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C: Bernard Schäferbarthold; HELLA GmbH & Co. KGaA; CFO
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COMPANY EDITED TRANSCRIPT

Operator: Dear ladies and gentlemen, welcome to the Analyst and Investor Call of HELLA. (Operator Instructions) After the presentation, there will be an opportunity to ask questions. (Operator Instructions)
May I now hand you over to Dr. Rolf Breidenbach and Bernard Schäferbarthold, who will lead you through this conference. Please go ahead.

Rolf Breidenbach: Yes, thank you very much. Yes, dear ladies and gentlemen, good afternoon to all of you. Thanks a lot for dialing in. Welcome to the HELLA investor call on our first quarter of our fiscal year 2021/22. Also a warm welcome on behalf of my colleague, and our CFO, Mr. Schäferbarthold.
Before we quickly go through our presentation, I would like to make, as always, some general remarks on the current business situation and the outlook. Starting with the business situation. I think it's fair to say that the first quarter of our fiscal year was quite challenging and the disruptions in the global supply and logistic chains, due to the shortages of the electronic components have significantly worsened with the Corona pandemic-related production shutdowns, especially in Malaysia. We experienced additional back-end disruption since June. The shortages, particularly for microchips worsened and led to market volumes, which were significantly lower, compared to what we expected at the beginning of our fiscal year.
With September data of IHS predicted a decline of the global LVP by 6%, compared to a growth of 3.7%, which was forecasted in June. So significantly worse outlook from one month into the other. And the bottlenecks placed a significant burden on the industry, and HELLA affecting both our sales and earnings, so that we were unable to fully achieve our internal targets in this

respect in the first quarter. Of course, we continue to work closely with our customers and suppliers in order to remain -- able to deliver and to meet call-offs as far as possible. Furthermore, we continue to pursue our intensive cost management.

Against the background of a difficult market environment, which -- with declining production volumes and the sales development in the first quarter has led to strong outperformance, compared to the overall market. The Automotive business grew due to a high demand for lighting and electronics products, with several SOPs, especially in the Chinese market. In addition, automotive benefited from a high level of reimbursement from customers in the first quarter. The ability to grow shows our strong order book, which reflects HELLA's excellent strategic positioning with regard to key trends such as electromobility, autonomous driving and digital light.

Furthermore, Aftermarket and Special Application continuously showed strong sales performance with a good spare parts and workshop business, as well as high sales with our core customer groups, especially with manufacturers of agriculture and construction machineries. Profitability was, let's say, solid in the first quarter, supported by a positive development in Aftermarket and Special Applications, which could seamlessly continue the good performance of the last fiscal year. In addition to leverage effect and a high level of reimbursements, the automotive margin was positively affected by a low level of project-related costs.

Additional costs related to production inefficiency, higher freight, material, as well as increase in raw material prices negatively impacted the profitability of the Automotive segment. Together with a higher expected project-related cost, negative P&L effects on the before mentioned additional costs will most probably be seen in the coming quarters.

Let me now shortly comment on our outlook for the current fiscal year, and also at some remarks on the IHS forecast. With the publication of the September figures, IHS has already said significantly reduced the outlook for our fiscal year from a growth of approximately 4% to a significant decline of almost 9%. The reason for this was the aforementioned closures in some Asian countries, which in addition to the already existing structural shortages have significantly worsened the supply situation for microcontrollers.

The ramp-up of production there will take several months and the required capacities will not be available for a large part of our fiscal year. Due to the worsening bottleneck situation, a significantly decline in global vehicle production is to be expected. In particular, we have to assume from today's perspective that there will be most likely no recovery in the second half of our fiscal year. We had originally expected production figures of between 83 million to 88 million vehicles for our fiscal year, which at the upper end roughly corresponds to the IHS forecast from June.

Due to the adjustment of IHS, we are now assuming around 75 million to 80 million vehicles, which represents a reduction at the midpoint of nearly 10%. The new sales range mirrors not only the continuing shortages but also the high market uncertainties. At the midpoint, the cut reflects reduction in sales for the HELLA Group of around 7%, which is lower, compared to the underlining reduction of the light vehicle production figures. Main reasons for that are the very good outperformance we achieved in the first quarter, our ability to manage the bottlenecks and a solid development we expect for Aftermarket and Special Applications.

In order to stabilize the earnings, we have initiated, of course, far-reaching countermeasures particularly as we are faced with further increases of material and raw material prices, as well as a continuing burden from production inefficiencies. In addition, we are working with customers to find possible solutions for bearing additional costs at a fair share.

Against the background of full order books, we must continue to bear high development costs. Project-specific cost will also rise in the coming quarters as a result of measures to secure our long-term competitiveness. It will therefore not be possible in the subsequent quarters to maintain the low-cost level we have seen in the first quarter. Together with the reduction in sales range, this result in a range for adjusted EBIT, which is significantly lower than the original forecast.

