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C: Bernard Schäferbarthold; HELLA GmbH & Co. KGaA; CFO
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P: Gabriel Adler - Citigroup Inc., Research Division – Assistant VP& Senior Associate
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P: Edoardo Spina - HSBC Bank Plc– Senior Analyst
P: Michael Punzet – DZ Bank AG – Equity Analyst

P: Operator

COMPANY EDITED TRANSCRIPT

Operator: Good morning, and welcome to the conference call of HELLA for the 9 months results of the fiscal year 20/21. At our customers' request, this conference will be recorded. May I now hand you over to Dr. Breidenbach, CEO; and Mr. Schäferbarthold, CFO.

Rolf Breidenbach: Yes, thank you very much for the introduction. Dear ladies and gentlemen, good morning to all of you. Thanks again for dialing in. This is Breidenbach speaking. Welcome to the HELLA investor call on our 9 months result for the fiscal year 2020-2021. Also, of course, a warm welcome on behalf of my colleague, the HELLA CFO, Mr. Schäferbarthold.

Before we go through the presentation, allow me, as always, to start with some general comments on the market development and HELLA's business situation.

Let me begin with the market. The global light vehicle production has developed relatively positively in recent months. In the third quarter, the market grew by 2.7%. However, the market is still highly affected by the unchanged high dynamics of the corona pandemic and further increasing bottlenecks regarding semiconductors, but also other components. This is also reflected in the IHS figures. The steady improvement of the outlook by IHS, which we have seen since July last year, has come to an end. Since January, volume expectations have been reduced. We believe that this will continue in the months to come. The bottleneck situation is most critical and will continue to have an impact on the entire industry.

On the short term, we do not see any sign of improvements. It is uncertain when catch-up effects will or can occur. We do not expect them before the fourth quarter of this calendar year.

We already talked about the issues of bottlenecks in December and that HELLA has set up an extensive task force that is working on the best possible management of those bottlenecks. These efforts also come with increased costs, for example, for additional transports or the use of brokers. The bottleneck situation has also a negative impact on our top line growth compared to our last sales planning. This effect is in the high double-digit million range.

In view of the current market challenges, we can be quite satisfied from our perspective with our business development. In the first 9 months of the current fiscal year, our currency and portfolio adjusted sales decreased only slightly by 0.3% compared to the prior year. Our profitability continued to develop positive, mainly due to continued strict cost control. Thus, our adjusted EBIT margin improved by around 0.9 percentage points to 8.0%.

Looking at the segments, we see that over the entire 9-months period, our Automotive segment continues to be affected by the decline in vehicle production and thus, recorded a 2.7% drop in sales. We also see a clearly negative effect on sales from development of the exchange rates compared to the previous year. However, based on a slight growth in third quarter, we closed the sales gap further.

In Q3, we outperformed the market in Europe by around 10.5%. Also, in China, we were able to grow significantly of over 30% in Q3. In NSA, we underperformed the market in Q3, mainly due to the above-average reimbursements for tooling and development services in the prior year's quarter.

The 2 other segments also showed a very satisfactory performance in the first 9 months. The Aftermarket segment significantly increased its profitability in connection with slightly higher sales. In particular, the independent

aftermarket business recovered. Our growing e-commerce business in Germany also supported the overall business development in this segment. In addition to various efficiency improvements, this increased share of business with software licenses was responsible for the rise in earnings.
And the Special Applications segment shows a positive sales development. Again, strong growth impetus came, especially from the agriculture product group and business with small car manufacturers. From my perspective, the good development will continue for both Aftermarket and Special Applications in the months to come.
After looking at the segments, I would also like to make a short comment on our cash flow situation. We saw a very good development also in the third quarter and could realize improvements in working capital. Nevertheless, we have not yet been able to normalize working capital due to an above-average level of inventories, which is attributable to the current bottleneck situation. With respect to CapEx, we started some investments already in the second quarter and continue to invest in the third quarter. In the next months to come, capital spending will intensify. Overall, we expect a positive adjusted free cash flow development in the last quarter and, therefore, also for the full fiscal year 2020-2021.
Looking forward, we can say that we have started well into the fourth quarter. March showed a solid sales and profitability development. For April and May, we expect a certain decrease in our planned sales, especially due to the bottleneck situation. However, despite these increasing market uncertainties, we have specified the company outlook raised in December last year. We thus, expect currency and portfolio-adjusted sales in the upper half of the forecasted range of around EUR 6.1 billion to EUR 6.6 billion. And we expect an adjusted EBIT margin also in the upper half of the forecast range of around 6.0% to 8.0%. Nevertheless, we expect the market environment to remain volatile and subject to very high uncertainties. Neither the development of the corona pandemic, which continues to spread with high momentum nor the effects from the risk within the global supply and logistic chains can be estimated at present. A general worsening of the situation appears possible at any time, especially with regards to the bottleneck situation.

