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C: Bernard Schäferbarthold; HELLA GmbH & Co. KGaA; CFO
P: Christoph Laskawi - Deutsche Bank AG, Research Division - Research Analyst
P: Kai Alexander Mueller - BofA Merrill Lynch, Research Division - Associate and Analyst
P: Henning Cosman - HSBC, Research Division - Analyst
P: Raghav Gupta-Chaudhary - Citigroup Inc, Research Division - Analyst
P: Christian Ludwig - Bankhaus Lampe KG, Research Division - Analyst
P: Florian Treisch - MainFirst Bank AG, Research Division - Research Analyst
P: Marc-René Tonn - Warburg Research GmbH - Senior Analyst
P: Julian Radlinger - UBS Investment Bank, Research Division - Equity Research Analyst
P: Michael Raab - Kepler Cheuvreux, Research Division - Head of Automobile (Thematic) Research
P: Akshat Kacker - JP Morgan Chase & Co, Research Division - Analyst
P: Sascha Gommel, Credit Suisse - Analyst

COMPANY EDITED TRANSCRIPT

Operator:

Good morning, ladies and gentlemen. Thank you for standing by. Welcome to today's HELLA Investor Call. (Operator Instructions) And I would now like to hand the Webcast over to your presenter today, Dr. Rolf Breidenbach. Thank you. Please go ahead.

Rolf Breidenbach

Yes, thank you very much for the introduction, and hello to everybody to this telephone conference. Also, on behalf of my colleague the HELLA CFO Mr. Schäferbarthold, we both really appreciate that you have taken the time for this discussion.

We would like today present to you our financial results of our last financial year 2017/2018. Overall, we are very satisfied with the results we have achieved. And we think, in a quite challenging environment, we once again were able to profitably grow. This growth is supported by all segments. And for the HELLA management, this is a confirmation that we are well positioned to benefit from the upcoming changes and challenges of our industry and the transformation process our industry will go through.

Coming now to the figures, we were able to grow by 9.3% on a year-on-year comparison to EUR 7.1 billion. This is a reported growth rate of 7.2%, which is by far higher than the growth of the automotive market and shows that we continue to be able to grow much faster than the automotive market.

In addition, we could also improve our profitability. Our adjusted gross profit margin is now at a level of 27.9%, so a plus of 0.4pp. Also, our adjusted EBIT could be increased by EUR47 million. We are now at a level of EUR581 million, which results into adjusted EBIT margin of 8.2%, a plus of 0.1 pp.

So the profitability development for us is satisfying. We are especially satisfied with the development of our liquidity. And perhaps you are aware that we put a special focus with regards to the cash flow development in the fiscal year '17/'18. And the increase of our adjusted free cash flow by more than 60% shows that, in this area, we were very successful, which of course gives us now additional freedom to invest into the future of our company.

This improvement is, for example, on the one hand, of course, related to higher funds from operations. But we were also able to lower significantly our net CapEx. And so we think it's a sustainable development which should also continue in the future.

Coming to the adjusted sales figures at page 5, as I said, the growth rate of 7.2% is reported. And the adjustment of EUR135 million comes from the development of the different exchange rates. The growth, of course, was supported by automotive. We were able to grow by 8%, especially from the demand for advanced lighting products, also interior lighting products was quite significant. And also, the demand of energy products and radar solutions was, yes, very positive in the last fiscal year and was one of the backbones of our growth and activities in automotive.

But also, the two other segments were able to contribute to this growth. External sales in aftermarket went up by 3.4%. And our small segment over-proportionally contributed to this growth. Special applications grew by 11.6%. The market, the relevant markets in special applications, like construction and agriculture, developed quite positively. And our products were very well received by the market.

Finishing my opening remarks, I would like to lead you a little bit through the different growth rates of our automotive division in the different regions at Page 6. To sum it up, we were able to grow much faster, not only on a global base, but also with regard to the -- for HELLA-relevant markets in Europe, North and South America, and Asia and rest of work.

What is especially important for us that we all proportionally grow in North and South America and Asia and rest of world. And with growth rates of

17.3% and 14.9%, we could fulfill in here our expectations because mid and long term, of course, we would continue to over-proportionally grow in these markets to balance our market exposure worldwide. So far, the European market is dominating. And step by step, we would like to reduce this dominance a little bit. And therefore, we are satisfied, as I said, with the development in these 2 other regions very much.

