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COMPANY EDITED TRANSCRIPT

Operator: Dear ladies and gentlemen, welcome to the conference call of HELLA. At our customer's request, this conference will be recorded. (Operator Instructions)
This call is hosted by Dr. Breidenbach, CEO; and Mr. Schäferbarthold, CFO.
May I now hand you over to Dr. Breidenbach, who will lead you through this conference. Please go ahead.

Rolf Breidenbach: Yes. Dear ladies and gentlemen, good morning to all of you. This was Breidenbach speaking. Thanks a lot for dialing in. Welcome to the HELLA investor call on the first 9 months of our fiscal year 2021/2022. And as always, of course, also a warm welcome on behalf of my colleague and our CFO, Mr. Schäferbarthold.
Before we start with our presentation, I would like to make as always, some general remarks. Let me start with the market situation. We have seen higher volumes and then upside revision of the production forecast compared to the December estimates. IHS changes its assessments from an assumed decline of 9.1% for our fiscal year to a decline of 7.6% with its March forecast.
Production volumes in the second and third quarter declined year-on-year, but to a smaller extent than assumed months ago.
Nevertheless, the stabilization of IHS figures, which has been observed with the December, January and the February forecast ended with the update in March due to the impact of the Ukraine crisis. Especially the outlook for the fourth quarter of our fiscal year was corrected downwards in March to a small plus of around 0.3% compared to a growth expectation for fourth quarter of around 6%, which IHS expected in February and the downward revision was

mainly related to the European market. The correction shows that short-term uncertainties are very high, something we also pointed out in our last investor calls.

The full impact of the Ukraine crisis is, from our perspective, still not completely visible. And furthermore, COVID restrictions, especially in China are not fully reflected in our view. Actually, we see local shutdowns in cities like Shanghai and Changchun with respective closures of production facilities and disruptions of logistic chains. Despite the severe containment measures taken, the case load still is increasing. Therefore, production volumes in the coming months are from our perspective at high risk. The underlying demand in all regions is still strong, but the development of production in the next months and in the second half of 2022 is hardly to predict.

As mentioned several times, we think that the impact of bottlenecks will persist. Also, we expect relief step-by-step over the next quarters. This view hasn't changed. It is subject to the condition that the impact from the Ukraine crisis on the overall supply and logistic chains can be mitigated. We also see high risk for the supply chain in China. But for now, we only have limited visibility in this regard.

Let's now move to our actual business situation. In view of the challenging market environment, we can be somewhat satisfied with our performance in the first 9 months of our current fiscal year. In the third quarter, we performed, let's say, this way better than expected. At the beginning of this quarter, we assumed that the market would decline much more sharply, but this did not materialize. We commented already in our last call that we had a quite good start into the third quarter with overall better volumes in December, but we were cautious with respect to the development in January and February. Now with stabilizing volumes, our Automotive segment showed a sales growth of 4.4% compared to the prior year's quarter and again outperformed the market with the ongoing demand for our lighting and electronics products. The outperformance in the third quarter amounted to around 6.7 percentage points. We are especially satisfied with our performance in China, where we were able to realize important SOPs and outperformed the market by nearly 51 percentage points. Despite the growth, automotive only could reach an EBIT margin of 4% due to increasing cost

burdens, which I will comment on later. The profitability was better than expected and improved compared to the second quarter. I think here, strict cost management with dedicated measures as well as first results from customer negotiations supported the profitability in the third quarter. Our other 2 segments, Aftermarket and Special Applications, again, developed from our perspective, very positively in the third quarter. Both segments increased sales and show very solid profitability margins. The aftermarket business was driven by strong spare parts and workshop businesses, while special application benefits again from good businesses with agriculture and construction machinery.

With this better-than-expected third quarter, HELLA reached at group level, a currency and portfolio adjusted sales of EUR 4.6 billion for the first 9 months of the fiscal year 2021/2022, which is nearly on prior year's level.

By contrast, the margin is only at a level of 5.1%, which again constitutes a significant decline compared to the prior year's level of 8%. As commented several times, our profitability is negatively affected -- significantly negatively affected by additional costs caused by the disruptions in the global supply chain and logistics chain, ongoing production inefficiencies and raw material price increases, which especially put a burden on our Automotive segment. During our last call in January, we commented already on this increase in additional cost. And currently, we see them surpassing the upper range of the communicated level of monthly EUR 15 million to EUR 20 million. As mentioned, we see that energy costs are increasing to unexpected levels, and part of these rising costs are not fully hedged. In addition, some material price increases came into effect with supplier contract from January onwards. Furthermore, wage increases in some areas and countries are higher compared to last year coming into place now also from January onwards.

