

HELLA

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P: Operator

COMPANY EDITED TRANSCRIPT

Operator: Hello, ladies and gentlemen, and welcome to the EQS Group Conference Call regarding HELLA Investor Call 9 Months 2023. The call will be hosted by CEO, Michel Favre; and the CFO, Bernard Schäferbarthold. At this time, all the participants have been placed on a listen mode only. The floor will be open for questions following the presentation.

Let me now turn the floor over to your host, Michel Favre.

Michel Favre: Thank you very much. Good morning to everybody. We are, of course, as well with Kerstin Dodel, the Investor Relations. So we will comment on the 9 months results. You have the slide shown on the Internet or you have received it.

So we will start now with Page 5 with the key highlights. And I am very pleased again to comment -- to announce because it has been announced that Bernard, who is present today, will take the lead of this beautiful company on the 1st of January. I think you know Bernard very well. He was, as I said, different times, he is a very smart CFO. He has all the competencies, the experience of HELLA, he knows the business very well. So he will be a fantastic CEO. And Bernard, I am very pleased again to congratulate you for this nomination.

Second nomination as well is Stefanie Rheker, so it is taking some time because she has a big notice period. She is coming from Arvato, and she will join HELLA in the first quarter. The date is still to be fine-tuned. But we'll be very happy to receive her in the management board and to continue to transform the company. You know that today, the pattern is quite challenging

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with change of powertrain, the development of EV, the integration with FORVIA, so a lot of, I will say, challenges.

Second key event in the period: with MAHLE, we agreed to put our common JVs BHTC specialized in HMI on sale. The process has been successful. AUO is the buyer. And we have announced this sale, I would say, late September. It will be an enterprise value of roughly EUR 600 million, and that means for us a profit of EUR 100 million. I will say the management of this company is a very efficient management. This company has a very good technology. So I think it is a win-win story for everybody.

Third key fact, we continue to be successful on the order intake, which is important. We are a growth company. So we are today challenged by the fact that our customers are slightly underperforming the market, but we will continue to drive, I will say, a good growth on both activities, Electronics, Lighting, and as well on Lifecycle Solutions. And I will say this order book is made with strategic customers, good conditions, and of course, on, I will say, the new technologies.

Last but not least, we have, I would say, the IAA in Munich, it was in September. It was a very successful, I would say, event, much better than 2 years ago. And it was the opportunity for FORVIA, for HELLA to display all our technologies and to meet a lot of customers starting, of course, with German, but as well with a lot of Chinese customers, and we say that they are very much interested, the Chinese by the technology of HELLA, mainly towards the segment C&D.

Going to the Page 6. We are displaying our results, and of course, it's not easy in a period, where volumes are slightly slowing down and challenging because we have a big growth in Asia, less -- much less in our core, I would say, regions, Europe and North America.

Second, we are still facing inflation. And so, the motto is that we have to defend our P&L, we have to defend our cash. We are making the job with the customers in a win-win story because HELLA a technological company, HELLA has to provide the right resources. So our goal to pass through the 100% inflation on raw material will be achieved by the end of the year. So we are quite satisfied with the way we have managed that with customers and the way that our sales force have managed it.

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We have on the cash side, one issue at the end of September that we have to cash all these agreements. This is in a good process to be achieved by the end of the year. It will be a major contributor to the improvement of the cash in the last quarter. Saying that, we have an outperformance in the third quarter, but slightly below the previous period. We have, I would say, a good demand, mainly in Lighting, which is very good.

And on the results, we are posting, I will say, what is called a decent profitability with a 6.1%. I will say, it's a permanent fight to be sure that we have the right cost management in order to secure this result and, of course, the guidance that we will repeat at the end of this presentation. I have already mentioned for the cash flow, which is our key focus today with the management board.

Page 7, you have an illustration of some, I would say, key order intakes/awards. Radars, we are a worldwide leader in radars. We confirm that with the new family. We have as well a sizable award in high voltage battery management, and which is for us a new field and a new very important field. And of course, the traditional smart car access, where we have as well a worldwide leadership position.

