

**Rating Action: Moody's upgrades Hella to Baa1, outlook stable**

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06 Sep 2018

Frankfurt am Main, September 06, 2018 -- Moody's Investors Service, ("Moody's") has today upgraded the ratings pertaining to German automotive supplier Hella GmbH & Co. KGaA (Hella) to Baa1, from Baa2. The ratings include the senior unsecured ratings relating to both Hella and Hella Finance International B.V., a subsidiary of Hella. Moody's has affirmed the P-2 short-term issuer rating of Hella. The outlook on all ratings is stable.

The following ratings are affected:

Rating Upgrades:

..Issuer: Hella GmbH & Co. KGaA

.... LT Issuer Rating, Upgraded to Baa1, from Baa2

....Senior Unsecured Bank Credit Facility, Upgraded to Baa1, from Baa2

....Senior Unsecured Regular Bond/Debenture, Upgraded to Baa1, from Baa2

..Issuer: Hella Finance International B.V.

....Backed Senior Unsecured Regular Bond/Debenture, Upgraded to Baa1, from Baa2

Rating Affirmation:

..Issuer: Hella GmbH & Co. KGaA

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

Outlook Actions:

..Issuer: Hella GmbH & Co. KGaA

....Outlook Stable

..Issuer: Hella Finance International B.V.

....No Outlook

**RATINGS RATIONALE**

The rating upgrade reflects the gradual strengthening of Hella's key credit metrics in recent years and our expectation that those metrics will further improve over the next 12-18 months. Hella's leverage (debt / EBITDA, adjusted by Moody's) has fallen steadily in recent years, from 2.9x in financial year 2013/14 (ended May 31st) to 1.7x at the end of 2017/18. With this, Hella has met our expectations of less than 2x for a rating upgrade to Baa1. In July 2018, Hella announced the disposal of its wholesale activities for €395 million in cash. Despite a dividend payment on the expected book gain, we expect that the vast majority of proceeds, more than €300 million, will remain within the company for the time being and could be used for further deleveraging when its existing €500 million bonds mature in 2020.

Deleveraging was primarily achieved through a combination of: (1) revenue growth driven by rising global automotive production; (2) outperformance of the Hella group reflecting its focus on innovative lighting products and electronics which has enabled the group's content per vehicle to rise; which led to (3) an improvement in profitability. For the latter, Moody's notes that EBITA margins have risen modestly in recent years from 6.0% in 2013/14 to 7.1% in 2017/18, reflecting a better absorption of fixed costs because of a shift in product mix and the growth in automotive production but also because of the success of recent efficiency programs. This level of profitability also compares favourably to other auto suppliers, such as Valeo (Baa2) or ZF Friedrichshafen

(Baa3).

Moody's notes that Free Cash Flow (FCF) generation was relatively weak in the recent years, driven by the need to invest in the development of more technologically advanced products and to further grow the company. The rating upgrade, however, takes into consideration the expectation that both research & development and capital expenditure, as a percentage of turnover, is likely to moderate over the next 2-3 years which should help improve FCF in conjunction with stronger profitability.

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) strong credit metrics rendering the rating well positioned within the current category (debt / EBITDA of 1.7x at May 2018).

Nevertheless, the rating also reflects as negatives the company's: (a) strong dependency on the automotive end market which is highly cyclical; (b) relatively low, albeit improved, profitability, as reflected in an operating margin of around 7%; (c) significant expenditure on research & development (R&D) activities, around 9-10% of revenue given the technology that is needed for Hella's products to stay competitive; and (d) limited recent free cash flow generation, resulting from high capital expenditure.

#### RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects the expectation that Hella's debt/EBITDA will sustain in a range of 1.0x-2.0x (Moody's adjusted), whilst margins remain at healthy levels of at least 7%. The stable outlook also reflects the expectation that Hella will generate positive free cash flows.

#### WHAT COULD CHANGE THE RATING UP/DOWN

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, a sustainable reduction of gross leverage (Moody's adjusted debt / EBITDA) to below 1.0x, improved profitability to more than 9% (Moody's adjusted EBITA margin) and material positive levels of FCF on a sustainable basis would be required for a higher rating. In contrast, Moody's could downgrade Hella's ratings if leverage were to increase above 2.0x debt / EBITDA, EBITA margins were to decrease below 6.5%, or if FCF generation were sizably negative.

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

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