Let me quickly make a short remark on the development of the free cash flow. As mentioned already several times, we only have limited possibilities to reduce CapEx as we need to invest into product-specific equipment and also to do structural investments. Despite some improvements in sales, the working capital situation is still challenging, especially with respect to inventories due to the already known discrepancies between customer orders and actual deliveries. Therefore, the free cash flow in the third quarter is also negative,

although to a lower extent compared to what we have seen in the second quarter.

We do not see a big swing in inventories in the fourth quarter, and therefore, no normalization of working capital in this fiscal year. Although we expect a positive free cash flow in the fourth quarter, the free cash flow at the end of the year will stay negative. The envisaged black zero was the very best scenario anyway, as mentioned in our last call in January.

Let me now shortly comment on our outlook for the current fiscal year. The company outlook remains in line with the forecast that was lowered in November to reflect the lack of market recovery and rising costs. So we are expecting for the current fiscal year 2021/2022, a currency and portfolio-adjusted sales in the range of around EUR 5.9 billion to EUR 6.2 billion, and we expect an adjusted EBIT margin of around 3.5% to 5.0%.

This sales range still reflects the persistent bottlenecks and high market uncertainties, especially with respect to our customer demands. It accounts for a potential loss in volumes for the European market to up to 30% in our fourth quarter. So far, we had a good start into the fourth quarter. In May, we saw only a limited impact on the European volumes of around 10%. And the sales volumes in China was quite solid. The outlook for April and May is difficult and especially dependent on further COVID related measures in China. Currently, the dynamics of the pandemic in China are not developing into the right direction. We already had to close plants in affected areas and see also more and more customers and suppliers affected across China. We have very low visibility on how long closes will persists and how shutdowns will spread over China. So we see risk for extended and expanded shutdowns in China with associated losses of volumes.

The range for the adjusted EBIT margin reflects the ongoing burdens imposed to the HELLA business. Next, to ongoing inefficiency due to stop and go production, especially in the Automotive segment suffers from accelerating cost inflation and higher development expenses. We are working on the contracts with our customers, and we are able to sign first agreements to recoup additional costs that will support the margin in the fourth quarter. Last but not least, let me emphasize once again that our strategic parameters have not changed. The demands for our product and technology portfolio is

very solid. And the order book for strategically important areas like headlamps and electrification is very strong. And overall, the order book for this fiscal year, again, will be very strong. We will, therefore, continue our profitable growth path and continue to outperform the overall market. We see chances in a volume recovery in 2023, together with successful customer negotiations on pass-throughs and the volumes are needed to counterbalance increased cost burdens that will continue in 2023 and beyond.

Of course, we are working step-by-step in the coming time to improve our profitability. So we do not see any structural issues that might hinder us to bring our profitability mid and long term back to the level of 8% we have seen already in the past. Prerequisite for this is that volumes are coming back and that the influence of inflation can be compensated.

Having said this, let me now move to Page 4 of our presentation, starting with our financial results for the first 9 months of our fiscal year 2021/2022. As you can see, our currency and portfolio adjusted sales decreased by 0.9%. The reported group sales increased by around 0.2%. Our adjusted EBIT margin decreased by 36% to EUR 238 million. And thus, our adjusted EBIT margin is at a level of 5.1%. This is a decline of 2.9 percentage points compared to the first 9 months of the previous year.

Our reported EBIT margin is at a level of 4.8%. This number includes restructuring costs, mainly for the improvement program in Germany. Our adjusted free cash flow decreased by EUR 325 million to minus EUR 228 million. Lower operating profit, a negative working capital development within unusual high inventory buildup and higher CapEx are the reason for this.

Then let's quickly come to our automotive performance, our growth performance in the different regions on Page 5. As you can see, we outperformed the market in all regions. Our outperformance in Europe was at a level of around 11 percentage points. In North and South America, we outperformed the market by around 2 percentage points. And with regards to the rest of the world, our outperformance was at a level of around 40%. As already said, this is mainly due to a very strong performance in China. So all in all, on a global level, our automotive business outperformed the market by 8.2 percentage points in the first 9 months of our fiscal year.