Overall, the adjusted company outlook for HELLA reflects next to production cuts and missing recovery in the second half of our fiscal year the aforementioned expected cost increases. So we are now expecting for the current fiscal year 2021/22 currency and portfolio adjusted sales in the range of around EUR 6.0 billion to EUR 6.5 billion, and we expect an adjusted EBIT margin of around 5.0 to 7.0%.

Before we move to the presentation, let me, in addition, quickly say something about the expected development of our free cash flow. In the view of the tight situation, all investments are, of course, under scrutiny, but we can only reduce them to a limited extent as we need to invest into product-specific equipment, into our worldwide network in our automation initiative.

With respect to the working capital, we also experienced some challenges, particularly in the area of inventories. Therefore, the expected free cash flow in the second quarter will be negative. Only in the second half of the fiscal year, we expect the free cash flow to improve.

Having said this, let me now come to the presentation and move to Page 4, starting with our financial results for the first quarter of fiscal year 2021/22. Our currency and portfolio-adjusted sales, as I said, increased by 9.5%. Our adjusted EBIT increased by 62% to EUR 91 million. Thus, our adjusted EBIT margin is at a level of 6.2%. This is an improvement of 2.0% points, compared to the first quarter of the previous year. Our reported EBIT margin is at a level of 5.4%, this number includes restructuring costs, mainly for the improvement program in Germany. And our adjusted free cash flow increased by EUR 209 million to minus EUR 31 million.

On Page 5, you can see an overview of our Automotive performance in the single regions. You can see that we were able to outperform the global automotive markets, as well in Asia and Europe. In Europe, our outperformance was quite strong. We outgrew the market by around 19 percentage points mainly due to a strong performance in Germany, which was supported by a higher level of customer reimbursements.

In North and South America, we outperformed the market by around 5 percentage points. The performance here was positively impact by a low comparable basis of the last fiscal year. In Asia and the rest of the world, we significantly outperformed the market by nearly 32 percentage points, this is mainly due -- and I think we also talked about this in the last investor call, due to a very strong performance in China. We communicated that we expect several SOPs in China that are now ramping up. Nevertheless, a normalization of outperformance in the coming months is expected.

So all in all, on a global level, our Automotive business outperformed the market by 13.2 percentage points in the first quarter. This is a quite good outperformance we do not anticipate it continuing in the upcoming quarters. Overall, the prediction of outperformance is currently difficult, due to the bottlenecks and due to the allocation decisions of our customers.

Having said this, let me now hand over to my colleague, Mr. Schäferbarthold to provide you with more details.

Bernard Schäferbarthold: Yes. Thank you, Mr. Breidenbach. And good afternoon, ladies and gentlemen, also from my side.

I would continue on our presentation on Page 7. Sales in the first quarter is FX and portfolio adjusted at EUR 1.5 billion. This is a growth of 9.5%, compared to previous year, the FX effect is insignificant, and there are no portfolio adjustments in our first quarter. Positively, all 3 segments have grown significantly in comparison to prior year, whereas the comparable base is certainly in the prior year was strongly affected by the first wave of the COVID pandemic.

In addition, as said, we were able to outperform the market significantly in the first quarter by 13.2%, and a very decent outperformance also as said in the Chinese market. Overall, in terms of sales, there were some positive results in the first quarter, but we are significantly below our internal expectations and the situations remains challenging regarding the bottleneck on semis and all operational topics, which relates out of that.

Going to Page 8. Our gross profit increased in absolute terms by EUR 63 million to around EUR 382 million. In addition, our gross profit margin increased by 2.2 percentage points to 25.9% on a year-on-year comparison. Positively, the higher sales led to a better utilization of our plants, compared to previous year. In addition, the reimbursements on tooling and also development cost have been at a high level in the first quarter following SOPs we performed. And the project-specific costs were at low level in the first quarter.

On the other side, the COVID's related measures and the bottleneck situation on semis led continuously to high additional cost with stop and go in our productions, broker cost and additional breakup. We expect the bottleneck