In Lighting, this quarter, after some successful quarter in headlamps, we have a very important rear lamps for Chinese premium OEM. And interior lighting is more and more a flagship activity because it helps our customers to differentiate the cars, mainly again for the segment C&D. And last but not least, we have some sizable as well awards in the special applications activity, mainly Lighting.

Page 8. We are, of course, focused on profitability, cash. We have made our work to, I will say, sort the business, which is the famous sale of BHTC. We continue to work on synergies. We are above the target, mainly HELLA in this year 2023, which means that we are managing a close collaboration with FORVIA and with the management board, with Bernard, we are totally focused to improve to downsize our cost base, whatever the fact that we are, of course, managing the growth.

We repeat that for the cooperation/collaboration with FORVIA, there was an intensification this quarter with the creation of joint ventures mainly to manage IT, indirect purchasing, and to put in common the organization

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between the two groups in order to be more efficient. At the time, where, for instance, in IT, we need to transform because we are actively working for the new SAP platform called S/4HANA.

Now, I will give the floor to Bernard to detail the financial results.

Bernard Schäferbarthold: Thank you very much, Michel. So good morning also from my side to all of you. If we continue on Page 10, so some more details on our sales development. So overall, the organic growth is at 16.8%, which is a good number, slightly behind our internal targets. And we mentioned it also before, some of the programs we have booked in the past are not running as good specifically on the German overall customer base.

If we look at the inflation compensation, this makes around 4% in our sales number. We are covering and we have increased the coverage in comparison to our inflation, as of September to a ratio of around 90%. And Michel also confirmed that we think that in the remaining quarter, we should be able to fully compensate it, so to 100% similar to last year.

The effect out of reimbursements on tooling and development has increased within our sales number in comparison to last year. So it's around EUR 90 million more, which is also related to a higher order book in comparison to '22. So this makes around 1.5 percentage points of growth.

The FX effect is very negative, mainly because of the U.S. dollar and the Chinese renminbi, which you can see in the bridge.

If we look specifically on the segments, so going to Page 11, starting with Electronics. So in Electronics, the growth organically is at 12.5% in comparison to the LVP growth of 9%. Our outperformance is not high -- and by far lower than what we expected starting into the year. Here, we can mainly see that some of the programs we were expecting higher volumes, as I mentioned, specifically related to some of the German carmakers.

Despite that, there is a significant growth, especially within our product groups energy management and also automated driving, which are growing at a pace of energy management of around 16% and automated driving above 20% of growth. So still, we have an effect also overall of the bottleneck situation on the supply side, less on our side, but overall in the industry, which

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has an impact also on volumes and partially also on take rates of our products, as of now in the 9-month period.

The operating income increased. So we are now at a ratio of 7.1%, which is an improvement compared to prior year of 1.1%. We are quite satisfied in terms of the development of our gross margin. But still, I have to say that the R&D expenses are too high, specifically in Electronics due to some investments in specific programs and here, especially in one, which is the electronic power steering, where we are over-expensing a very significant amount in this year. So I hope that we will be through in the next quarters. We are now starting the launch of this program now very soon.

If we look at Lighting on Page 12. So a very decent growth, very much over proportional to the LVP growth. So here, we are benefiting from very strong programs in the first 9 months of this year. And this helped very much to improve the operating income from a low level last year now to 2.8%. So we are continuing in improving now the business and the mix on customers in Lighting overall. And specifically, the topic of underutilization, partially in Europe is something we address consequently now in our industrialization plan on Europe, we have now started to execute.

If we look at Lifecycle Solutions, going to Page 13, a continuous good development. We benefit this year from a strong business in our independent aftermarket spare parts business, but also in our workshop product business and as well also for SOE. So all 3 different businesses have a good growth momentum in the year of 2023, and this leads to an organic growth overall of above 15% and is the main reason for a very strong operating income. We improved the operating income margin to a level of around 13% in the first 9-months period.

Looking at the regional mix on Page 14. So our growth is very much related to Europe. You see that the growth in Asia and NSA is slower, but specifically also with the FX effect, which is also in these numbers. So if we would correct and adjust to the FX effect, the overall organic outperformance is actually at 780 basis points in comparison to the volumes.

