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P: Bjorn Voss Warburg - Analyst
P: Lucile Leroux Morgan Stanley - Analyst
P: Christian Ludwig BHL - Analyst
P: Lello Della Ragione Intermonte – Analyst
P: Operator

Operator: This is conference # 955020.

Thank you for standing by. Welcome to the Hella investor call for Q1.

At this time all participants are in a listen-only mode. There will be a presentation followed by a question and answer session, at which time if you wish to ask a question you will need to press star followed by one on your telephone keypad.

I must advise you that this conference is being recorded today on Friday, September 25, 2015.

I would now like to turn the conference over to your speaker today, Dr. Wolfgang Ollig. Please go ahead, sir.

Wolfgang Ollig: Thank you very much. Hello, everybody. As well I would like to welcome you to our investor update call Q1 financial year 2015/2016. Together with Carl, I will give you some insights.

In fact, we already had a call on our preliminary numbers last Friday due to as well the extraordinary supplier failure which we had to encounter, incorporate into our Q1 numbers. So I think the one or the other information already is transparent to you, so I would try to be quite quick with the presentation and then we would be open for your questions.

So key message we would like to transfer to you is that on the one hand there was a specific supplier failure issue which has burdened our Q1 numbers and as well will have an effect for the full year which cannot be compensated. But outside of this effect, we are sticking to our guidance we have given on the one hand for the full year and as well to the operational performance we have achieved. You can see that taking out the supplier issue already in the Q1 numbers and as well that should be the effect for the full year.

So now, going into the presentation, we would like to give you some key highlights about the Group and then two charts on the outlook, one on the market and the other on our guidance for the year, and then we'll go to the Q&A. In the annex you will find a summary of our key data for the Q1. It's already available on the web and you probably have seen it already.

So starting with the highlights on page 4, clearly we would like to outline that the sales development has been quite strong. So in total we have achieved a growth of 14 percent, out of which 4 percent are due to positive currency effects. So organic growth has been 10 percent, and this has been quite strongly driven by our automotive business. Here, we see that the general megatrends which are supporting our business are still valid and we don't see currently any effect which is changing that.

So, about the three megatrends, we're talking about the LED penetration in the market which globally and as well European-wide is still at a quite low level, and we expect this to significantly increase with a high growth rate over the next years; second megatrend being CO2 reduction and fuel efficiency topics, which as well are more and more on the agenda and in fact are supporting as well our business activities in electronics. And autonomous driving is a third megatrend which, as you all know, is heavily impacting the way the automotive industry is developing over the next year. So these trends are still intact and in fact are supporting the automotive business.

Looking to the aftermarket, here you see as well a growth of 10 percent. You might remember that in the first half of last financial year we had an extraordinary weakness, especially in the German aftermarket. This has been overcome in the second half of last financial year and this positive market trend is continuing, so here we are on a sound growth track. And we have not yet seen substantial positive profitability effects in Q1, but if the trend on the sales side continues, we should be able to incur these effects for the full financial year.

Special applications had, in fact, significant reductions in the last financial year due to the agriculture business weakness, which is one of our important target groups. This, in fact, now has leveled out because the comparable year basis is lower. In general, we see a certain stabilization but as well no positive movement upwards.

Looking to the profitability, of course the gross profit margin as well is impacted by the supplier issue, mainly here on the asset impairment we have done for our local company and as well the costs we have had to reorganize our supply chain.

Taking these effects out, and there's a chart later on to it, you will see that the gross profit has in fact operationally improved, taking out negative hedging costs, although less strong than you might have expected and we would have expected in other situation. But coming to this later, this is due as well to the technology rollout we're currently facing in lighting to regions outside of Germany.

The R&D cost has been a little bit higher, at 9.3 percent, but here this is just a question of comparable basis in Q1 last year. A more reliable picture you see if you include the Q2 numbers of last financial year, because a lot of the charges and efforts have been booked, in fact, last year in Q2.

So with the 9.3 percent, although there seems to be an increase, in fact we are in line with our internal target. We're in line as well with the figure we have communicated for the full year in May and are as well on track concerning the guidance for the full year.

So this leaves the EBIT including the supplier effect at a level of EUR69 million, with a margin of 4.6 percent, which of course is significantly below our target. But taking these effects out, we would in fact have an increase in our EBIT, a small increase by 4 percent to EUR98 million.