When we look at the product portfolio in North and South America, especially our radar and battery sensors were significantly asked for by our customer as well as our steering sensors in China, especially on our energy management products, like DC/DC converters and battery management system, over proportionally grow. And so as I said, the investments in, for example, autonomous driving and also energy management products are starting to really pay off.

Yes, this sets as a quick introduction with regard to the highlights of our financial year '17/'18. And now allow me to hand over to Mr. Schäferbarthold, who will lead you through the details of our financial results.

Bernard Schäferbarthold

Thank you. Good morning also from my side. Please allow me to start with a general remark coming to the overall results. We are, I have to say, very satisfied with the full year. All in all, it's fully in line with the guidance which we have given to you and also as we see it also with all the outlooks we have given and the reasons caused and where we outlined basically the expectations on the full year.

In all relevant financial KPIs, we are showing a record year for HELLA. First time ever, we passed the EUR7 billion line. We reached an EBIT of EUR581 million, 8.2%, which is also a record. And personally, I'm also very happy about the improvement in cash conversion and the overall absolute number in free cash flow of EUR241 million, and that I have to say despite not or no real strong support of the market. Headwinds certainly as it comes to FX and also raw material prices, and a very high activity level also on our side, especially if it comes to the ramp up of new production facilities and also of new production alliance globally.

So all in all, we reached also all internal targets we have set ourselves, which is good. Coming now to the detailed numbers, starting on Page 8, a good improvement in gross margin. Certainly, volume has supported the increase, but what is even more important is that the quality of our gross margin has improved. And what also is important that all 3 segments of our business had contributed to that improvement.

Overall, EUR157 million of higher gross margin and improvement of 40 basis points to 27.9%, exactly in line what our target expectation was. And as we stated also earlier before and also in our Capital Markets Day, we said that it is our internal goal to grow the gross margin, and even at a high level, we have been able to improve it by 0.4 percentage points.

Moving to Page 9, we stated that it is focus for us really to benefit from the market trends and that we will invest even more to secure our position if it comes to our technology leadership in the respective areas. We did it. We invested around EUR56 million in additional R&D, on one hand side, supported mostly by booked business. In addition, as we said also, a part of these costs are also supporting activities if it comes to the production ramp ups, which are also supported by our R&D teams globally.

The relative R&D expenses are on a very similar level to the previous year, what we targeted also. All in all, I have to say is that if we look also at the profitability overall, it's the balance we are trying to do to have, on one hand side, a profitable growth, on the other hand side, to invest in new products and new technologies also to secure our future overall.

Coming to Page 10, the SG&A ratio is flat. It's in our view a good result that, if we look in the details that, on one hand side, distribution expenses and also administrative expenses increased under-proportionally, what is good. On the other hand, side, we are also continuously investing in our IT infrastructure and our systems and application landscape and also in our processes to be able then also to realize higher efficiencies also in the future.

All in all, on Page 11, you see the EBIT development over the years. To sum it up, again, an increase in our adjusted EBIT number of 8.8%, EUR581 million, which is then a relative increase of 0.1% to 8.2%. And this number considers also a weaker result in our joint venture results of EUR8 million, which is a minus 0.2% effect in our margin, which is mostly related to a weaker or lower contribution of our Chinese and Korean joint ventures, which we explained.

Second half of our fiscal year was better, also in respect to our activities in China and Korea. We had a slight recovery, which was good and which we were already seeing starting in Q3.

On Page 12, you see an even higher increase in our reported EBIT. We had lower adjustments compared to previous year; this year only related to the restructuring programs, which are ongoing.

We have a stable net financial result. What we had especially seen also now in Q4 is that the effect out of the local financing in Mexico in US dollars starts to pay off so that the much lower hedging volumes we have to do shows an improvement which is reflected in our financial results, and that certainly will give us also support in seeing also improvements in the next fiscal year now.

We also have a slight improvement in our tax ratio overall so that, all in all, our EPS has increased by 14% to EUR3.50.

If we look at the single quarter, Q4, on Page 13, a solid growth in autos and also in special application. In aftermarket, if we look at the important growth number if it comes to our third-party growth, 2.1%, which was also good. In EBIT, we have seen a very good result in aftermarket and also in special application.

Aftermarket, we were stating also during our half year call, but also in Q3 that we are very confident about second half because of strong demand we are seeing, especially also in our workshop product business, but also in aftermarket business. And that has been realized so that, overall, we reached the 7.1% in aftermarket. We guided full year with a very strong Q4.