situation to remain within our full fiscal year 2021/22. We expect even an increase in additional cost in comparison to the level we had in Q1.
The increase results from higher personnel cost we expect for the full-year, due to ongoing stop and go in production and additional efforts to support the stability of deliveries to our customers, on top higher freight and material cost than previously expected. The mentioned effect in previous calls of additional cost of EUR 8 million to EUR 9 million will, from our today's perspective, most probably increase therefore to levels of EUR 15 million to EUR 20 million in the upcoming quarters on a monthly basis.
If we move to Page 9. R&D expenses are EUR 17 million higher on a year-on-year comparison. We remain very much focused on activities related to serial development and production ramp-ups. The higher level reflects the strong order intakes we had in the last periods. Our R&D ratio increased slightly to 11.1% on a year-on-year comparison. We expect our R&D ratio to be around 10% also in the fiscal year 2021/22, but certainly, that also depends somehow on the sales development we will then have for the full year.
Moving to the next page. The SG&A cost increased to EUR 130 million. We maintain our stringent cost discipline. The comparables are quite low in the last year. Also due to the subsidies we got especially with the short-time work we had especially in Germany. Overall, SG&A ratio in Q1 stable at 8.8%.
Summing that up on the next page, as said, our adjusted EBIT is at EUR 91 million, EBIT margin increased to 6.2%. The adjusted EBIT improvement as said is compared to low previous year numbers. We have to stay that due to this challenging market environment, we were still not able to get back to results we had in the years 2018/19 and 2019/20 in the respective quarter.
The reported EBIT on the next page, we have all details, reported EBIT is at EUR 79 million. The adjustments we have done were mostly related to our structure measures in Germany, which we were not able to accrue in the previous year in the first quarter. As you remember, we accrued around EUR 170 million related to the restructuring measures for our German facility.
Moving to Page 13 our adjusted free cash flow was at minus EUR 31 million in the first quarter. We had an increase in working capital at the end of the first quarter, due to increases in inventories with the actual operational

situation. CapEx is at comparable levels to previous year with the investments we are doing in preparation of new launches.

Mr. Breidenbach also already commented that we expect continuous challenges in terms of working capital increases, due to higher inventories and lower sales levels, especially now in the second quarter. We expect to see improvements only in the second half of our fiscal year.

Looking at the segments on Page 14. Automotive sales is 7.2% higher in comparison to previous year. This is a solid and a very good outperformance. The profitability in Automotive increased to EUR 61 million, respectively 4.9% of EBIT margin.

Aftermarket had a continuous decent sales development, as well in the first quarter with a growth rate of 25% with very strong momentum in our independent aftermarket business or spare part business, as well as also on our workshop business. Profitability increased also at a very positive level with a good product mix and continuous cost savings to around EUR 16 million, 11.5% of EBIT margin.

Special Application performed also very well in terms of sales and profitability, with a good growth momentum in most of our customer segments and especially on the important segment agriculture and construction. Profitability is at a high level of around 16% in the first quarter. Both segments are expected to have a good continuous performance also in the following quarters. So we see a good chance here to realize our internal targets we have set.

So having said that, I hand back to Mr. Breidenbach for the outlook and the closing remarks.

Rolf Breidenbach: now a decline of the market of 8.6%. This negative development is true for all the different regions. China with minus 11.3% and Europe with minus 9.1% show the strongest decline.

When we look at the different quarters, especially the second quarter, but also the third quarter are quite weak compared to the last fiscal year with minus 21.3% and minus 6.9%. This quite negative market development leads to the changed outlook I already shared with you, the EUR 6.0 billion to EUR 6.5 billion sales range and the range in the adjusted EBIT margin, excluding

restructuring and portfolio effects between 5% and 7%. So significant reduction of our guidance compared to the figures we shared with you at the beginning of our fiscal year.
Allow me at the end to shortly comment on the Faurecia situation. You might have seen that the voluntary public tender offer commenced. The offer document has been published on Monday. So the first acceptance period will end on October 25th, followed by second acceptance period until 11th of November. As already communicated the HELLA Management and the Supervisory Board will thoroughly review the offer document and will issue a Fairness Opinion until October 11th. We already commented that the Management Board, the Shareholders' Committee and the Supervisory Board welcome the transaction and subject to a review of the published offer document, the Management and Supervisory Board of HELLA expect to recommend the acceptance of the offer to the shareholders. For further details, I will for now refer you to the offer document, which is published at the Faurecia webpage.
Having said this, I think we are now ready to answer your questions.

Operator: And we will now begin the question-and-answer session. (Operator Instructions) The first question we've received is from Christoph Laskawi, Deutsche Bank.

Christoph Laskawi: Christoph Laskawi from Deutsche. Three please, if I may. And the first one would be, do you get any feedback from the semi suppliers from which you're sourcing with regards to the capacity utilization and potential ramp-up of the plants that have been shut down? And at what point there might be a more continuous flow of products compared to the very volatile situation we are currently in? In the sense that the ramp-up more at 10% of capacity currently and goes up very slowly to a higher level? Or are there other issues than just ramping up production for those suppliers as well?
And then the second question would be, when we look at your SOPs that obviously help on the top line but giving the lower-than-expected volumes with which they come, they are most likely net negative on EBIT, because of the project cost and R&D spend that you select briefly before that. How long

do you expect them to weight on the cost base in case the volumes are not coming in? Do we see the additional costs from the ramp-up phasing out fairly quickly or rather long-term?
And then the last question, a quicker one. Are you willing to share an update on the negotiations that you have with OEMs to pass on the semi cost and potentially others as well?