And the ratio of the EBIT would be at 6.6 percent, on the one hand due to the fact that -- lower than last year, to the fact that we are not taking as much profit and gross margin out of our new ramp-up business due to the automotive topics I've mentioned and as well to the dilutive effect of currency, which topline of course is quite strong, but due to our hedging effects is less so in the EBIT line. And this is the reason why we have a dilutive effect on our relative margin.

We talk as well about adjusted EBIT. So besides the supplier topic here, we still have the restructuring efforts we have talked about as well last year. So here we -- for the full year, we talk only about an amount of EUR10 million [EUR 20 million]. The amount for the first quarter is at around EUR3 million, so not so significant, leaving then the EBIT margin at 6.8 percent, and this probably is the clear operational key figure you should look at.

Quite positively has developed our liquidity, so our cash flow which has been already quite strong in Q4, in fact this trend continues. So EUR65 million operative cash flow. We are significantly better than -- starting into the year than last year, and this should give you an effect, as well, operational topics which we have initiated and which came through as well on the financial effects as well are continuing. And in fact we are quite positive about this development.

So looking at the markets, and here we have two full pictures. On the top you see the market for new passenger car registrations in automotive, global and then for the key regions. Below you see the Hella numbers, on the left-hand side just for the Group and then for the regions, just looking at automotive.

What you see here, and this is our key message, that we are outperforming the market both on Group level, so including a structurally low growth aftermarket business, but as well or explicitly even more so in the automotive business. If we look on the specific regions, we are in fact quite positive about our current development.

So the outperformance of the 5 percentage points -- 500 basis points we have achieved last financial year in fact is continuing. And in Q1 at least it seems that this trend might even grow, or at least give us some headroom as well for the uncertainties which might be there in the full year.

So looking to the segments, you know this picture already and I mentioned the one or the other topic already. So you see automotive, of course, strongly growing, then the operational profitability EBIT margin going down due to the supplier issue. We have (selected) this now with the EUR29 million in the column on the right-hand side.

In the preliminary call, we talked about approximately EUR30 million. So finally it's EUR29 million. But this doesn't change anything on our general guidance we have given for this effect as a whole, with negative as well operational costs coming especially then in Q2 and might continue for the full financial year of up to EUR50 million.

What in fact has been quite positive is the general positive demand in Europe and NAFTA, as you have seen on the chart before. The China market has been slightly lower, by 3 percent. But due to the product launches which we have in this market, due to our strong acquisitions we have done in the last two, three years, due to the fact that we have significantly increased our capacity, as you know, in fact we are growing in the market even though the market has been quite, let's say, (calm).

We talked about this technology rollout of our complex lighting projects. This trend already took a burden on the profitability side in Q4, and as well, as communicated, this trend is continuing. Our projection is it should at least last until the first -- the end of the first half, so end of Q2. Before then, in the second half of the financial year, we should see more positive operational leverage effects of the general growth development.

And we talked about the supplier issue already.

When we look to the aftermarket, there has been a quite substantial growth. Especially the wholesale business here has developed quite strongly, but as well the aftermarket is on a solid track. We still have a negative product mix effect which has been overcompensated by growth, and we have to see now how the development will continue for the full year.

And special applications, as mentioned, agriculture still weak but now on a lower comparable previous year basis, so therefore the business seems to be more stable. Due to product mix effects, there is a positive effect on the EBIT margin, which as well should give an indication that this segment, although small in terms of profit factor and ratio, can be attractive and should become even more attractive mid to long term.

If we look to the, more specifically, profit development on page 7, and this chart we have already shown in our preliminary call, you see that -- and now I talk about the gross profit margin, that taking out the hedge costs, which accounted for 40 basis points in the first quarter, in fact we would have increased our operational gross profit margin by 50 basis points. But in fact, netting this effect out, we are at 26.7 percent.

And then adjusting the supplier default topic, we are in fact at the level of the 25 percent.

When we look at the EBIT ratio here, then you see in addition the R&D topic I've mentioned which is just a temporary effect. We will have or we have incurred a negative effect on the JV income.

So profits here have been down a little bit, on the one hand due to one-time effects we had on special tax payments; on the other hand as well due to a weaker than expected and weaker than previous year market level, especially of our Korean joint ventures and the customer base we have there, seeing some issues in a lower Asian market.