Yes. Having said this, I would like now to hand over to my colleague, Mr. Schäferbarthold.

Bernard Schäferbarthold: Yes. Thank you, Mr. Breidenbach. Good morning also to all of you from my side. Starting with the group sales picture on Page 7. As already commented, volumes in Q3 were better than we expected. With that, reported sales is at the end of Q3 at around EUR 4.7 billion, which is at a comparable level to prior year. Currency adjusted sales is 0.9% lower compared to last year at EUR 4.6 billion. This year, there are no portfolio adjustments. Automotive is still negative in terms of growth at minus 1.6%. Positively, Q3 for automotive was again with a positive growth. In addition, we are growing strongly in China, as said, what we already anticipated and also strategically targeted for the future. We are also again pleased about the decent outperformance we had again in the third quarter, and we assume also as of today, a continuous outperformance also in the upcoming periods. The segments Aftermarket Special Application are continuously growing. End of Q3, both segments have reached a very strong double-digit percentage growth. Mr. Breidenbach commented our start into the fourth quarter, with the month of March was good despite the Ukraine war and still the bottleneck situation being severe. The risks for April and May until our fiscal year-end remain high. We here see that the lockdown situation in China, especially also for us in Shanghai as of today faces a significant risk for us, where we will have to see how long this takes.

If we go to Page 8, some comments on the development on our gross profits. We are seeing a reduction in gross profits due to inefficiencies in production, higher cost on materials, taking into account, especially the high broker costs we have taken, higher energy costs and the lower volume effects with still constant stop and go and the short-term changes of our shifts in all the plants globally. We already commented the additional cost impact due to these effects being around EUR 20 million with an increasing trend in the last months. This has reduced our gross profit margin by 0.9 percentage points to 24.7%. In auto, the reduction in gross profit margin is the most significant on a level of 1.5 percentage points. We expect going forward that the cost increases will continue. On the other hand side, we now are finalizing first

agreements with our customers on compensations and pass-throughs of these additional costs, so that we believe we could mitigate this effect in the upcoming period at least partially.

Going to Page 9. R&D expenses have increased. With the high level of acquisitions we reached in the past periods, the R&D ratio is at 10.9%. With lower sales, we are not at the R&D expense ratio between 9% and 10%, which we anticipated. We target with the recovery of volumes in upcoming periods to come back to this level below 10%.

Looking at the SG&A development on Page 10. We remain, for sure, very cost sensitive. The SG&A expenses increased by EUR 30 million in comparison to prior year. We have to take into account that last year there was a positive effect of EUR 19 million due to the reversal of one impairment we had in the past. Taking that a part, the cost level remains on a very similar low level year-on-year, also considering higher logistic costs we had.

Page 11. The adjusted EBIT decreased to EUR 238 million in total. High inefficiencies in addition to the cost increases mentioned led to this reduction. With that, the EBIT margin is at 5.1%.

More details also on Page 12. Reported EBIT is at EUR 225 million. Adjustments made are in total at minus EUR 13 million. The adjustments are especially considering structural measures related to our program in Germany and the impairment of our activity with one Chinese partner, which we already also commented at our half year results. Overall, this brings us to earnings of the period of EUR 154 million, which represents earnings per share of EUR 1.40.

Coming to Page 13 with some comments on Q3 only, positively all three segments are growing in the third quarter. And the profitability in Auto, unfortunately, is down to 4% in comparison to 5.7% prior year due to the reasons I already commented before. Aftermarkets and Special Application were both again at decent levels, whereas Aftermarket was below prior year level in terms of EBIT margin, especially due to product mix effects.

