MOODY'S
INVESTORS SERVICE

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

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 de-leveraging 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 cyclicality 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 for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

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