So this trend, however, is not at a level that we in general would change our indication for the JV ratio for the full year. So we still think that a level of 0.7 percent to 1 percent of our profitability margin, in this range, as we have achieved the last two years, is a quite good guidance.

Going to the next -- or maybe one last topic for the supplier default. In addition to the gross profit effect, there is another 40 basis points effect due to the goodwill asset impairment we are doing then below the gross margin. Therefore, the overall effect accounts for 2 percentage points of our profitability.

Then here you see the picture of our adjusted EBIT and EBIT line, as already explained. Significant difference, of course, is the supplier failure of EUR28 million and the EUR3 million restructuring expenses.

Looking at the structure cost below the gross profit, administration and distribution expenses are on track. As well, you have seen that they have been significantly reduced in the last financial year by equally 30 basis points, which has been quite strongly. So this year there should be a rather stable development, and here we are on track, I would say, in the first Q1 development.

And the last page I would like to show to you is our operative cash flow. So not only there has been increase in absolute terms but as well in the cash conversion ratio, which now is above 60 percent. Of course, here a quarterly review is nice, but a more longer-term perspective here has to be taken.

In general, this gives an indication that the general operational profitability development together with the higher payout due to the investments we have taken into structures where now business is coming through and as well investments can be reduced is visible. Of course, the supplier failure costs as well will have a cash effect in the next quarters and as well will have a negative effect.

So this would be our short introduction for Q1, and now we're happy to listen to your Q&As. Thank you. Sorry. I was a little bit quick. So now we go to the outlook.

So looking into the market 2014/2015, I think it's interesting to see what changes have been done. So for China, now as well the official numbers become a little bit more moderate. So the latest estimate of what we think is reliable is around a growth of 4 percent for the full year. There has been a reduction from around 6 percent.

Whereas for the U.S. the projection has been increased slightly, by 1 percentage point, and as well Western Europe has been increased from 4 percent to 6 percent. So, in general, here we see a certain shift from China to the U.S. and Western Europe, and of course this is as well incorporated into our guidance.

So coming to our guidance, I already mentioned to you that taking out the supplier issue we are in line with the guidance we have given for the full year, operationally. So we stick, in fact, with the growth of the medium to high single-digit percentage, which of course in the first quarter has been outperformed. So we have to see now how the market will develop and the business will develop in the next quarters, but currently we feel quite positive about this guidance.

The one-off charges, as mentioned, so in addition to the EUR28 million we have in Q1, there will be further costs, actual costs for the supply chain reorganization for the deliveries we have to initiate.

The impairment topics have been done. So these will be operational costs and it will depend on how fast we in fact can also reduce our costs in reorganizing the supply chain of how much further costs will come up. This is the reason why we are guiding up to EUR50 million.

And the EBIT, in fact, due to this effect, will be lower than previous year. Taking this effect out, we should as well be in line with our old guidance.

So now, sorry for being a little bit quick, we are looking forward to your questions.

Operator: That if you wish to ask a question please press star one on your telephone keypad and wait for your name to be taken by an operator. To cancel your request please press the hash key.

Once again, to ask a question please press star one on your telephone keypad. Please standby while we compile the Q&A list.

We would like to ask you to limit your questions to a maximum of three per person.

Your first question comes from the line of Bjorn Voss. Please ask your question.

Bjorn Voss: Yes, hi. (Technical difficulty) three quick questions. First of all, you provided information on your development in Asia and rest of world. I would be and probably also the whole market would be interested in your development in China specifically. I think you were pretty precise during the roadshows regarding China, and we would also be interested now in the first-quarter development here in China.

Secondly, your strong free cash flow generation in the first quarter, is there any specific seasonality in your business in your free cash flow generation? And maybe you can give us a guidance for the full year. I think with the preliminary results you already indicated that cash flow should be quite sound this year.

And lastly, maybe you can clarify the actual expenses related to the Chinese supplier failure. I think Carl spoke about up to EUR50 million, with a chance of just reaching EUR40 million. Maybe you have new figures here. Thank you.

Wolfgang Ollig: OK. So your first question, about China and the Q1 figure, in fact our Chinese business has developed quite positively. It has been above the Group average of 14 percent. So just the China business of the local companies, so not taking into account the export has been at a level of around 24 percent.

