



C: Dr. Rolf Breidenbach; HELLA GmbH & Co. KGaA; CEO and President
C: Bernard Schäferbarthold; HELLA GmbH & Co. KGaA; CFO
P: Christoph Laskawi - Deutsche Bank AG, Research Division – Research Analyst
P: Akshat Kacker JPMorgan Chase & Co, Research Division – Analyst
P: Edoardo Spina HSBC, Research Division - Analyst of Automotive Research
P: Gabriel Adler - Citigroup Inc., Research Division – Assistant VP& Senior Associate
P: Philipp König Goldman Sachs, Research Division – Research Analyst
P: Operator

COMPANY EDITED TRANSCRIPT

Operator: Good day, and welcome to the HELLA Investor Update. Today's conference is being recorded. At this time, I would like to turn the conference over to Dr. Rolf Breidenbach, Chief Executive Officer. Please go ahead.

Rolf Breidenbach: Yes. Ladies and gentlemen, good afternoon to all of you. Thanks a lot for dialing in. This is Rolf Breidenbach speaking. Welcome to this extraordinary investor update following our release today. Also a warm welcome on behalf of my colleague and our CFO, Mr. Schäferbarthold. The focus of today's call will be, on the one hand, the preliminary results for the second quarter. And on the other hand, the necessary update for our company's outlook for the current fiscal year.

Starting with the preliminary results. The second quarter of the current fiscal year was even more challenging than the previous one. The disruptions in the global supply and logistic chains are ongoing. And the bottlenecks placed a significant burden on HELLA, affecting both our sales and our earnings, especially in the Automotive segment. According to these preliminary figures, the Automotive segment will show a double-digit sales decline compared to the prior year's quarter. Automotive still outperformed the market significantly in the second quarter, with demand for lighting and electronic products and several SOPs, especially in the Chinese market, leading to the year-to-date outperformance at a level of around 10 percentage points. Due to the negative leverage effects ongoing production inefficiencies, strong material increases, which continuously are realized in the P&L, as well as the

higher logistic costs, the profitability will be significantly affected, leading to an adjusted EBIT of around EUR 60 million for the second quarter.

During our call in September, we commented on this increase in additional costs in comparison to the level we had in the first quarter. We see this additional increases currently at the upper end of the communicated level of the monthly EUR 15 million to EUR 20 million, and we expect further increases. Therefore, the impact of the bottlenecks is even higher than we expected at the beginning of the second quarter. We stated clearly in our first quarter call that we also see an increase in project-related costs and development expenses in the second quarter and going forward.

According to our preliminary figures, Aftermarket and Special Applications will continuously show good sales performances, and support the profitability with solid EBIT margins also in the second quarter. Altogether, at the group level, HELLA is therefore expecting currency and portfolio adjusted sales of around EUR 1.5 billion, representing a decline of around 13% compared to the prior year's quarter, and the adjusted EBIT margin will be at a level of around 4%.

So with this difficult second quarter, the expected sales decline on group level for the first half of the fiscal year 2021/2022 is at a level of around 3% with a margin level of around 5%, which constitutes a significant decline compared to the prior year's level of 8.7%. As a consequence, a reassessment of the business development for the second half of the fiscal year, and the given outlook was deemed necessary.

So before I comment on our further business development, let me quickly make a short remark on the free cash flow. As mentioned already several times, we only have limited possibilities to reduce our CapEx as we need to invest into product-specific equipment, into our worldwide network and into our automation initiative. Furthermore, the development of the working capital is still challenging, especially with respect to the inventories.

Therefore, the free cash flow in the second quarter will be strongly negative. As mentioned in our last call, we expect the free cash flow to improve only in the second half of our fiscal year. The final results with all details for the second quarter and the first half of the fiscal year 2021/2022 will be published as planned on January 13, 2022.

Looking quickly ahead into the third quarter of our current financial year. We mentioned already in our last call that the negative P&L effects of the before mentioned additional costs will increase: Together with the reduced sales volume due to missing recovery from bottlenecks the profitability level in the third quarter is expected to be on a lower level compared to the second quarter. For the last quarter of our fiscal year, we are not expecting a meaningful stabilization of the bottleneck situation. Together with the continuously low sales momentum, we expect a margin level, which is also clearly below our target level.

