MOODY'S
INVESTORS SERVICE

Rating Action: Moody's changes outlook on Hella's ratings to negative, affirms Baa1 ratings

22 Aug 2019

Frankfurt am Main, August 22, 2019 -- Moody's Investors Service ("Moody's") has today changed the outlook of German automotive supplier HELLA GmbH & Co. KGaA (Hella) to negative from stable. Concurrently, Moody's affirmed Hella's long term issuer and senior unsecured ratings at Baa1 and the short-term issuer rating at P-2.

RATINGS RATIONALE

The negative outlook reflects the overall negative sector environment for European automotive parts suppliers and the challenges for Hella to sustain (i) debt/EBITDA in the range of 1.0x-2.0x (Moody's adjusted) and (ii) margins at a level of at 6.5% (Moody's adjusted EBITA).

On 09 August 2019, Hella announced results for fiscal year 2018-2019 (ended May), including sales of EUR7.0 billion and a company-adjusted EBIT margin of 8.4%. For fiscal year 2019-2020, the company expects currency and portfolio adjusted sales of EUR6.5-7.0 billion and a decline of its adjusted EBIT margin to 6.5-7.5%. At the same time, Hella proposed a special dividend for the recent disposal of its wholesale business of EUR2.30 per share.

Hella's outlook reflects a more challenging global automotive industry environment, in line with Moody's expectations. On 01 August 2019, Moody's lowered its expectations of global light vehicle sales in 2019 to minus 3.8% and another minus 0.9% in 2020. Moody's industry outlook on global automotive manufacturers and European automotive parts suppliers is negative.

On a Moody's adjusted basis, Hella's EBITA margins declined to 6.7% in fiscal 2018-2019, from 7.1% in 2017-2018. Moody's expects EBITDA margins to decline to around 5.5-6.0% in 2019-2020, which is below expectations of at least 6.5% for the Baa1 rating. In the ongoing weak industry environment, it will be also challenging for Hella to improve margins materially in 2020-2021. Hella's debt/EBITDA increased to 2.2x in fiscal 2018-2019, from 1.7x in 2017-2018. For 2020, Moody's expects leverage to remain broadly stable and above our expectation of a maximum of 2.0x for the Baa1 rating. Due to its relatively high cash balance Hella's net debt / EBITDA (0.4x at May 2019), however, still remains in line with our expectations for the Baa1 (maximum 1.0x).

The rating affirmation reflects as positives the company's: (a) leading position in the lighting technology and original equipment electronics markets; (b) meaningfully sized aftermarket business unit which is generally more stable than the original equipment business; (c) diversification through its Special Applications segment which reduces exposure to the automotive end market; (d) track record in reducing operational costs and improving operational efficiency; (e) increase in customer and geographical diversification; (f) conservative financial policy which includes limited shareholder distribution and the maintenance of a large cash (& equivalents) balance; and (g) relatively strong credit metrics (debt/EBITDA of 2.2x and net debt / EBITDA of 0.4x as of May 2019).

Nevertheless, the rating also reflects as negatives the company's: (a) strong dependency on the automotive end market which is highly cyclical; (b) relatively low profitability, as reflected in an EBITA margin as defined by Moodys of 6.7% in 2019, which is expected to decline further to around 5.5-6.0% in 2020; (c) significant expenditure on research & development (R&D) activities, around 9-10% of revenue given the technology that is needed for Hella's products to stay competitive; and (d) limited recent free cash flow generation, resulting from high capital expenditure.

WHAT COULD CHANGE THE RATING UP/DOWN

Moody's could downgrade Hella's ratings if (i) leverage were to increase above 2.0x debt / EBITDA and/or 1.0x net debt/EBITDA, (ii) EBITA margins were to decrease below 6.5%, or (iii) if FCF generation were sizably negative.

In contrast, Moody's would consider to upgrade Hella's ratings, if the company improved size and diversification, and if this would reduce Hella's exposure to the cyclicality of the automotive industry. In addition, (i) a sustainable reduction of gross leverage (Moody's adjusted debt/EBITDA) to below 1.0x, (ii) improved profitability to more than 9% (Moody's adjusted EBITA margin) and (iii) material positive levels of FCF on a sustainable basis would be required for a higher rating.

The principal methodology used in these ratings was Global Automotive Supplier Industry published in June 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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