Special application had also on a quarter-on-quarter development a strong performance, very good demand in most areas of our business in special application. And we were even better than full year, where we had guided on roughly 10%. The outcome overall was now 11%, also a strong fourth quarter we have seen.

On Page 14, as I mentioned in my entry remarks, very good adjusted free cash flow outcome of EUR241 million and an improvement in our cash conversion rate of 13.6 percentage points. Remember that we said also that we will see a continuous improvement also in second half. And that is there.

We see there the improvements in all areas, certainly high operational profits, but also intensive CapEx focus and also a lot of working capital management measures, which we realized overall. On the CapEx, just one comment that especially on the tooling side, if it comes to activities in the Americas, but also in Asia, tooling investments are reflected in the inventories in comparison to Europe, where it's in CapEx. And due to our much stronger growth in NAFTA, but also in China, roughly EUR36 million here is higher tooling, which is reflected in an inventory increase. And this you need to know if you see the reduction in CapEx, which is partly related to that. In addition, last year, we had higher reimbursements also which are reflected in that number. But all in all, we are well on track if it comes to free cash flow. And we will continue our efforts here also to show further improvements in the future.

Looking at the segments, in auto, overall, a good reported growth of 8%. Our lighting business and our electronic business had a very similar growth dynamic. Mr. Breidenbach mentioned the regional outperformance in all 3 regions, which is important for us, and especially a very strong growth in China and in NAFTA, which is for us key also to get the better global balance also if it comes to our regional distribution of our sales.

As outlined, we have improved in our EBIT, but only under-proportionally. Several reasons for that we also mentioned in our previous call. So a lot of launches in parallel with inefficiencies also coming off less capacity utilization. Headwind also if it comes to FX, also a lower JV result overall, a lower or less favorable or higher raw material prices, which especially we also have seen in the fourth quarter and additional investments in R&D. So all in all, I can say that we are satisfied, but it was challenging to manage all these different factors overall.

If we look at '18/'19, certainly, there are some elements which we do not see as critical as last year. So especially the FX topic is not as critical this year as we have seen it 12 months ago. Certainly, also the JV topic is less severe actually how we see it now. On the other side, we will see continuous efforts also if it comes to the launches. There, we are still in progress and also if it comes to raw material impacts, but also the, continuous investments in R&D will be something which we will work hardly on if it comes to the fiscal year we just started.

Some remarks to aftermarket and special application, starting with aftermarket. I'm on Page 16 now of our presentation. As I mentioned, also a solid external growth. All our 3 business areas have contributed, so our independent aftermarket, our wholesale business and also our workshop product business. A very strong result, as I mentioned, especially in the second half. Overall, very good development and a strong increase in profitability.

Our aftermarket business is going now into a change with the selloff of our wholesale businesses in Denmark and Poland. So the focus now we have and the restructuring which we are ongoing now to focus the business will certainly be something which will now be prominent in that fiscal year. But we believe that we can be able also to have a very similar margin also in this year.

Special application had a very good growth, especially in agriculture and in construction. We had also a strong demand in our Australian plants, which is somehow exceptionally or was exceptionally because of our customers leaving the market and having asked us to produce their all-time needs for their demand so that, if you look at the number EUR45 million, which we have produced there in the Australian market, it's certainly something now which, if we look now at the growth perspective in this year, will be lower because this plant now has stopped its activities. That is important, especially if you look at the growth expectation in that segment for this year.

In all relevant other business areas in special application, we see a continuous solid growth so that we are not only very happy about a very excellent result last year, but we also look very promising also for this year. And we continue also to be optimistic to have a very similar EBIT ratio compared to '17/'18 in this fiscal year.

Some more details to our aftermarket business, as I mentioned, we have sold our wholesale business in Denmark, FTZ, and our Polish business, INTER-TEAM, to Mekonomen 2 months ago. The enterprise value is EUR395 million. We have now some more, I would say, information that the closing now is expected to happen in September. And as I mentioned now, it's key and focus for us now really to reshape and to adapt the organization to the future business.

We see that we are very strong if it comes to our proximity to the independent garage and that the combination also with the workshop products offer we have and also digital solutions we are working on makes us very confident that we can have a very strong business also in the future. We will much more focus on also the key technologies, especially within lighting and electronics, and to leverage that knowhow also in our independent aftermarket business.