Bottleneck management regarding semiconductors and also other components will continue to be one of our most important issues in the coming months involving a high level of efforts. Due to the bottleneck situation, we are expecting additional costs in the area of freight and also materials. This will affect the performance of the Automotive segment, in particular, most likely until the end of this calendar year.

For the mid- and long-term perspective, we continue to be optimistic for the entire HELLA group. With our strong product portfolio and our technological strengths, as presented to you also in our Capital Markets Day in mid-February, for example, with respect to energy management, radar sensors or digital lighting technologies, we are very well positioned to continue our profitable growth path with adjusted EBIT margins of 8% and higher.

The key lever in this context is not, at least, our improvement program in Germany. We continue to make progress here. The part-time retirement program has concluded with roughly 380 contracts signed. In addition, the discussions on the voluntary severance programs are well underway. We expect to reach a solution here in the next few months.

Having said this, allow me to move to Page 4 of our presentation to give you a rough overview about our financial figures. As already mentioned, our currency and portfolio-adjusted sales decreased only slightly by 0.3% and is, therefore, pretty much on the prior year level again. Our adjusted EBIT increased by around 10% to EUR 373 million. Thus, our adjusted EBIT margin is at a level of 8%. This is an improvement of around 1 percentage point compared to the previous year.

Our reported EBIT margin is at a level of 6.7%. This includes provisions for restructuring levels in Germany in the first quarter and the income from the sale of the business with front camera software in the third quarter. Our adjusted free cash flow declined by EUR 89 million to EUR 97 million. The reason for this, I have already mentioned briefly.

On Page 5, we give you an overview about our Automotive performance in the single regions. You can see that we were able to outperform the market in Europe, North and South America. Our performance in Europe is very positive. We outgrew the market by around 5 percentage points due to the ongoing project ramp ups and higher volumes in East Europe. In North and

South America, we outperformed the market by around 0.8 percentage point. And in Asia and the rest of world, we outperformed the market by 0.4 percentage points. All in all, on a global level, our Automotive business underperformed the market by around 1.6 percentage for 9 months. This is mainly due to the high weighting of the Chinese growth for the global automotive market.

Having said this, allow me to hand over to my colleague, Mr. Schäferbarthold, who will give you much more detail about our financial performance.

Bernard Schäferbarthold: Yes. Thank you, Mr. Breidenbach. Good morning, ladies and gentlemen, also from my side.

Continuing on Page 7 with our sales development, currency and portfolio-adjusted sales is at EUR 4.74 billion. As already mentioned, this is minus 0.3% compared to prior year. The reported sales are at 4.65, respectively, minus 4.2%. The FX effect this fiscal year is negative, especially due to the development of the U.S. dollar and the Renminbi related to the Euro on a year-on-year comparison. The negative effect this fiscal year is minus 2.1%. And in addition, the portfolio changed with the sale of the Thermo business leads also to a negative effect of minus 1.9%.

And if we look at the regional development, Europe is flat in terms of sales development compared to previous year. We are growing in APAC by 4.9% due to a solid growth in China, which is double digit. We have grown in the first months 13.3% in China. Whereas NSA, North and South America, is negative with the, on one hand side, FX development, as mentioned. But in addition, our sales is also impacted by lower tooling sales and D&D reimbursements. Overall, EUR 66 million on a group level where most of it comes from NSA in this year.

As Mr. Breidenbach already commented, we outperformed the market in all 3 regions. Going forward, we expect this outperformance also to improve in the upcoming quarters with several SOPs ahead of us, and also higher tooling and D&D reimbursements to come in the upcoming quarters.

Going to Page 8. Our gross profit is at EUR 1.17 billion. The most relevant, as already stated, is the reduction of gross profit in Automotive. This year, the gross margin is strongly affected, on one hand side, by strict cost savings in the first half with the lockdowns at the beginning of the year. And with that also, a significant underutilization during the summer last year. At the beginning of 2021 the continuous pandemic and the shortage on the semiconductor side led to high additional costs, as already mentioned also by Mr. Breidenbach. We expect the shortage of semiconductors to be the most important topic now within our operations in the upcoming month and quarters.