Looking on the cash flow and CapEx on Page 14. In terms of adjusted free cash flow, we are at a very disappointing level of minus EUR 228 million. The very high increase in inventories of more than EUR 200 million is the main reason for that. This is due to the very high volatility in production

volumes and the low reliability in customer demands still we have in our system. CapEx is slightly up by EUR 30 million. Despite a lot of efforts also on our side to reduce CapEx to a maximum, we reduced roughly compared to our internal plan by around 20%. We expect the fourth quarter as set to be positive. But unfortunately, we will remain negative for the full year. Looking at the segments on Page 15. We have grown in sales in lighting even in a shrinking market. Electronics has been impacted largely with the bottleneck situation on semis, especially due to that, we have a negative growth of minus 5.6% with our electronic products despite a very solid order book we actually have. The reduction in EBIT, again, is mainly due to the higher material prices as well as special freight costs and the production inefficiencies and course of COVID and the bottlenecks in the supply chain. Going to Aftermarket and Special Application on Page 16. Both segments have a very decent performance in the 9-months period. Aftermarket is growing strongly in the independent aftermarket. And as well also within our workshop products business, profitability is slightly increasing. The EBIT margin is down with higher cost investments into our workshop product business and the product mix I mentioned also before. Special Application is continuously growing, especially in agriculture and construction. The profitability has developed very nicely. With that, I hand back to Mr. Breidenbach and happy to take your questions later.

Rolf Breidenbach: Yes. Mr. Schäferbarthold, thank you very much. A short outlook with regard to the market development. As already mentioned, IHS expects this minus 7.6% with regards to the global light vehicle production. We think that both figures, this 76.9 million vehicles for '21/'22 as well this 20.2 million vehicles for the fourth quarter of our fiscal year are at risk due to, on the one hand, the midterm impact of the Ukraine crisis, but especially due to the upcoming and already installed COVID restrictions in China. So the visibility is very limited for us with regards to this two effects.

With regards to our guidance, I already mentioned the EUR 5.9 billion to EUR 6.2 billion with regard to our currency and portfolio-adjusted group sales

and also the range of 3.5% to 5.0% with regard to our adjusted EBIT margin. So we fully confirmed the guidance we had given on November 29.

Allow me also to comment on our business combination with Faurecia. As communicated, we are focusing on the integration of both companies and to leverage synergy potentials we discussed in February that we are concentrating on the top 10 synergy projects, which are planned to cover more than 95% of the jointly identified cost synergy potential. To realize synergies, clear measures and clear implementation routes have been set and the verification and final validation started in February right after the closing. We make sure that all integrational steps and synergies are implemented at arm's length. And the anticipated benefits will be fairly shared between both companies having in consideration the best interest of all our shareholders and relevant stakeholders.

All processes are on track so far. For example, direct and indirect purchasing have been identified as the most important areas for cost synergies. So offering additional scale and standardization to suppliers should help them to reduce their cost base and offer better prices to HELLA. For now, we do not have enough visibility to comment on to which extent these discussions will support a margin improvement going forward. We will share this, of course, with you when we have more visibility.

Having said this, now Mr. Schäferbarthold and I are happy to take your questions.

Operator: Operator Instructions) And the first question is from Akshat Kacker, JPMorgan

Akshat Kacker: Akshat from JPMorgan. Three from my side, please. The first one on cost recoveries from OEMs. Can you please give us more details around the discussions that you are having right now, not just on raw materials, but also on other inflation elements that are going through the P&L? How have the current discussions been just with OEM? Also in this production environment of low volume and the frequent start-stops that you mentioned, how do you negotiate the annual contractual price downs with OEMs?

The second question that I have is also on the medium-term negotiations on sharing the burden of structurally higher semiconductor costs going forward. You mentioned in your presentation that you still think you can get back to the 8% margin level in the medium term. On the other hand, what we're hearing from a number of OEMs that they are pushing back on suppliers on sharing a large chunk of the cost burden that they are seeing right now. So how should we think about this going forward?

Finally, the last question on the semi linked shortages and auto production. Despite the Russia-Ukraine situation and the COVID surge in China, it feels like semi is still the main bottleneck. And the industry as such keeps waiting for the sequential improvement in production levels. From your point of view, when do you expect meaningful new capacity for the sector? Or do you think new capacity is offset by higher semi content per car that we are seeing in the modern car today?

Rolf Breidenbach: Thank you very much for your questions. Let's start with the third one. With regard to the bottleneck situation, we still see that the shortage in semiconductors is and will remain the dominating factor for the sales figures. This has not changed due to the Ukraine crisis or the COVID situation in China. From our perspective, we will see a slight improvement in the third and fourth quarter of this calendar year and an even better situation in Q1/Q2 of 2023.

