers who can deliver these kind of headlamps, we also see, not so many. So this further development of the LED technology is in our opinion a good opportunity for us.

Ashik Kurian^ Perfect. Thanks a lot.

Operator^ Thank you very much.

Your next question comes from Michael Punzet. Michael, your line is open.

Michael Punzet^ Yes, Michael Punzet, DZ Bank. Good afternoon.

I have two questions left. First one is, once again on the CapEx, you

mentioned higher CapEx in the next fiscal year only want to clarify that this is related to the absolute figure. Is it fair to assume that the CapEx ratio will go slightly down, especially if you take into account the expected sales growth?

And the second one is with regard to a former statement that you see a higher interest in product and solutions related to electrification, digitalization. Is that already included in your guidance and when do you expect some positive impetus on your sales development from these higher interest you recognized in the past?

Rolf Breidenbach^

Yes, perhaps to answer your second question first, the digitalization of headlamps has, let's say, already occurred within our opinion in the new headlamp of the E-Class. I mean here we have a significant increase of the single-light sources. Here we are talking about 84 light sources and this now step-by-step will be increased to 1,024 light sources, 50,000 light sources and so on, but the penetration of this new technology will, in our opinion, significantly influence the growth possibilities in more in, let's say, three to five years, and is not so significant for the development of the growth rate in the years to come.

Bernard Schäferbarthold^

On the CapEx, I was referring to an absolute increase. As of today, I do not expect now, that in percentages to sales, we would see an increase. On the other hand side, there is no value in itself, that we are only looking at CapEx. A lot of CapEx is also related to projects and project acquisition and related plans. What we are actually looking at, also with projects we are winning, if it makes sense to invest or not. But, as of today, we would only see an absolute increase and not a relative increase.

Michael Punzet^ Okay. Thank you.

Operator^ Thank you.

And your final question comes from Christian Ludwig. Christian, your line is open.

Christian Ludwig^

Yes, just a quick follow-up, also for modeling purposes, last year you had the highest result from your at equity contributions in Q4 with close to EUR20 million. Is this something you expect going to repeat itself this year or is this a more normalized level that we should expect in Q4?

Bernard Schäferbarthold^

Yes, honestly, I don't really have now the number in mind, we had in Q4 last year. Our expectation, if we would look now at the first nine months and you would divide it by three, this could be a more normalized level.

Christian Ludwig^ Okay. Thank you. Very clear.

Operator^ There are no further questions at this time, so please do continue.

Rolf Breidenbach^ Okay.

When there are no further questions then from the side of Mr. Schäferbarthold and myself, again thank you very much to all of you for your time, for your interesting questions and in general for your interest in our company HELLA. Thanks again and all the best. Bye.

Operator^ Thank you, ladies and gentlemen. That does conclude your conference call for today. Thank you all for participating. You may all disconnect, but speakers, please standby.

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