Looking at Page 9. The R&D expenses are EUR 42 million below previous year. The R&D ratio is at 9.6%. The lower expenses are a result of the continuous strict cost control and focus of our R&D activities. We have gradually restarted development activities, especially related to improvement projects and also predevelopment projects since end of 2020. But overall, we remain with our target to keep the R&D ratio below 10% going forward.

Looking at the SG&A costs on Page 10, we again have seen a continuous decline. The decrease in SG&A expenses is at a level of EUR 56 million. This results in a 1 percentage point improvement in SG&A ratio to a level of 8.0%. Most improvements this year come from lower distribution costs with a decrease in marketing and logistic costs. We will remain very strict to cost savings. We decide case-by-case on additional cost now to spend having been now on a very low cost level now in the last months to try to sustain that good level on SG&A ratio we have reached now.

On Page 11, we have the development of our headcount. We, again, have seen a decrease in comparison to prior year of 1.6%. The highest reductions are coming from sales, marketing, administration and R&D. This corresponds to the lower expense level in SG&A and R&D, I also just commented. The highest reduction is in Germany on a year-on-year comparison. We are continuously working on reducing our number of employees in Germany pointed out also by Mr. Breidenbach, but also in earlier calls. This is an important part of improving our competitiveness in the coming years.

Continuing on Page 12. The adjusted EBIT improved by EUR 34 million to EUR 373 million. This results in an adjusted EBIT margin of 8.0%. The lower gross margin due to underutilization and high inefficiencies related to the pandemic and bottleneck situation, and the supply chain could be overcompensated by lower R&D and lower SG&A expenses.

One additional remark related to our JV income. The decline of EUR 7 million to previous year is, on one hand side, due to the sale of our Korean joint venture, HELLA Samlip last year with a EUR 4 million results last year, which is not portfolio-adjusted this year. In addition, especially our joint venture, HBPO, had lower results also due to the very challenging market situation in the last 9 months.

Going to Page 13, looking at full reported numbers. Our reported EBIT is exactly on prior level. The overall adjustments are at a negative minus EUR 61 million. Restructuring costs related to the announced plans to improve competitiveness are at EUR 182 million. Against that, we realized a book gain out of the sales of our camera business of EUR 121 million pretax where transaction costs are already deducted. Net financial results improved also decently. So in total, our net profits improved to EUR 236 million after 3 quarters.

Looking at the third quarter. On Page 14, all 3 segments had a total sales growth in quarter 3 and also improved in terms of EBIT margin in comparison to prior year. We had a very decent development of margin also in our segments Aftermarket and Special Application. The Automotive margin improved as well. But as already mentioned several times, the impact of the bottleneck situation was clearly also strong in that quarter.

Going to Page 15, looking at cash flow and CapEx. We are back on positive numbers now, end of February, in terms of operating free cash flow. After a very good second quarter, the third quarter was also strong. We improved in working capital in the third quarter. Nevertheless, as already also pointed out, we are not fully back to normalized levels. And this, from my perspective, will also remain challenging in the actual environment where the prioritization lies in securing, let's say, customer supply going forward and especially on inventory levels, this comes with higher inventories we actually have. Net CapEx is on a similar level compared to previous years. As also, we mentioned in previous calls, we expect higher CapEx to come in the upcoming quarters. Here due to some structural investments we are planning to do, but also strong order intakes we had in the last periods. We will see also some higher CapEx levels now in the next years.

Going to Page 16. Looking at the segments and starting with Automotive. Reported sales is negative due to the reasons mentioned earlier. Electronics is nearly at prior year level. Our lighting business is showing a higher decline. This, we expect to improve near-term with several SOPs now to come. The Auto margin improved in absolute but also in relative terms. The main aspects have been already mentioned, underutilization, stop and go in production with the pandemic and bottleneck situation, significant additional extra costs due to also higher cost with supply at brokers, higher logistics and against that, restrict cost control.

Going to Page 17, look at Aftermarket and Special Applications, both showing very decent results. As mentioned before, both segments improved in absolute and relative terms, especially Aftermarket shows an excellent performance from my perspective. A very strong business in Aftermarket in the independent aftermarket, but also our workshop business remains an important factor for the improvement of that segment.

In Special Applications, especially the very good development of our agriculture business was the main driver for this very good performance.

Having said that, I hand back to Mr. Breidenbach for the outlook, and I'm happy to take your questions together with Mr. Breidenbach afterwards.

Rolf Breidenbach: Yes. Mr. Schäferbarthold, thank you very much.

Yes, let's have a short look on the market development at Page 19. Now IHS forecast a market growth of 10.3% for our fiscal year coming from a level above 11%. Of course, we will see a huge growth in Q4 according to IHS due to the fact that the basis, especially in April and May 2020, was so low; that we will see the growth in all, of course, the areas when we look at the yearly growth rates. Asia and NSA are specifically strong, but also Europe and a little bit less in Germany, which is 4.4%.