But bottlenecks will also be an important topic in 2023 because on the one hand, additional capacity will be available on the market. But on the other hand, the demand per car, especially when we look at the fully equipped cars with autonomous driving functionalities on the one hand and also the e-vehicles will increase. So we will see in 2023 an improvement, but still a bottleneck situation, especially for the, let's say, common technologies relevant for automotive.

With regards to the cost recovery, we are in, from our perspective, very open and constructive discussions with our customers. We have already signed first agreements and others are very close for signature. And the logic of these agreements is, of course, different from OEM to OEM. But in general, we will get compensation for material and price increases for every quarter. So we

look at the demand of components we deliver to the customers. We have negotiated price increases. And quarter-by-quarter, the price increases will be compensated.

Currently, we are negotiating for the calendar year 2022 and also the last quarter of 2021. And I assume, of course, then the next wave of negotiations in October, November this calendar year for 2023. And of course, these negotiations include, on the one hand, specific price increases for components, but of course, also overall inflation effects, for example, from energy, and we also try to include this inefficiency we currently see in our production. With regards to price reductions, we negotiated with our customers, of course, all this is on the table when we are negotiating these additional cost burdens. And in the end, it's a compromise between giving price reductions on the one hand, getting cost compensations from the customers. But as I said, in these negotiations, everything is on the table. And we so far find solutions with all our customers. There's no customer who is rejecting, negotiating with us. And medium term, of course, on the one hand, we see that the volume restriction step-by-step will get a relief, and this will give us the possibility from my perspective, to at least improve our gross profit by 1%. And I expect another 1% with regard to the negotiations with our customers and compensation agreements. And of course, the third relevant lever will be efficiency improvements in our own value chain, our productivity activities on the one hand, in our plans and, of course, negotiations with our suppliers as an important element.

Operator: The next question is from Sascha Gommel, Jefferies.

Sascha Gommel: I have got 3 questions as well. The first one is on the R&D ratio. You already elaborated a little bit on it, but I was wondering if you can share a bit more detail on what is behind the elevated spend in terms of relation to the product portfolio. And then how long do you think you will be at that elevated level? And how fast can you go back to your target level? That would be my first question. The second one, a bit shorter. You mentioned cash flow will be positive in Q4, but not enough to bring the full year free cash flow to break even. Would you be willing to share a rough ballpark number? What do you

expect? And then very lastly, on the synergies, I was wondering how much synergies actually do you leave on the table by kind of having to work at an arm's length with Faurecia. Is there any way to quantify what you cannot achieve right now?

Rolf Breidenbach: Yes, thank you very much for your questions. Allow me to answer the first one. With regard to R&D, as Mr. Schäferbarthold said, we have the target to stay at a level between 9% to 10%, between 9%, 9.5% perhaps is better. Currently, the order book in the past years was very strong. Year-by-year, we were very successful in acquiring new business. And it is clear that the same is true also for this fiscal year. We have acquired a lot of very important strategic products based on new technology developments in the electronic areas, from electronic brake pedal to cool & control hub, new orders in the area of battery management systems and so on. So we are very satisfied with this. And the same is true for our lighting product acquisition portfolio. And we will go on with that. And we will reduce the percentage number when the volumes will come back. And we think, as I said, that we will see a better development, a slightly better development in the third and fourth quarter of this calendar year and then again, additional relief in 2023, so that we step-by-step can come back to, let's say, the normal usual number, which, from my perspective, fits very well to the HELLA business model based on profitable growth of high-tech products.

Bernard Schäferbarthold: In terms of free cash flow, we would assume the fourth quarter to be between EUR 60 million and EUR 100 million. So still the range is quite large, but this relates, let's say, to the uncertainty, especially how much now in the, let's say, upcoming weeks, the difference could be out of the different -- yes, the aspects we mentioned in China, but partially also Europe where volatility also is continuously high.

Rolf Breidenbach: And third question with regard to the synergies. As I said, we are currently in the phase of the verification and the final validation of all these measures. Therefore, we do not have currently enough visibility to comment on which

extent these activities will support a margin improvement. It's a little bit too early.

Sascha Gommel: Okay. But on the synergies, is there anything where you would say those are still stumbling blocks in terms of arm's length that are in the way? Or is that just there's a lot of lawyers working to make sure everything is fine?