In view of the financial figures for the first half of our fiscal year and the weak outlook, we have further reduced the sales and earnings guidance for the current fiscal year. So we are now 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%. Previously, we expected currency and portfolio adjusted sales between EUR 6.0 billion to EUR 6.5 billion, and an adjusted EBIT margin between 5.0% to 7.0%.

Let me make some additional remarks concerning our updated company outlook. On the market environment, we have seen further downside revisions of the production forecast with missing recovery in the second half of our fiscal year. IHS currently assumes a decline of around 10% for the global light vehicle production for our fiscal year 2021/2022, and around 74.7 million vehicles, which is a further reduction of around 1.3 million vehicles compared to the September forecast. Especially in our core region Europe, the growth rate has been significantly lowered. A decline of around 17% is now expected compared to a decline of around 9%, which was forecasted in September, acknowledging that European OEMs are over-proportionately affected from the semi shortages. We already mentioned in our last call that the ramp-up of the production after the closures in some Asian countries will take some months. And even though the capacity situation improved, we do not see these fully available for the automotive industry for a large part of our financial year.

The new sales range mirrors not only the continuous shortages leading to a lack of volume recovery during the second half of our fiscal year, but also

renewed COVID-19 restrictions and the high market uncertainties, especially with respect to our customer demands. At the midpoint, the cut reflects a reduction in sales for the HELLA Group compared to our September outlook of around 3%, which is higher compared to the underlying IHS reduction of the global light vehicle production figures. The sales range reflects an underlying production of 71 million to 75 million vehicles for our current fiscal year, with the IHS forecast at the upper end of the range. We see therefore, a high risk for further reductions of the IHS forecast.

The lower range of the adjusted EBIT margin reflects next to the reduced sales expectations, ongoing inefficiencies due to stop-and-go production in absence of normalizing production schedules, strongly increasing material and raw material prices as well as logistic costs as well as higher development expenses. Against the background of full order books, we must continue to bear high development costs. Given the reduced sales expectations, the target level of around 10% for the full year cannot be reached.

Facing all these extraordinary challenges, we continue to pursue our intensive cost management in order to stabilize the earnings. In addition, as mentioned already in our first call, we are working with customers to find possible solutions for bearing additional costs at a fair share, and this is something which we are now pushing very hard. We have started negotiations with nearly all our customers and the results of these negotiations are expected to have a positive impact beyond this fiscal year. For now, we do not see any meaningful effects in our P&L.

Last but not least, let me emphasize once again that our strategic parameters have not changed. HELLA has a strong position with respect to financial health, technology and strategy to outperform the global market significantly also in the future.

Having said this, let me now hand over to Mr. Schäferbarthold, who will guide you through our presentation.

Bernard Schäferbarthold: Yes. Thank you, Mr. Breidenbach. So a very warm welcome also from my side. Good afternoon. So I would continue in the presentation on Page 3. Here are, again, summarized all numbers, Mr. Breidenbach referred to. So on one hand side, on the preliminary results on the second quarter and

also H1 in total. As also commented, these are preliminary numbers, but we assume that we should be very close to these numbers at the end. And in Chapter B, the guidance, I will not repeat the numbers.

If we go to the next page, in more details here, the development in terms of sales and adjusted EBIT. We have in H1, a decline in sales of minus 3%, and more important is the decline in the second quarter of minus 13%. On a positive note, as said, we are quite satisfied with our outperformance in Auto. So this will be again at a level in H1 overall, which would be around 10% or even higher depending on production numbers we would see. But here, we are quite happy about the good demand on our products, and overall the sales development.

On top of that, the business segments, Special Applications and also Aftermarket have a continuously positive trend both with high growth momentum also in the second quarter. Looking at the EBIT, a strong decline in the first half, especially due to the weaker second quarter. We had, on one hand side, the negative sales development and the negative leverage effect. But as Mr. Breidenbach stated, especially in Auto, the cost increase with higher material cost, broker costs, but also continuous stop-and-go and higher logistic costs, which had a severe impact on our results in Auto.

In Special Applications and Independent Aftermarket, as I said, with the positive sales development also a good business performance in terms of EBIT. And here, we are quite satisfied. But overall, around EUR 60 million is by far lower what we expected when we started into the fiscal year.