With regards and perhaps based, of course, now on the growth, we will see, especially in Europe and in NSA, where our business basis is much stronger than currently in China and Asia, we're also quite optimistic that step by step, we will come to the situation that we, again, also outperform in the Automotive market. But of course, this will now especially depend on the

business development in the next months, especially in Europe, where we have the biggest installed basis and the biggest sales.
With regard to the guidance at Page 20, I already said, we now guide at the upper half of the forecast range. We already mentioned the EUR 6.1 billion to EUR 6.6 billion with regard to the currency and portfolio-adjusted group sales. And also, we see now the company developing in the upper half of the forecast range of around 6% to 8% with regard to the adjusted EBIT margin. Again, allow me to point out that this outlook assume that there will be no significant production interruptions at HELLA in the fourth quarter. So far, March, as I said, has gone well. Let's see how the next weeks will develop, especially with regard to the semiconductor shortage.
Having said this, now Mr. Schäferbarthold and I look forward to answering your questions.

Operator: (Operator Instructions)

Sascha Gommel: The first one would actually be on your market outlook on Slide 19. Do you think that in light of the semi shortages that global light vehicle production can actually go up sequentially by 800,000 units from kind of 19.9 to 20.7? Is that a realistic assumption?

Rolf Breidenbach: This is, as I try to explain, very difficult to assess because for us, it's -- we have no full transparency with regard to the semiconductor shortage for the next, let's say, 6 to 8 weeks. With regards to the market demand, there is no problem to reach these figures, from our perspective, this 20.7. But the question is, can these vehicles be produced based on the availability of the semiconductor. And this is really difficult for us to assess. There is a risk, but we also see a chance.

Sascha Gommel: I see. Perfect. My second question on the semi impact on your earnings. In Q3, if you could quantify it? And then also what you expect in Q4 and potentially next year if you have a rough indication on the impact on your financials?

Rolf Breidenbach: Yes. Currently, and this perhaps started in January, we had a burden with regard to these semiconductor shortages of around, let's say, EUR 8 million to EUR 9 million per month related to special freights, buying broker parts and other special efforts we have to do to keep the lines at the customer running. And from our perspective, this will continue. Perhaps it can slightly go up or down, but at this range, EUR 8 million to EUR 9 million per month for the months to come, I think it's a realistic assessment. And this, at least, will remain until the end of the third quarter of this calendar year. So we do not see a recovery and improvement of the bottleneck shortage situation near term. And in addition, we already mentioned this additional EUR 10 million per month we now are spending due to the, let's say, switch of our very strict cost control we have carried out, especially in the first half of our fiscal year. We are now again investing into training, into internal projects, improvement activities, structural projects like the improvement of our IT systems, our standardized processes and so on and so on. This is an additional rough figure.

Sascha Gommel: Perfect. That's very clear. My last question is on the acceleration of outperformance, you mentioned. Can you just specify what product groups is driving that? And should we already expect independent of the regional mix, which will be a lot better in Q4, but independent of the real mix, should we expect Q4 already a significant acceleration and then more to come in '22?

Rolf Breidenbach: Yes. As you said, when you look -- and perhaps this sounds a little bit counterintuitive, yes, we outperformed all single markets. This means Asia and rest of world, Europe and also in North and South America. But due to the weighting of the big Chinese market as a big Asian markets in the end, we showed an underperformance. And when we are now expecting, of course, and this is pure mathematics, and due to the low basis of the European business in April and March, a huge acceleration, a huge growth in Europe. And due to the fact that the basis is here much bigger, we think, but let's see what's coming out that we come back to this outperformance we have shown also in the past years.

And from our perspective, structural,- let's put COVID, let's put the semiconductor shortage away, - we are very, very optimistic to show this outperformance, short, mid- and long term. And to give you perhaps a perspective, about the product, of course, our LED lighting products, especially headlamps will play here an important role. But the same is true for our radar components and also our energy management products like DC/DC converters, battery management systems, these are important growth areas in Automotive.

(Operator instructions)

Akshat Kacker: Akshat from JPMorgan. 2, please. The first one, again, on your FY '21 margin guidance. Can I confirm that the new guidance roughly implies flat margins sequentially in Q4 versus Q3, which would roughly imply second half margins for the group at close to 7%? And also, interested in hearing your view if that is a good level of profitability to think about as we go to the first half of FY '22? Or should we expect a meaningful step-up from the reversal of these short-term cost pressures and the restructuring plan that you have in Germany?