The seasonality of the cash flow, of course this is quite -- can be a quite significant effect. However, we don't see generally that the Q1 is at the level we have achieved. So there will be certain burden. As I mentioned, the supplier topic, but as well investments should increase during the course of the year, but stay within our general guidance. So the cash flow for the full year, we have not given a guidance this year but we are in general quite solid on our development here.

And mentioning the supplier costs and where these costs come from, as we have said last quarter for the last preliminary call already, they are a bundle of costs. On the one hand we have to reorganize the supply chain in delivering products and components from Europe, including freight costs and additional hire costs, because buying these products from sometimes even competitors is more costly.

Then we have initiated new tools, so duplicated tools, so these costs in fact are there as well. And as well we have a lot of efforts, of course, at other suppliers who are helping us to reorganize supply chain in order to get the registrations done at the customer, et cetera. And all these efforts in fact are incurring these costs and will continue until we have fully reorganized the supply chain. So therefore there will be further costs after this.

I don't think that we have ever said there will be less costs than EUR50 million. I don't think that we have mentioned the EUR40 million, so in fact nobody really knows how high these costs will be. We just have given the guidance that they should be below or up to EUR50 million. So at this point in time, there's nothing more we can say to this.

Bjorn Voss: OK. Thank you.

Operator: And your next question comes from the line of Lucile Leroux. Please ask your question.

Lucile Leroux: Yes. Hello. Thank you for taking my question. So I have three questions. The first one, I was wondering if you can give us an indication of your exposure to Volkswagen in terms of sales and how you see the implication for Hella of the recent VW news flow.

My second question would be regarding the R&D. It was actually better than I expected. I was wondering if you can give us a bit more color on the midterm target. You are saying that you expect a decrease. Which time horizons shall we expect and which kind of magnitude?

And finally, I think that you had a positive development in China. Some OEMs have actually turned to their suppliers asking for a price reduction, Hyundai and Toyota. I was wondering if you have experienced something similar or if you expect to see the usual 1.5 percent to 5 percent price decrease for next year. Thank you.

Wolfgang Ollig: Yes. Thank you, Lucile, for the questions. So concerning the specific customer sales, unfortunately I cannot be too precise there because we are not reporting on individual customers. As you know, the exposure we have to the German OEMs, including direct sales to other Tier X companies, is around -- in the automotive business is around 50 percent. And of course, the VW Group has a certain share here. That's clear.

Currently, however, it's very difficult for us to assess the effects and consequences the whole situation might have on our business, so therefore we cannot comment on this. I hope you understand this.

Lucile Leroux: OK. Shall we expect that it's similar to the market exposure, or will it be slightly higher?

Wolfgang Ollig: As I said, unfortunately, we cannot comment on that.

(Multiple speakers)

Lucile Leroux: OK.

Wolfgang Ollig: But generally, we feel quite comfortable in our global setup and as well with the distribution of our business. Of course, we have a variety of OEMs. So, in fact, to really assess these effects, facts probably have to become a little clearer.

Lucile Leroux: OK.

Wolfgang Ollig: So concerning the R&D level, so the 9.3 percent we think is a quite good expectation for the full year. We guided on a stable R&D ratio, due to the fact that on one hand we have to give application engineering support for our automotive business, which is in a launch phase currently, and as well because we have acquired a lot of new businesses which now have to be developed.

So therefore there will be a stabilization this year and next year, 2016/2017, there should be a further reduction. As we have said, the guidance here should be below 9 percent.

Lucile Leroux: Below 9 percent?

Wolfgang Ollig: Below 9 percent, if the full reduction below 9 percent can be achieved. Next financial year, however, is not clear, but there should be a reduction.

And concerning the price reduction efforts in China, clearly the automotive business is competitive. Especially when the markets get more difficult for the end customer and for the OEMs, clearly the discussions are increasing. But here as well there's nothing what we currently can say and nothing where we think there is a fundamental change to the general tough negotiations we have anyway.

Lucile Leroux: OK. Thank you.

Operator: As a reminder to ask a question please press star one on your telephone keypad.

Your next question comes from the line of Christian Ludwig. Please ask your question.

