

Rating Action: Moody's changes outlook on Hella's ratings to stable, affirms Baa1/P-2 rating

13 Jul 2021

Frankfurt am Main, July 13, 2021 -- Moody's Investors Service ("Moody's") has today changed the outlook of German automotive supplier HELLA GmbH & Co. KGaA (Hella) to stable from negative. Concurrently, Moody's affirmed Hella's Baa1 long-term issuer rating, Baa1 senior unsecured ratings and the short-term issuer rating at P-2.

"The affirmation of Hella's ratings reflects the company swift recovery from the global coronavirus outbreak and our expectation of further improvements in profitability and cash generation driven by the benefits of its efficiency programme", said Falk Frey, a Moody's Senior Vice President and lead analyst for Hella. "While Hella's margins and gross leverage will be weak for a Baa1 in financial year ending May 2021, the stable outlook reflects Hella's strong cash position and the expected improvements in profitability and cash flows that will position the company solidly for the Baa1 ratings within the next 12-18 month.", added Mr. Frey.

A full list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

The affirmation of Hella's ratings reflects Moody's expectation that the company will manage to recover its margins (Moody's adjusted EBITA) to at least 6.5% in the next 12-18 month. This expectation is supported by (i) Hella's track record of continued outperformance of its revenues versus global light vehicle production, which Moody's expects to continue over the next two years at least, and (ii) the company's actions to mitigate the negative impact of the global coronavirus outbreak by cost reduction and flexibilization and capex reduction, and (iii) Hella's conservative financial policy, including maintenance of strong liquidity and the suspension of dividend payments for fiscal 2019/20.

Moody's forecasts for the global automotive sector a 7% increase in unit sales in 2021, with a recovery in the second half of some of the sales lost in the first half of 2021 from the ongoing semiconductor chip shortage. We expect 2022 industry unit sales to continue to grow at 6.1%. However, future demand for vehicles could be weaker than our current estimates, the already competitive environment in the auto sector could intensify further, and Hella could encounter greater headwinds than currently anticipated.

Hella's ratings reflects as positives the company's: (a) leading position in the lighting technology and original equipment electronics markets; (b) meaningfully sized aftermarket business unit which is generally more stable than the original equipment business; (c) diversification through its Special Applications segment which reduces exposure to the automotive end market; (d) track record in reducing operational costs and improving operational efficiency; (e) increase in customer and geographical diversification; (f) conservative financial policy which includes limited shareholder distribution and the maintenance of a large cash (& equivalents) balance; and (g) still relatively strong credit metrics (debt / EBITDA of 4.7x and net debt / EBITDA of 1.0x at February 2021), which includes the severely impacted Q4 2019/20 (March - May 2020, with a y-o-y revenue decline of 46%).

Nevertheless, the rating also reflects the company's: (a) strong dependency on the automotive end market which is highly cyclical; (b) relatively low profitability, as reflected in an operating margin of 0.6% in the last twelve months to February 2021 (Moody's adjusted EBITA margin), which is expected to improve to around 3.5%-4% in fiscal 2020/21 (ending May 2021, including restructuring costs); (c) significant expenditure on research & development (R&D) activities, around 9-10% of revenue; and (d) limited recent free cash flow generation, resulting from high capital expenditure and a special dividend paid out in Q2 2019/20.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects Moody's expectation that Hella's debt/EBITDA will recover into a range of 1.0x-2.0x (Moody's adjusted) and net debt/ EBITDA will sustain in a range of 0.5x-1.0x (Moody's adjusted) over the next 12-18 months, whilst margins should improve towards 7% over the next two years. The stable outlook also reflects our expectation that Hella will generate positive free cash flows.

LIQUIDITY

Hella's liquidity position is excellent and consists primarily of around €1.4 billion in cash and cash equivalents (including marketable securities) at the end of February 2021. The company also has a €450 million long-term credit facility in place due in June 2022 and fully undrawn. Moreover, the Hella secured an additional €500 million syndicated credit facility due June 2022 with a 1-year extension option. Together with funds from operations, which we estimate at around €580 million and around €60 million proceeds from the sale of its minority stake in Mando Hella Electronics (PR dated 3 February 2021), Hella's sources of liquidity for the next twelve months amount to approximately €2.9 billion. These funds amply exceed expected cash needs of around €0.9 billion over the next 12 months, mainly comprising of working cash, some working capital built up and capex. Short-term debt maturities will consume only minor amounts of cash.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Moody's could downgrade Hella's ratings when there is rising likelihood that by its fiscal year end May 2022 Hella will likely display metrics at levels weaker than appropriate for its current Baa1 rating including (i) leverage above 2.0x debt / EBITDA and/or 1.0x net debt/EBITDA, (ii) EBITA margins were to remain below 6.5%, or (iii) if FCF generation were sizably negative.

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

LIST OF AFFECTED RATINGS:

..Issuer: HELLA GmbH & Co. KGaA

Affirmations:

.... LT Issuer Rating, Affirmed Baa1

.... ST Issuer Rating, Affirmed P-2

....Senior Unsecured Bank Credit Facility, Affirmed Baa1

....Senior Unsecured Regular Bond/Debenture, Affirmed Baa1

Outlook Actions:

....Outlook, Changed To Stable From Negative

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Automotive Suppliers published in May 2021 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1276105. Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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