Going to Page 15, looking at the full P&L. So we are quite satisfied about the development on the gross profit even considering a continuous high volatility on the demand and changes on very short notice to the demand planning of

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our customers. We managed to stabilize the gross profit above 25%. That was certainly supported by the inflation compensation we were able to achieve also on the customer side.

The R&D ratio is too high. As I said, 11% is by far higher what we were expecting, certainly above 1% of that is related to over-expenses in this one program of electronic power steering. So this is something we need to solve to come then to our target level, which is at least at 10% and slightly below.

The SG&A has increased in absolute terms, in relative terms, we are at a constant level. As Michel said, we have initiated some structural projects, specifically also on our ERP side, but also different others, which we have paused partially also during the Covid time, and we have relaunched these ones now in the last fiscal year. So overall, we are at 6.1%. And no major effects to comment also on the JV side or on the non-recurring elements, so that overall, we report, as well an EBIT of 6.1%, which is around 200 basis point improvement to previous year.

On Page 16, the development on net cash flow. This, honestly, is a result now end of September, which is not satisfying for us. So we are at EUR 40 million, and there are specifically two reasons for that Michel also already mentioned. One is our inventory level is still by far too high. So it's still the impact out of a very high volatility on demand by our customer, which in a complex supply chain with specifically semis, we have to order in advance -- around 1 year in advance. It's a challenge for us.

And the second is that on the inflation compensation, we settled the agreements, but the time to process these that we have the purchase orders, we reinvoice and we cash in takes some time. So we are in time now to do that and to cash in the most significant amounts until end of the year, and this should bring us to the level of around 2% we were -- and we are still guiding on net cash flow in relation to sales. This amount should consider also somehow a certain factoring amount, which we also commented in September, the EUR 91 million, but we expect to the end of the year that this amount will be less than in September also to reach that target.

CapEx is slightly lower in comparison to last year. It remains also a focus topic on us to manage CapEx, most efficient possible.

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Having said that, I hand back to Michel for the outlook and happy to answer your questions later.

Michel Favre: Thank you, Bernard. So with the Page 18, you see the volumes per regions. We were giving our guidance on the basis of 86 million. As you see that the last forecast of S&P Global Mobility is at 88.6 million, so something like 4% above.

Unfortunately, the geographic mix, the customer mix are not favorable for HELLA. And you know that our key, I will say, customers, are the German ones, mainly are not taking advantage of this additional volume, which is this year a difficulty for us.

But anyway, going to Page 19, we can confirm, I will say, the figures for the guidance, and we can confirm today that we are in the middle of this guidance. So consolidated sales EUR 8 billion to EUR 8.5 billion. When I say middle of the guidance, it is, of course, with the ForEx impact, which is today negative, we see for the end of the year. Operating margin, 5.5% to 7% and net cash flow. And with, I will say, the result of October, we are with Bernard more and more confident that we will reach this target whatever, I will say, the mixed result of end of September. So we are fully committed to deliver these figures in this, I would say, not easy environment.

So Page 21 to take the, I would say, the key takeaways. We continue to deliver. We are today at our -- at the end of September at our budget, I will say commitments, which is as well for our people, a very positive performance. And I would like to take advantage to thank all the HELLA employees for their contribution, for their efficiency in this current time. We confirm, of course, the outlook for everything. And (but I will repeat that) we will have, I will say, an analyst meeting, November 28th to focus more on perspectives, knowing that with the war et cetera, the visions for the next two years are not obvious. But we will be very happy with Bernard to share our view at this stage.

Now, I propose to go to the Q&A session. Operator, can you launch this session?

Operator: (Operator Instructions) So the first question is from Giulio Pescatore.

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Giulio Pescatore: Yes. If you can hear me. So just asking about the free cash flow effect in Q4 of the collection of the compensation benefit. If you can maybe help us quantify how much is -- should we expect a tailwind in Q4?

Bernard Schäferbarthold: So for the last 3 months, we would expect around EUR 140 million to be cashed in.

Giulio Pescatore: Okay. Perfect. Very precise. And then the other question I had is on the gross margin. I mean, clearly, a very positive result in Q3 on the gross margin front. How much of that is sustainable? I mean, what is -- what do you think is -- if you adjust for the retroactive pricing compensation or any potential effect linked to pricing? How much do you think is that sustainable? What is a sustainable gross margin? Where are you today? And what do you think is sustainable in the future as well?