The second one is coming back to the question on outperformance. As Sascha was asking, you have previously talked about increasing ramp-ups and several launches globally. Can I get into some more detail on lighting specifically over the last few quarters, even on a geo-adjusted light vehicle production basis, there has been very limited outperformance. Can you just shed some more light or tell us more details of what's going on in that division? And when do you expect the organic growth to improve?

Bernard Schäferbarthold: Yes. Akshat, starting with your first question. So as Mr. Breidenbach stated, so March was a very good month. So actually, we are trading at the upper end of our guidance. So the uncertainty with the months of April and May remains high. So the visibility we have is only, let's say, some days, if really it comes to also sales development, and there is a high uncertainty, even if there is only 7 weeks now to go until the end of our fiscal year. So this is where we see the risk of downside so that we remain cautious, if really it comes to where we could come out with the top line and also on EBIT with also costs we have to spend to, let's say, secure supply delivery. As of today, I would say, a good trading so there is the opportunity we could remain on the upper end as of today, but with high risks we actually see which could occur. There's also some downside risk. So the range remains, but it does not mean that we actually see that we, at the end, we would then print, let's say, a Q3 margin. Also, in Q4, this would really be then a case where, let's say, additional risks occur and we would have to spend even more what we expect.

Going forward, if we look at then the start into our new fiscal year with the comments, Mr. Breidenbach did. So we actually see the risks that these additional costs of EUR 8 million to EUR 9 million will remain also in the first 2 quarters of our new fiscal year. So this, in addition to a slightly higher cost run rate, is certainly something, which we will try to compensate. But it really then also depends on how, let's say, the volatility of the market remains, and how also we are able to run our operations. Today, it's day by day. As I said, we are prioritizing really to secure deliveries of our customers, independent how costly it is and it is very ineffective now how we are running our operations. If that remains in the first half of the year, in that way, so that certainly comes for that -- in these upcoming months with a high burden also for us. So let's see. It's too early now really to, from my perspective, give now a guidance on next year. On the other hand side, we see and this was also a comment Mr. Breidenbach did, so the demand in the market is there. The order book is good. So if really, we would see an improvement now in this high market volatility, especially due to the shortage on semis, I think there is a good opportunity for us now to improve the profitability, if really, these additional costs would then disappear

Rolf Breidenbach: Coming to your second question, with regard to lighting, of course, we will remain strong in the premium car segment. And the add-on and additional growth improvement will, at least, partly come from now some the launches in the BEV area or rollout in the BEV area, and this is true for all regions. China, the U.S., and also Europe. So this is -- you asked for, let's say, the change and the future growth acceleration in lighting. And as I said, we had a good order book with regard to successful BEV car manufacturers, 2.5, 2 years ago, and this now will pay off in the months to come with, as I said, headlamp lighting rollouts. And yes, this is, I think, the main growth driver in the months to come.

(Operator instructions)

Christoph Laskawi: Christoph Laskawi from Deutsche Bank. Can you hear me okay?

Rolf Breidenbach: Yes

Christoph Laskawi: Excellent. My first question will be more or less a follow question to what Sascha actually had asked. On the semi shortage, we hear that some suppliers will try to increase prices so that you have to cope with price increases of your suppliers. Would that even worsen the negative impact that you are facing just from the shortage? Or is it essentially when you use brokers about the same, and we shouldn't expect a run rate of monthly cost to increase, say, in calendar Q3 or so this year? That's the first question.

Rolf Breidenbach: Yes. We also, unfortunately, now expect price increases or we already are suffering with regard to this topic. But this is included in this, let's say, EUR 8 million to EUR 9 million per month. We do not see here additional burden.

Christoph Laskawi: Excellent. And then on outperformance, would you expect, at some point, the regions to sort of see a roughly similar level? Or will it always be just because of, obviously, different ramp-ups in SOPs in the various markets that you see the varying outperformance on a quarter-by-quarter, that is quite strong?

Rolf Breidenbach: Yes. I think we see all the regions well positioned in the, let's say, midterm period. We see China especially strong because our order book in China was very good in the last year. So perhaps we can see here a special outperformance, which also is, from a strategic point, very important for us because our business proportion in China currently is too small. We have to over proportionately grow in China to balance our region portfolio much better.

Christoph Laskawi: And last question would be on working capital. You already said it's not really normalized at this point in time. Should we expect essentially, whenever and hopefully soon, the semi shortages done that you can go back to the normalized levels? Or can you even slightly ahead of that once inventory levels have stabilized to a more normalized level?