We look at the market development on Page 5, we see a risk that this negative momentum will continue. Especially in the third quarter, we would expect a further decline of the expected November numbers. And we also would put a question mark on the expectation on the fourth quarter. Also, looking at the latest COVID development globally, we would see a risk that, especially the supply situation on the semis would improve so that at the end, these numbers could be reached. Our view would be that IHS reflects the best case. And with that to the upper end of our sales guidance, we would see on the lower end around 71 million vehicles, which would then represent the lower end of the sales guidance and reflect there our expectation on a lower Q3 with around 17

million vehicles. And in the fourth quarter, a volume which would be around 18 million vehicles, we also have seen in the second quarter. So that brings us to our guidance, and our updated guidance on the full year. So overall, as stated with our market perception, we do not expect any recovery of the market in the second half of our fiscal year. With that, we will continue to see a strong burden on our production and on our operations. We see us confronted also with cost inflation on different components so that overall we see a bandwidth of 3.5% to 5% in adjusted EBIT. On the lower end, certainly, there is not so much of claims we could realize here on customer side. Certainly, on the upper end, there is more what we expect to realize on the customer side. But as Mr. Breidenbach also commented, the negotiations are also not only focused on onetime effects being realized in this fiscal year. They are also more oriented to also next fiscal year and the midterm, especially. So having said that, Mr. Breidenbach and myself are now happy to take your questions.

Operator: We'll take our first question from Christoph Laskawi with Deutsche Bank:

Christoph Laskawi: The first one will be on free cash flow, and thank you for the remarks that you had already on that. It will be more on the full year. Understanding that Q2 will be significantly negative. Do you see a scenario where the full year free cash flow is still positive? And how would you achieve that? Or is it at this point in time, given the volatility of production and the working capital impacts this brings along with it, probably too early to comment on that? And the second question would be on the R&D costs for the new acquired customer projects. Is it more that you have, say, shift in the OEM schedules that led to now several projects ramping up at the same time? Or did you run into, say, more severe problems getting a solution on the street versus your previous expectations?

Bernard Schäferbarthold: So the probability of getting positive on the free cash flow is not high. So only in the best case of our new guidance, we would, at the end, be able to turn positive. The reason for that is that we only expect higher sales -- if we would see them late in our fiscal year. So that the reason now for the

negative cash flow, especially the high inventory increase (actually, we are facing around EUR 150 million of inventory increase) and this will only turn in a reduction and then being realized in cash, from our perspective, late in the fiscal year or starting of the new fiscal year. So the probability is high that this reduction timely will be then too late for this fiscal year.

We're also working on reductions in CapEx. But we also see with the significant higher order intakes we have realized that there is limited potential further to decrease. We have already initiated several -- or decided several reductions. But overall, CapEx will not be sufficient or the reductions will not be sufficient enough to turn that number positive. So the probability is high that it will stay negative.

Rolf Breidenbach: With regard to our R&D costs, they are at a level we have expected. And due to our strong order book, especially in the last fiscal years, or in general in the past fiscal years, we have a lot of development projects currently to handle. And therefore, percentagewise, our R&D costs are increasing the level, of course, we have targeted under, let's say, normal conditions, but no surprises here with regard to our R&D efficiency with regard to the launch volumes of these projects. But yes, as I said, unfortunately, percentage-wise due to the lower sales, the percentages are higher than we had planned.

Christoph Laskawi: A quick follow-up, if I may, just on the reimbursement that you target from the OEMs. When you enter the discussions, are the OEMs actually delaying the outcome? Or is it just something that takes time currently and the OEMs or your customers don't really see the need to act quite quickly on this?

Rolf Breidenbach: Of course, it takes time, but no -- when we talk about reimbursement for the R&D projects, no delay. Of course, when we are talking about reimbursements with regard to material costs and other things, of course, we are in intensive discussions. And we are optimistic to achieve a fair share of these costs. But so far, the first steps have been made, and the first agreements are very close for signing, but it needs time because we are not only talking about a compensation for the calendar year 2021. But also, we are now laying out the approach for 2022. And here and there, we are also discussing 2023.

Operator: We'll go to our next question from Akshat Kacker with JPMorgan.

Akshat Kacker: Akshat from JPMorgan. Just one from my side. Obviously, it is difficult to look too far ahead in the current environment. But I just want to ask if anything has changed when it comes to your medium-term vision to deliver 8% to 9% margins as a stand-alone company?