Bernard Schäferbarthold: There are not so much, let's say, non-sustainable effects now within the quarter. So if you would look now the last 3 quarters, we were in all quarters above the 25% of gross margin. So the settlements we were able to achieve are only really accrued on the real volumes we already -- or we have delivered in the effective period, so that the margin you see, from my point of view, is a sustainable margin.

For sure, some of the settlements or agreements we have with our customers are based on yearly agreements, so that if we look also ahead next year, not all what we have reached is how we call it recurrent on a continuous basis. So some of the agreements we have need to be renegotiated in 2024.

Michel Favre: Mainly for the semiconductor prices because, of course, customers do not want to take a definitive commitment on the price. So it is something that we are justifying quarter or semester after semester. But the process has been defined with each customer. Your topic is very important. Gross margin is key, I mean, in this business. I think all companies must protect the gross margin. And in our guidance, we target to improve the gross margin, which is not easy, but we target to continue to improve the gross margin, mainly with

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the contribution of new businesses at least as profitable as today in respect for the HELLA business.

Giulio Pescatore: Okay. Very clear. And maybe another one on the order book. I mean, very good to see you winning business with the Chinese car makers on Lighting. I think that's clearly an area of potential growth for you. But more broadly, if we look at the orders you have been accumulating over the last maybe couple of years, if you take those orders in the light of the market share changes you see in the market, do you think there is any reason to believe that some of those orders might not be realistic in the way they were framed by your customers and maybe conservative enough, so you don't have to do adjustment. But I think there is a concern in the market that some of those orders might never come to fruition because of the market share changes. So how do you see that playing out.

Michel Favre: It's a key question because, of course, when a customer is making a RFQ, he is not underestimating the volume, he might be successful. So usually, a new model must be more efficient, more volumes than the previous one. So we have always to discount. According to customers, we have to discount between 10% to 20%. So it is always a key exercise. With the change of powertrain, with the move to EV, we sometimes have some difficulties on the segments for a customer. The visibility is not fantastic. And we have seen -- there was some announcement of reduction of EV expectations from some key customers for us when we are convinced, as HELLA that EV will accelerate. So what to say, what to do, with respect to this, I will say, current environment. But it is something that I propose to share with you the 28th of November.

Operator: The next question comes from Michael Jacks from Bank of America. It looks like he removed his question. Then I hand over to the next question from Akshat Kacker from JPM.

Akshat Kacker: Good morning, Michel. Good morning, Bernard. Akshat from JPMorgan. Michel, firstly, thank you so much for all the collaboration and amazing

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discussion we have had over the years. It has always been super transparent and enlightening in my view. So I wish you all the best in your future endeavors.

Michel Favre: Thank you for your message.

Akshat Kacker: Yes. I have 4 questions, actually. The first one on Mercedes and one of your key German customers. Mercedes obviously on their Q3 results has talked about higher supplier compensation, not just in the second half of this year, but also as a recurring topic going forward into 2024. And what they have said is that this covers not only inflation, but also structurally lower industry volumes that you just talked about. So could you just shed some more light on the discussions that you're having with Mercedes or any other major customers on these lines basically?

The second one is on cash conversion. Can you talk about your current expectations for cash restructuring in 2023 and 2024, please? And your overall plan to improve cash conversion going into 2024?

And the third one is on inflation. I know it's still early to talk about 2024. But based on what you see now and your current budgeting, what do you expect for gross inflation going into 2024, please?

Michel Favre: Thank you very much for your questions. I will take the first one and the last one. The last one is very easy (unfortunately) to answer. Today, when we make our global vision, we have a 5% inflation to face in HELLA. It is what we have in the budget with, of course, higher inflation in East Europe with respect to some other countries. So inflation is slowing down, but still a major topic and higher and probably the sector I was expecting.

From Mercedes, Mercedes is a very important customer for us, it is our customer #2, #3 according to the amounts. It is a very long-term relationship and winning relationship, partnership with Mercedes. So of course, it is a win-win story.