Christian Ludwig: Yes. Good morning. Thank you for taking my questions. First of all, I'd like to get back to the restructuring costs. You mentioned that it's going to be EUR10 million for the year. I believe in the full-year guidance call you said it's going to be EUR20 million for the year. Is this a change or did I just misunderstand something?

Secondly, when I look at your split in the growth of the automotive business, lighting is growing at more than double the rate of electronics, which is also a big change to what we've seen in the previous years. Is this also a structural change in your business that you think is going to continue for a while, going forward?

And last question, again on the free cash flow, I know you said you're not going to give a guidance, but with this start to the year is it at least fair to assume that your free cash flow will be above last year's level? Thank you.

Wolfgang Ollig: Thank you for giving the question and as well mentioning the restructuring costs again. In fact, the EUR10 million I was referring to was just the T20 effect. So, thank you for giving me the opportunity to be a little bit more precise. So the T20 restructuring effort we have done in Germany two years ago, and in addition to these EUR10 million for the full year there will be other adjacent restructuring efforts we have in other companies. So the guidance of the EUR20 million is still valid.

Concerning the growth perspective for lighting and electronics, the first quarter probably is a little bit too early to make any fundamental judgments on this trend. That's the reason why we as well like to see longer periods for really taking more fundamental views. So six months, nine months probably is a better perspective.

We don't see, as I mentioned, a general change in the trend of the mega support we are getting by CO2 reduction and autonomous driving, but there might be specific changes due to shifts of product launches or product launches being done in different years. And generally, of course, the growth in lighting is quite substantial, and it might be that the growth will be stronger for a certain time period than for electronics.

And your last question, on operative cash flow, in fact I'm a little bit hesitating to be a little bit more precise because this year probably we will incur some further burdening. I mentioned the supplier topic as extraordinary. We had a good year, but I would not extrapolate the numbers for the full year.

Christian Ludwig: OK. Then just let me get back to those restructuring costs. So you've got basically EUR10 million from your T20 and then you've basically given us another EUR10 million as a kind of safety net because you're not sure what exactly it's going to be but that's kind of what you expect every year; is that the way I have to see this?

Wolfgang Ollig: No. No, there are specific projects related to this.

Christian Ludwig: OK. So there is a guarantee that they will come?

Wolfgang Ollig: Yes.

Christian Ludwig: OK. Thank you.

Operator: And as a reminder to ask a question please press star one on your telephone keypad.

Your next question comes from the line of Lello Ragione. Please ask your question.

Lello Della Ragione: Hi. This is Lello Della Ragione. I would like to ask a question on the R&D. You mentioned that you incurred several additional costs due to the rollout of new products and the new technology in LED. I was wondering if you can give us an idea on how this impacted your R&D expenses in general terms or as a ratio.

And the other question, I understand that you don't want to give us guidance on free cash flow for the full year, but I was wondering, looking at the net debt evolution, if we can assume that if this pattern will continue we should see higher dividends than we actually have in our numbers. Thank you.

Wolfgang Ollig: OK. So for the R&D efforts, I mentioned two effects, on one hand the application engineering support for the launches and secondly more effort due to higher order intake we have had and in fact effort we now have to develop, getting these products on the market.

So when we talk about the application support, so you have to imagine that we have quite many new LED product launches, which is a new technology, new processes. So when we talk about assembly environment, this is more becoming electronic production, so coming from a mechanical to a more electronic production facility and environment.

There are more suppliers which have to be managed, and in fact as well the products have to be -- project management being done, managed in another way. And of course here our engineering team is supporting our production teams to make these launches as fast as possible. So therefore there is a special effect incurred to this.

Lello Della Ragione: Yes, but in terms of -- for instance, might these two effects have impacted the overall expenses on R&D? If you can give us an idea on how big these were during the quarter.

Wolfgang Ollig: You mean how big these were?

Lello Della Ragione: Yes.

Wolfgang Ollig: To be honest, it's very difficult to say. In fact, these effects are as big that the reduction and efficiency topics which of course we have initiated, which are continuing. All the things we have done in the last year are not coming through because we have these additional effects.

And if you look at the reduction we have achieved last year, it was 30 basis points. If you assume that these effects are continuing and we are not showing these effects, then maybe this gives you an idea on one hand on the application support, on the other hand on the efforts we're doing now on new order intake for developing these projects.