Rolf Breidenbach: So that is our clear perspective. So at the end, we -- with the, let's say, stabilization of the situation, perhaps at the end of this calendar year, we would expect a certain normalization. Certainly, it's now too early really to state how much potential do we now see. I think also on the customer side, and together with our suppliers, we are structurally in discussions how to going forward secure, let's say, or better manage the situation so that such an impact could be better be foreseen in the future. That could lead also to, let's say, different concepts with our customers, but also suppliers, if it comes to perhaps also buffer stocks, which could be negotiated for some of the important components. So that is certainly is something we are looking at today, where, from today's perspective, it's difficult now really to make a judgment what results out of it. But overall, I see that there is a strong, let's say, potential now on the inventory side, which we will realize, most probably from, if I would make an estimation, second half of next fiscal year, we will be then able to realize. But -- so hopefully, during the next fiscal year, the second half, we will come back to more normalized levels.

(Operator Instructions)

Gabriel Adler: It's Gabriel Adler from Citi. 2 questions from me. One on the chip shortages again. And then just a quick follow-up on working capital. But on the chip shortage, maybe you can just comment around how you plan to manage your cost base in light of this issue because on the one hand, the costs start to come back following a significant reduction last year during the pandemic and you're now facing this new EUR 8 million, EUR 9 million headwind from the chip shortage. So how do you plan to manage its return to a normalized cost base? And when should we expect your R&D and SG&A costs to fully normalize?

Rolf Breidenbach: This normalized cost base will come when the shortage, at least, will be step-by-step reduced. So hopefully, in the, let's say, fourth quarter of this calendar year and step by step. As I said, we do not see an improvement of the situation in Q3 of this calendar year. And of course, the special efforts then will be reduced like special freights, broker buying and so on.

And with regard to the cost increases on parts, we see good chances then to renegotiate. And this because we grow, we could offer a new business also to the microcontroller suppliers. And then here, we see us then well positioned. So then this additional burden can be managed and significantly reduced or to 100% reduced. But not today, because, as I said, this shortage will remain.

With regard to the other cost positions, this additional EUR 10 million with regard to the normalizing of our business, of course, will remain, but we see midterm good chances to continue to improve our admin rate. Here is improvement potential. No doubt about this. And based on step-by-step new tools, we will introduce to our R&D areas and also improvement of processes. We think we can also here improve the efficiency also here, midterm, a very good efficiency lever to improve our profitability.

Gabriel Adler: Okay. And my second question on working capital is just around reverse factoring, but you've spoken before about using these programs or introducing these programs to improve your working capital. Will the stacks to your inventories and our elevators is likely to remain elevated in the next couple of quarters, mean that you accelerate that program when you're going to try or are you able to offset that through payables, perhaps?

Bernard Schäferbarthold: Yes. So this program is actually still in the, let's say, ramping up. we are step-by-step improving or getting suppliers into that program. So we started now 8, 9 months ago. We have already around 50 suppliers who agreed to that program. If we look at the payable or the higher payable number we have now reached, this is around EUR 40 million as of today, if we look at the working capital reduction due to that. It's still something where, as of today, we mostly see let's say, smaller and mid-sized suppliers, which are with ratings or which are in situations in this market environment that they have ratings, which are under pressure and where they improve their liquidity situation by that. It's a good let's say, tool, which at the end, from our perspective, is less or the most relevant reason why we have introduced it is really to, let's say, stabilize also the supply chain. For sure, if we also can improve our working capital situation. This is something we are also considering. But at the end, most relevant for this program is as the support of a lot of suppliers we have and to, let's say, remain and keep the payment terms we have with these suppliers, it's less the intention really to have a further big extension of payment terms. But as said with the numbers I made, we have already an improvement out of that.

(Operator Instructions)

George Galliers-Pratt: It's George Galliers from Goldman Sachs. The first question I wanted to ask was just on the inventory. I think you've explained why the inventory is elevated today. But what I wanted to ask is, as things normalize, hopefully, over the next 12 to 18 months, what is the appropriate level of inventory for HELLA? I think at the end of the quarter, you were at about EUR 942 million. Pre-COVID, that number stood closer to EUR 800 million. Would you expect to see inventories return to around the EUR 800 million level under more normalized operating conditions?

Bernard Schäferbarthold: So for sure, if we talk absolute numbers, it also depends on the sales level. So from today's perspective, I would say that we have a high double-digit million amount of inventories, which are, let's say, too high from a perspective, where is the optimum. So I think if I look at February numbers, it's around between EUR 70 million and EUR 80 million of too high inventory level from today's perspective at the sales level, we are actually showing. And this is a potential. I would see as of today, which we need to reduce in the upcoming quarters.