And for the compensation, we have worked with Mercedes on different processes. It's quite transparent. We have justified everything. And we settled everything with them end of June. So we are today, I think, in a winning

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situation with Mercedes. And we have, of course, a lot of resources dedicated to Mercedes. Now, Bernard for the cash conversion.

Bernard Schäferbarthold: So we basically see going forward, 3 main levers. One is that we continuously want to improve our EBITDA and this is certainly also in 2024. And the second and third is basically working capital and CapEx. On working capital, the main focus is on inventories. So our inventory level is, I would say, around EUR 200 million today too high. It's mostly related to what I mentioned on one hand side, volatility of the demand, but also on agreements we have on the supplier side, specifically on semis, which we are actually trying to find now a better structural way in how to be more flexible in terms of the volumes.

We are progressing here to find the right agreements, but this is -- this has a significant lever. So there are certainly 2% to 3% of working capital, which we need to address in the, let's say, next 15 months until end of next year, which should be a strong lever specifically on next year's perspective.

On CapEx, we work more, let's say, structurally in a way that one of the topics, which is significant for us is that the programs are highly individualized in terms of tooling we need and also the setup of the lines. And we have now introduced the concept of universal lines, especially in Lighting and a higher degree of standardization on different elements of the Lighting technologies, specifically modules, for example. And this should lead not immediately, but over time to a much lower CapEx level structurally also in the time to come, specifically for Lighting. So CapEx is a very important lever. But on the -- on the let's say, cash trajectory and improvement more also a midterm lever to reduce the amount of investments we need to do.

Akshat Kacker: A quick follow-up on inflation. So when we talk about the 5% increase in 2024, are we mainly talking about labor inflation? Or are there any other factors that we should keep in mind?

And another one quickly on R&D. When you think about your budget for next year, do you have a range in mind in terms of absolute R&D spend going into 2024?

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Michel Favre: Yes. Thank you for these two big questions, important. So of course, I speak about labor first. Second, we cannot say that there is no inflation on indirect purchasing, et cetera. So we have to mitigate that and with some technical actions, et cetera. It's more difficult to illustrate how much it will be on that. What we -- I can say today is that our vision is that on semiconductors, on raw material apparent inflation is no more the case. But to be confirmed in the next months, mainly in this period, where we have some troubles, if I can use this nice expression with respect to what is happening in Israel and in Ukraine. So the environment remains complicated. But the 5% inflation means that we have to offset a little more than 1 point starting with the budget. And of course, we will do it through our different, I would say, measures, which are some reduction of people, some SG&A optimization, some, I would say, development of R&D, of course, in low-cost countries like India. R&D in absolute terms will increase due to, first, the order intake of this year. You know that we have another significant -- we will have a significant order intake. So we have an additional work linked with the order intake of this year and last year. And the second, we have some nice, I would say, opportunities, some very big RFQs on some key activities in Electronics mainly. And of course, we want to be successful, and we want to put to, I would say, the right means to be awarded.

Operator: And the next question comes from Michael Jacks from the Bank of America.

Michael Jacks: Good morning, Michel. Good morning, Bernard. 3 questions, if I may. The first one, just on the expected sequential margin development for Q4. Should we expect anything incremental from R&D reimbursements and from pricing recovery versus Q3? That's the first question. Second one is just touching on the blocks for cash flow for the year. You mentioned EUR 140 million to be cashed in from customer agreements. Should we expect any release from inventories in Q4 in addition to that? And then finally, just on, I guess, production levels. You mentioned that call-off volatility is still quite high. Are you able to quantify the impact of that on your gross margin this year?

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Michel Favre: Okay. For inventories, we have to be clear and fortunately or unfortunately, is done, end of October is done. After that, all what we will improve will be for 2024. Inventories, we have a small decrease, if I not mistaken, in the last 2 months, small one. So this means that we have stabilized the things. And we have some ambitious targets, I can tell you and to adapt some processes to take probably some more risk in order to optimize the inventories in 2024. It is a major part of our budget for the cash. And of course, a major part of, I will say, our efficiency improvement.

For the other points, Bernard?