Rolf Breidenbach: We make sure that we do everything on arm's length. This is our guideline, and we are quite satisfied what we already have achieved with this approach.

Operator: The next question is from Gabriel Adler, Citigroup.

Gabriel Adler: The first one, I just wanted to come back on cost inflation. Could you maybe provide an updated estimate for your 1Q run rate? You mentioned that the EUR 15 million to EUR 20 million is probably too low now. I'm just trying to understand how we should really think about this in Q4 because gross cost inflation is likely to be higher. But then you've already spoken about how you're expecting to see some benefit from price recoveries from your OEM customers. So any more color there on how we should expect your net on fee cost inflation run rate's trend would be really helpful. And then my second question is also on the synergies, but not so much on the cost side, more on the investment side of the equation. Could you provide an update here on how you're thinking about your investment strategy going forward? You mentioned that R&D expense and sales like to come down when volumes recover. You also mentioned in the presentation that CapEx has gone up and you may be struggling to cut back on CapEx a little bit this year. Going forward, as part of Faurecia, how are you thinking about your investment strategy in the midterm in relation to R&D and CapEx?

Bernard Schäferbarthold: So on cost inflation, we're actually seeing around 2% in terms of sales, what actually we are losing in comparison to prior year. Half of it, as said, is coming from material price increases. And the rest is coming out of stop and go, lower volumes, but also higher energy costs, we also mentioned. So this trend is -- as also said, we have now seen additional price increases,

which are already in the material price increases starting also from January with a lot of agreements with suppliers from that point of time.

I would assume, let's say, that this amount could slightly increase also in the upcoming periods. Especially on energy costs, we would assume in the upcoming, let's say, quarters, a continuous increase on the material price effect, we would also assume that this 1% could also step by step increase a little bit in comparison, let's say, to the -- again, to the prior year level.

On the other hand side, as you said, the cost compensations, pass-through agreements with the customers have not kicked in our P&L as of today. So this, as Mr. Breidenbach explained, is from a negotiation point of view, we first prove the higher costs. And there is then a timely delayed agreement where then these compensations would be then paid on customer side. So this effect should at least mitigate from our perspective going forward, a large part of these higher costs that I just explained.

On the R&D side, we see that this also in the upcoming period, there will be an increase related to the absolute number of our R&D expenses. The biggest -- or the higher increase it's coming out of the electronics portfolio. So we see, especially in terms of ADAS products, so radar, but also on our electrification portfolio that we had significant acquisitions we have done. We elaborated also that in the Capital Market Day that we will gain with some of our projects leading market positions in the upcoming years. So all what we are there doing is basically booked business and should also improve from our perspective, also the outperformance further on a midterm perspective.

So this is something which for sure is something where we think how can we be even also more competitive. In terms of also R&D expenses, you remember the rationale also of our program for Germany on the structural changes, a lot was also related to R&D with a significant shift also of resources, capabilities, also to Romania, but also to our Chinese, Indian and Mexican R&D hubs to improve our cost position also going forward. So this will certainly also improve our cost position going forward because we are still in the implementation of these measures. But as I said, we need a certain relief also on the volume side where, as I said, the volume impact is very significant in electronics. And if we would have some stabilization, hopefully,

2023 onwards at a higher degree, then we'll come back to levels below 10% what I said.

On CapEx, I think most of the CapEx is, as we said, is related to our booked business. So there, I think there is no different opinions also in the shareholder committee and in the boards what we discussed. We will also continue on the structural improvement programs, which we also commented, where we said, for example, in lighting, we already invested a lot into our automation programs, which are very well perceived also from the shareholder committee. So there are some structural investments we will continue. But for sure, also here, we're looking at opportunities and ideas how to reduce CapEx, especially with a higher degree, for example, in re-use, in optimization of the plans, in terms of the use of surfaces and so on. So a lot of activities also are ongoing here. But in general, no different views also on the shareholder committee in the new composition as it is today to the general strategy, which we already commented and presented also to you in the last Capital Market Day as of today.

Operator: And there are currently no further questions. (Operator Instructions).

Rolf Breidenbach: Okay. Then when there are no other questions, I think we're through. Thanks again for taking the time for your questions. We wish you all the best and stay healthy. Bye.

Operator: Ladies and gentlemen, thank you for your attendance. This call has been concluded. You may disconnect.

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