George Galliers-Pratt: Then the second question I had was, could you just confirm what was your China outperformance in the third quarter? And I noted that earlier on the call, you mentioned that you expect strong outperformance in China going forward due to the very strong order book. So effectively, when we look at the outperformance in Q3, what were the sectors or the areas of the Chinese market that you were not exposed to that could not lead to particularly strong outperformance in the third quarter?

Rolf Breidenbach: When I got it correctly, in the third quarter, in China, especially the small car segments grow over proportionately. Here, we are, let's say, not so well positioned. And the same is true for some local Chinese car manufacturers. Here, we also have a very selective portfolio and some car manufacturers, which suffered in the past months accelerated in Q3. So it's a customer and segment reason why our Q3 performance was okay but could be at a better level. So in China in Q3, I think our underperformance was at 3.4%, and we expect in year-to-date, it's at a level of a little bit above 5%. But step-by-step, I think we will come closer. And based on the order book, we will outperform perhaps in the -- in a range between, let's say, 1% to 5%, mid- and long term.

George Galliers-Pratt: And then the final question is just when I do sort of a back calculation based on your guidance and 9 months to date, is it correct or does this sound reasonable to assume that sequentially, the automotive margin is going to step down in Q4 versus Q3 by something in the magnitude of 100 basis points? And when we think about the sequential development of the Automotive margin for the first half of next year, do you expect it to improve? Or given the commentary around elevated costs and semiconductor concerns, do you expect sequentially to see no improvement at least at the start of next year?

Rolf Breidenbach: Yes. I think you are right. The performance in Q4, especially depends on the performance in Automotive and the Automotive margin, and the Automotive margin is directly linked to the bottleneck situation roughly as said. And here, and we try to make this also clear, there is really a high degree of uncertainty, how this bottleneck situation will continue in the weeks to come. Therefore, there is also a lot of uncertainty from our perspective in assessing that. But our current assessment is that the Automotive margin, due to the bottleneck situation, as you said, will go down significantly in the next 2 months because March was, as Mr. Schäferbarthold was said, okay. And this, of course, then will continue at least for the, let's say, first 3 to 4 months of our new fiscal year. And then step-by-step, we will see an improvement and then come back to the old levels, and we see a good chance to be even better because we are on a growth path and here, due to economies of scale and our prudent activities, we see a good chance to significantly improve here. But for the next, let's say, 5, 6 months, there will be -- there could be this burden, which is also included in our guidance

Operator: The next question is on hold. One moment, please.

Sanjay Bhagwani: This is Sanjay Bhagwani from Bank of America. My question is that you already mentioned that you're also seeing some sort of pricing increases from the semiconductor supplier. So to what extent do you see this to be temporary? Or it's more of a structural thing?

Rolf Breidenbach: We see it temporary because we think that midterm, based on the new business, we can offer to this supplier group that we can renegotiate this and can come back to the, let's say, before bottleneck times.

Sanjay Bhagwani: All right. And just if you can provide some back-of-the-envelope figures, what proportion of your material cost is, let's say, impacted by these cost increases from the semiconductor. So for example, let's say, I understand that you already have a strong order book for the new technology products. So how does the margins on these products basically get impacted if, let's say, this pricing increase on the semiconductor turns out to be more of a structural issue?

Rolf Breidenbach: Yes. First of all, we hope that this is not a structural topic. And we see good chances to really handle it as a temporary issue. With regard to the percentage of our material costs, I would assume in Automotive, I'm only talking about

Automotive, we are talking about between 15% to 20% of our material costs are covered by this product group.

Operator: The next question is on hold. One moment

Michael Punzet: Michael Punzet from DZ Bank. I have one question with regards to your logistics costs. You mentioned several times that you are facing higher logistic costs. In your view, is that only related to the semiconductor shortage? Or do you assume this will also more structural change in the logistics business, for example, with lower passenger flights, which also carry a lot of materials from one continent to the other? And should we expect, or could we expect some more burdens from that in coming quarters?

Rolf Breidenbach: From our perspective, the burdens are already there because the freight costs have increased significantly and are also a bottleneck, be it sea freight or air freights. This is true for all the regions and all the means of transport, especially sea and airfreight. And it's already there. So this will continue.

Michael Punzet: Yes. This will continue, okay. So you do not expect it will come back to precrisis level, let's say, in next fiscal or something like that?