And the second question, concerning cash flow and net debt situation, so there has been an increase in the guidance we have done last year, or let's say the general idea for giving dividends of 25 percent of net income to 30 percent. In general, there is no change of this dividend projected.

From our side, we still see Hella as a growth case, and a lot of growth we want to tackle organically within our network strategy and as well inorganically. As we have said as well, we are looking for acquisitions in the small- to mid-size range, but we will not set us under pressure to implement these, but we're really looking for the right targets. So therefore it can be that net debt is really at a very low level or even turns negative and we will have a positive cash position, but there should be no change in our general guidance and policy.

Operator: And we have no further questions at this time.

Once again to ask a question please press star one on your telephone keypad.

And we have another question from the line of Lucile Leroux. Please ask your question.

Lucile Leroux: Yes. Hello. Sorry. I have some follow-up questions, if we have time for it. The first one is on the lighting performance. I was wondering whether you could explain if it was mainly led by the increased LED penetration and more LED products.

Secondly, on the CapEx, the CapEx was quite low this time. I was wondering whether we can expect similar rates through the year.

And another question would be, just technically, the part of the supplier which fell, could you tell us if it was the mold itself or if it was the equipment to the injection mold?

And finally, on the admin costs, you had mentioned in the past that you had opened centers in Vietnam and Romania. I was wondering whether we should continue to expect for next year a decrease in admin costs, basically.

Wolfgang Ollig: So, starting with the last question, so clearly our corporate centers are becoming more effective and we have shifted already quite significant tasks from high cost countries, especially Germany. Was the reason for our restructuring effort.

Clearly, here we're having two trends. On the one hand, efficiency gains are continuing. On the other hand, however, we as well need to upgrade our teams globally to really make sure that capability and skill level is appropriate to our demands and to a business which is substantially growing. So probably there will be a reduction midterm, but it's unclear if we will be able to achieve it on a substantial level already next year.

Concerning the supplier product, so it has been mold -- a part out of injection molding, so no equipment but a component for red headlamps and rear lamps.

Lucile Leroux: OK. I think that -- maybe I remember incorrectly, but I think that you were saying that your competitors actually do most of the tools themselves -- no, are actually importing most of their tools in China. Did I understand correctly? Does it mean that you were the only one to actually use the tools directly in China versus the other competitors that you have?

Wolfgang Ollig: No, I think this is a misunderstanding.

Lucile Leroux: OK.

Wolfgang Ollig: So, in general, we as a technology leader are very, I would not say conservative, but of course try to ensure quality and the general standard of technology. So we are having tools in China. We have a tool shop in China already, an owned one, and as well we have suppliers for tools in China as well, but our suppliers are on a similar level.

But this is not a question of tools, the supplier failure, but it's just a question of the supplier not delivering components out of tools which are …

(Multiple speakers).

Lello Della Ragione: Oh, OK.

Wolfgang Ollig: And because these tools are in his hands, we cannot get them. And because we cannot get them, we have to somehow duplicate the tools and somehow get components which are really project specific, and this is really the issue.

Lucile Leroux: OK.

Wolfgang Ollig: Concerning the CapEx, we have guided for the full year a figure which was a little bit above last year. So last year we were at EUR347 million on a net CapEx basis, leading to a ratio of 6.0 percent. We already indicated that this number should be -- in absolute terms and as well relative terms be higher this year. So it's fair to say that there will be a CapEx increase in the next quarter.

And your first question, I'm not sure if I understood it correctly. Maybe you can repeat it.

Lucile Leroux: Yes. So I was wondering whether the good performance that we have seen in lighting this quarter is mainly driven by increased LED penetration.

Wolfgang Ollig: It's mainly driven by new product launches we have. And this is directly related to the specific efforts we have, not just for product launches and projects, but because for the first time now we have full LED projects in plants in Eastern Europe and in China. And we are not at the level of performance we want to be. Probably after the first half of this financial year, we should have overcome these problems and then we should have, let's say, a better performance base for taking out operational leverage out of the new plants which are then coming in.

Lucile Leroux: OK. Thank you very much.

Operator: We have no further questions at this time. Please continue.

Wolfgang Ollig: OK. Then thank you very much for your attendance and your questions, and looking forward to talk to you again then in the beginning of January about our half-year figures then. Thank you very much and all the best. Bye, bye.

Operator: That does conclude our conference for today. Thank you for participating. You may all disconnect.

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