Rolf Breidenbach: When the volumes are back, we are very optimistic to get again on this level. But of course, this depends on the one hand, the volume development, but also with regard to the material costs, whether we find the right approach with our customers and source the claims we currently have. So perhaps due to this, let's say, more severe cost pressure, 8% is a little bit more ambitious, but still in the solution room, and achievable in the midterm.

Operator: We'll take our next question from Philip König with Goldman Sachs.

Philipp Konig: My question is just sort of on the margins. You sort of obviously outside of the lower volumes, you lined out 3 major headwinds from the stop-and-go, the raw materials and the freight that obviously are weighing on the margins. If we think about sort of the path back towards sort of the 8% margin that you usually had. Which of these 3 do you feel are sort of the biggest headwind and then once they sort of normalize gets you back into the normalized margins? Is it more the bottlenecks or more the higher cost base in your view?

Rolf Breidenbach: So midterm, we think the bottlenecks topic will be solved. But the question is, is it at the end of 2022 or mid of 2023. Nobody knows. But then, of course, we expect that the stop-and-go burden, of course, will be solved. From our perspective, also midterm the logistic costs should be reduced. The most challenge we currently see at the material cost side here, it depends on the one hand on the sharing of this burden with our customers. And on the other hand, of course, with regard to negotiations, we are currently carrying out with our suppliers. But this material cost, of course, is the most significant challenge we midterm have to solve for this 8% perspective.

Operator: We'll go to our next question from Gabriel Adler with Citi.

Gabriel Adler: I've got two, please. The first, I'd like to come back to the point on OEM reimbursement. Maybe you could just help clarify when you think is the soonest you could start seeing impact there given the progress that you're already making on initial agreement? And then my second question was on the SG&A impact because I think previously, you've spoken about an SG&A reversal impacting profitability this year compared to last year. Could you just confirm whether SG&A is reversed as you were expecting? And if we should expect further SG&A cost pressure in the second half and if that's included in your guidance as well?

Rolf Breidenbach: With regard to the R&D imbursements, we intend to see first results in the fourth quarter. It's not clear, but we are fighting for that. And with regard to the SG&A, I hand over to my colleague, Mr. Schäferbarthold.

Bernard Schäferbarthold: So the increase is within our new guidance. So actually, we would see already in the second quarter, around 1 percentage point of increase, which partially is related to higher distribution costs with higher logistic costs as one important topic, but also with some additional costs also we had having started on some improvement projects we are now carrying out, and also the topic that we have no subsidy on short-time work in comparison also to last year. But as you can imagine, we have taken also some decisions in delaying and then also again stopping some activities really to limit the cost increase as much as possible. But again, to your point, the increase is already within the margin range.

Operator: Our next question is from Edoardo Spina with HSBC.

Eduardo Spina: I have one, and it's a bit more midterm or long term. We have heard from some of the customers that they are, of course, increasing focus on the so-called in-sourcing of some production, mostly they talk about electric vehicle powertrain, but we start to hear a bit more interest also on the software side

for electronics components as well. As you know in a couple of days, we have a major European OEM Software Day. So my question for you is, have you seen any changes in attitude of your customers for the electronics and software in general, components that you do? And/or do you believe that HELLA is in niche market for electronics, so you would not be, let's say, involved in the discussion at all?

Rolf Breidenbach: So the general trend at the customer side to do more on software development has not changed. So it is a clear trend. We have seen in combination with the change of the electronic architecture, let's say, 3, 4, 5 years ago, and this trend is continuing. Based on that, we, of course, continuously update our product portfolio with regard to developing pure software products, with regard to especially starting growth initiatives in the area of digital lighting of radar technology, for example, or energy management products like battery management systems, DC/DC converter and so on and so on. So we feel more than comfortable with this strategy, knowing, of course, that we here and there, based on the changing in-sourcing activities of our customers, that we have to be flexible and have to adapt it gradually. But overall, our strategy is intact and is of course, considering the in-sourcing strategies of our customers we even feel more, let's say, encouraged to continue the way because software development in the automotive supplier industry is more important than ever. And experienced electronic suppliers with know-how in fields like functional safety, cybersecurity and others are very welcomed in the supplier portfolio of our customers. And this is, from my perspective true for all the regions for all the segments for more or less all global customers.

Operator: It appears there are no further questions at this time.

Rolf Breidenbach: Okay. Then I would like to thank you also on behalf of Mr. Schäferbarthold for taking the time for your questions. Have a good day. By.

Operator: This concludes today's call. You may now disconnect.

END