Bernard Schäferbarthold: Yes. There is perhaps to add on the inventories, there is the so-called project stocks are also included in the inventory. So some of the tooling, which is developed on the customer side is part of it. It's around between EUR 250 million and EUR 300 million. And one focus is, in terms of launches, which are approaching now to finalize these tooling and developments and invoice these. So this is something where it's the second focus for us to the end of the year to finalize some of these bigger programs and reimbursements to cash them in. So this should lead at the end also to an inventory reduction, but it's not a raw material and production stock reduction. I have to admit I was not able to understand your first question because it was not loud enough. Can you repeat it, please?

Michael Jacks: Yes. Absolutely. Just on the expected sequential margin development for Q4, should we expect anything incremental from R&D reimbursements and additional pricing recovery versus Q3? Or is all of the pricing recovery now already in for Q3?

Bernard Schäferbarthold: No. We are actually at the compensation rate, what I mentioned of around 90%. So the compensation rate will slightly increase to the full recovery, so that we expect also on Q4 a higher ratio, and this should improve our margin also in Q4. As of today, we are in the 9-month at 6.1% exactly. So we still think that we can end up a little better. So we remain in our view that the midpoint overall is -- remains our ambition, so between 6.2%, 6.3% to the end of the year. And this would mean that Q4 will be better.

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And mostly within the gross margin, so we expect still R&D and also SG&A more on a similar level. So the improvement will come out of the gross margin and there specifically on the reimbursement, as you said, and inflation compensation.

Michel Favre: Inflation compensation for us, but I think it is the same for the sector. We speak of more than 4% of sales. So it is why it is a very important topic for everybody. And as I said, different times, it will be a differentiating topic according to the capacity for the different players to pass through the inflation.

Michael Jacks: Understood. And then just my last question on call-off volatility, which still seems to be quite high. Are you able to quantify the impact of that on your gross margin for this year? Is that something we could look to for next year, as a potential upside lever for the margin?

Bernard Schäferbarthold: What is very high. I cannot understand. Sorry.

Michael Jacks: Your call-off volatility, your call-offs, the volatility there?

Bernard Schäferbarthold: Yes, the call-off quality -- so one is that still the volatility remains very high. So Michel also mentioned, it's very unpredictable also on a more -- on a sustainable way really to understand how call-offs on a 6-, 9- or 12-month period would be. So what we have seen that, for example, some of the larger -- specifically on the German customer base, the electrified cars, the programs, the models there are by far lower than what we expected. It's there -- from our side, we expect that we will not come to the original volumes, which were expected even discounted on our side. So it's something, where specifically on next year, we do not expect that the call-offs on some of these programs, which are low, will increase. So on the other hand side, in terms of the volatility, we remain with the assumption that the volatility will remain high. So it's a continuous challenge. If it would at the end be better, for sure, it will be an improvement, but it's not our base assumption, as of today.

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Michel Favre: One year ago, a big topic for the customers, I speak for the final customers, were the waiting time. You needed 9 months, 12 months to get the car. Today, probably the waiting time is 4 months to 6 months. So which means that customers have recovered, I would say, production. So production should be over the actual sales and potentially because as we have some incomplete cars, where we have limited visibility.

So our conviction is that at least for Europe and probably for some other continents, production was boosted by this recovery. So this means that it could be a risk on the future volume for 2024 if this nice impact is now over. And of course, we have always the topics of what is the real sensitivity to price because car prices have increased by 20% to 25%. And of course, there is a risk that this will have, or this has an impact on the volumes. So it is why I was mentioning before that visibility on actual sales, actual order intake, actual production for each customer is today limited, which is a real problem for us.

Operator: All right. There are no further questions at the moment. So I hand over back to Michel Favre.

Michel Favre: Thank you. Thank you very much. Again, thank you for your attendance. I have a personal message because I started communication in February 2001. So after 23 years of financial communication, after more than 80 quarterly calls for results. I would like to thank you, to thank you for the quality of the relationship, for the permanent challenge, which is always positive for, I will say, as well, the confidence sometimes you give me. So it was a pleasure to work with you with the financial community. And I will be, from my lifetime very happy to see you, I hope physically the 28th of November in Frankfurt to speak more on the next future. Thank you very much and have a good day.

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