Rolf Breidenbach: First question, I think, you referred to the special situation in Asia, in Malaysia, Indonesia. Step by step, our suppliers are now ramping up and we expect now a phase, let's say, between perhaps 4 to 8 weeks that they are coming back to full capacity assuming that no, let's say, additional COVID impact will occur. What does it mean in capacity? This is very difficult to assess, because we do not know how these suppliers spread these additional capacities to different industries. And therefore we're little bit cautious with regard to this. But let's say in 4 to 8 weeks everybody should be again on full capacity, at least, with regard to the plants, which now were shut down. With regard to, let's say, additional equipment lead times, test equipment, and so on, we are quite optimistic, but of course, not sure.
And perhaps the second question, Mr. Schäferbarthold, would you like to take it

Bernard Schäferbarthold: That's a more general answer. So you are right that if we are not reaching the volumes then we're negatively impacted with not only SOPs, but all product lines we have. Contractually, there are volumes agreed with the customers. Normally, the customers then assuming also a certain catch-up. Normally this -- so we have to then see over lifetime if volumes are then reached, and then it's a commercial negotiation. And then if volumes are not reached that compensation is then given.
Second is that with the additional cost now we are facing, for example, on broker, and let's say, trying really to keep the stability on deliveries, we now have also started negotiations with the customers that these additional cost also have to be shared. This certainly is now something which we will have to see how -- then also with the different customers results would then be. So how a fair share could be now negotiated. But this is certainly now something,

which we are now pushing very hard so that we are, let's say, stopping the bleeding, we are actually seeing.

Operator: The next question is from Akshat Kacker, JPMorgan.

Akshat Kacker: Akshat from JPMorgan. Three from my side as well, please. The first one on near-term cost inflation and the flexibility that you have in the business. So are you adjusting your production structures, personnel costs or investments in line with what you're seeing in the market right now? Or do you see this as a temporary hiccup? And you want to be ready for the sharp rebound in auto production?

Also on that point, I was trying to gather all your comments on the business environment on this call. Am I right in believing that you still expect margins to improve sequentially in Q2 versus Q1 as Q1 is a seasonally weaker quarter? That's the first one, please

Rolf Breidenbach: With regard to our, let's say, near-term flexibility, of course, we try to flexibilize as much as possible to on the one hand achieve, let's say, under the current circumstances the best cost base possible. On the other hand, we have to be ready, so we cannot afford telling our customers that we have reduced capacity, be it with regard to investments or with regard to personnel. So it's a balance we are currently managing. Of course, we are more flexible with regard to personnel cost than investments, because when we talk about launches, we have at least to install limited level of capacity, of course, when we're talking about capacity increases, which we also have planned here and there. we are a little bit more reluctant.

With regard to the margins, we expect second quarter being a bit weaker than the first one, because I already made comment on the increasing project-specific costs, the now more and more realizing material price increases, and also the reduced reimbursement payments from the customers.

Bernard Schäferbarthold: And perhaps to add, from today's perspective, we are not anticipating a higher sales that we compared to the first quarter with this severeness of the bottleneck situation.

Akshat Kacker: Understood. The second one is on structural cost inflation. I think we can look through the short-term special freight and logistic costs that you have in the system, but can you shed some light on your discussion with microcontroller suppliers. What kind of margin headwind should we think about going forward when it comes to microcontrollers, please?

Rolf Breidenbach: This is very difficult to say because we are just in the negotiation and it's a tough negotiation. This is clear, but this is currently really ongoing business. Very difficult what will come out of it. Very difficult to assess what will come out of it.

Akshat Kacker: And any broad range that we should think about in terms of percentage?

Rolf Breidenbach: It's too early to say, because we are currently pushing hard to come into a ballpark, which is acceptable for us. But it's, of course, you can imagine, very tough negotiations.

Akshat Kacker: Sure. The last one for me is on Lippstadt and the German restructuring plan. Can you give us an update here? And can you please confirm if you still expect EUR 40 million to EUR 50 million benefit on the P&L, both FY 22/22 as well as FY 22/23?

Rolf Breidenbach: Here we are well on track. The measures are, let's say, implemented to, let's say, 85% and the savings we have communicated and you also mentioned are still valid and step-by-step will be realized in the weeks and months to come, so everything on plan

Operator: At the moment, there are no further question. (Operator Instructions)

Rolf Breidenbach: Okay. I think then we are through. So thank you very much for your questions, your time and, yes, have a good day. Thank very much. Bye.

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