Rolf Breidenbach: Of course, this is -- I'm not an expert of the global logistics business. But when I look at the development of the economy of cost acceleration effects we will see after the COVID pandemic. When I look at the overall development of Automotive, the huge demand in all the markets of new vehicles, which is only currently or cannot be fulfilled due to the semiconductor shortage. From my perspective, this will remain.

Operator: The next question is on the line. One moment, please.

Edoardo Spina: Eduardo Spina from HSBC. I had a question about the inflation in cost for chips and other materials. If you could clarify, first of all, what other materials are affecting the cost, I think you mentioned that in the presentation?

And secondly, just to understand a bit better the midterm development of this. If you could clarify how many semiconductor suppliers you source from? And whether you are renegotiating the contracts also in the midterm. I think you mentioned a price increase at the moment, but I suppose that this may continue in the future? Or how are you going to sort out this issue later on?

Rolf Breidenbach: Yes. Other material groups. One important other material group for HELLA is other resin groups. And here, we also see currently a lot of bottlenecks, force majeure occurred at the one or the other of our suppliers. So resin is a very important group. We also see the bottlenecks in steel, which is not so important for us. But to mention 2 important groups is resin and steel.
With regard to the semiconductors, we are sourcing microcontrollers from many manufacturers. I think it's 10 to 15. But of course, especially from the, let's say, top 5, we are sourcing from all of them and in a significant amount. Again, currently, these negotiations are going on. Currently, they are also temporarily fixed and negotiated to an end. But these kind of negotiations we are doing every year. And therefore, we see, as I said, a good chance when we come out of this bottleneck crisis to then come to pre-bottleneck levels due to the fact that we can offer a lot of new business. As already mentioned, we have a good order book in our ADAS area, also in our energy management area here. A lot of these partner components are needed. And based on that, as I said, we see good chances that this cost burden is only temporary and that we can renegotiate the prices.

Operator: The next question is on hold. One moment, please.

Akshat Kacker: Akshat from JPMorgan. One quick follow-up, please. Dr. Breidenbach, you mentioned an outperformance of 1% to 5% in the medium term. I just want to clarify, was that for China specifically? Or was that for the group?

Rolf Breidenbach: This was for China. For the group, we are quite optimistic to step-by-step come to this level between 5% to 10%.

Operator: Last question now for the moment is on hold. One moment, please.

Marc-René Tonn: This is Marc Tonn from Warburg. Just first of all, one clarification question because when it comes to the margin development in Q4, I think Mr. Schäferbarthold, you mentioned, let's say, a sequential improvement in profitability for the fourth quarter is the most likely outcome, but I think Mr. Breidenbach, you mentioned that there would be, let's say, a margin dilution or, let's say, lower margin, which could be possible for Q4. Perhaps you could clarify what your current expectations are based on the same conductor show that you are suffering and the step-up in structural cost? That'd be the first question.

Bernard Schäferbarthold: So there was perhaps a misunderstanding. I was commenting, if the margin in the fourth quarter would be on the same level as in the third quarter or could improve. And in the third quarter, we were at 6.7% on group level. And there, there is still the opportunity that this margin in the fourth quarter could be higher. And this is something where I commented that the March numbers, where -- and we commented, they were very solid. So that means that we also have seen higher sales numbers, and that is especially also driven by higher volumes now in March. So as of today, I commented that we are at the upper end of our margin target and also on sales level. But -- and that was what we were also saying, April and May, even if it's only 7 weeks to go, remain with a high-risk, if it comes to the sales development, additional costs, the pandemic situation, where we are also having extra cost with all the measures we are taking. So there is also -- there are risks so that the margin could go down in April and May. But still the opportunity and actual trading was at the upper end, and my comment was related to the 6.7% of group margin in Q3, which might be better in Q4.

Marc-René Tonn: The second question would be on the Aftermarket, where you are benefiting from the strong mix in EBITA. These margins, I think, close to 14% for the second quarter, 15% now in Q3. Would you expect this level to be sustainable? Or is it something which we should also say, be able to see in the next quarters ahead? Or do you expect, let's say, the mix to return to the less favorable level in the segment again?

Rolf Breidenbach: I think this 15%, this was an extraordinarily good quarter, but it's our clear expectation. And this is also my personal expectation to the management group of Aftermarket to run this business at a double-digit number. So 10% and better. But this 15% was due to a specially good quarter. So this is not sustainable. But about 10%, this is really our target midterm

Operator: There are no further questions so far.

Rolf Breidenbach: Good. Then thanks very much, again, for listening to us and asking the questions. Thank you very much for your time. Stay healthy. Bye.

Operator: We want to thank Dr. Breidenbach, Mr. Schäferbarthold and all the participants of this conference. Thank you very much, and goodbye.

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