In that respect, we also decided to step out of the joint venture we had with Mahle Behr, which is within the product field of the thermal management, where there our knowhow and competence within that product area is not as strong and where we do not see that as key and core for us also in the future.

So a much more focused approach in the future to be in line basically with the general strategic rationale we have. And in the areas where we are in, we want to have also a very strong core competence, a strong knowhow on technology, a kind of leadership and also then that regard a strong market position and that a refocus topic is now fully ongoing in the aftermarket business.

Our last comments to our business and wholesale in Norway and also our ecommerce business, there, the strategic reviews and options are ongoing, and there will be then updates in the near future to these pieces of our business.

That's all from my side. And with that, I will hand back to Mr. Breidenbach with the outlook for the fiscal year which started June 1st.

Rolf Breidenbach

Mr. Schäferbarthold , thank you very much. So some quick remarks with regard to the market development and our guidance for the current fiscal year. From the market, nothing new. I think you are all aware about the latest, for example, IHS numbers. We base our guidance on this. So we expect the market -- global market growth of 2.7%, 4.2% from China, 4.8% from NSA and a very limited growth, 0.9% from Europe.

Let's see how this is going on, but this is -- these estimations are quite in line also with our experience and information we get from the market. So as I said, these are the figures also our guidance is based on.

When I look at the guidance, it is very similar to the one we have given to you at the starting of the last fiscal year. So we expect to grow, excluding exchange rate effects and portfolio effects, between 5% to 10%. Excluding restructuring and portfolio effects, we also expect a growth in our adjusted EBIT margin at the same level, so between 5% and 10%. And with regards to the adjusted EBIT margin, excluding restructuring and portfolio effects, we expect approximately an equal level compared to the last fiscal year.

We will continue our strategy of focus and balance. This means, on the one hand, and Mr. Schäferbarthold shortly also comment on that, in all the areas where we think we cannot at least midterm reach a dominant market position, number 1 to number 3 globally or in the relevant market and be one of the technology leader and in addition can fulfill our expectations with regard to our financial target figures, we will go out of this business.

And Mr. Schäferbarthold mentioned 2 areas where we did this in the last fiscal year. And this was on the one hand our wholesale activity and, on the other hand, our joint venture with Mahle. As I said, we will continue in again and again checking our activities with regard to these 3 criteria.

The second main strategy focus is balance. And here also, Mr. Schäferbarthold comment on that. So we try to find the balance on the one hand with regards to the, from our perspective, outstanding opportunities we have with regard to growth, so investing into energy management, driver assistance systems, body control products or into our sensor and component activities or our lighting activities. These opportunities are significant. But we cannot do all.

Therefore, we also always have a look on the one hand of our profitability level and, on the other hand, of course, also on the capabilities of our organization, our ability to get new people in, to increase our resources, to build many plants at the same time. And this balance direction and synergy, of course, is also one key element of all the things we will do in this just started fiscal year.

With regards, of course, to the outside effects, of course, we do not know what will happen between the US and China. Of course, here are some insecurities. And Mr. Schäferbarthold said, as of today, we do not expect so many negative exchange rate effects. But of course, nobody knows. The development of raw material also was mentioned by my colleague. So currently, of course, it's a burden. We are trying to compensate this with design-to-cost and redesign-to-cost special activities. But let's see what's coming out of it.

And of course, with regard to the WLTP activities, so far, we cannot see a clear pattern. So far, the volumes in our systems are quite stable. But of course, also, we have to watch this effect very carefully, especially in the first days and weeks of September.

Yes, having said this, allow me to close the, let's say, presentation and part of our phone call. And now we would appreciate answering your questions.

Q&A

Operator

And your first question comes from the line of Raghav Gupta. Thank you

Raghav Gupta-Chaudhary

Q. Good morning, gents. Yes, it's Raghav Gupta from Citigroup. The first question I had was on the automotive growth rate. When I look at the organic growth in Q4, it looks like it's kept above 10% level. What can you say to us about your expectations for growth for the coming quarters I guess in light of that strong exit rate? Anything about the ramp up of projects or certain models that we should be aware of? I had a follow up on automotive, but if I can start there, please.

Bernard Schäferbarthold

A. So we had, I would say, quite a good start into the new fiscal year. So Q1 is still, I would say, not over. So we will not comment really on our exact numbers, but it's in line what we expect. And it will basically show a good, I would say, continuation of our growth. As our second quarter is now starting September 1st, so as Mr. Breidenbach also pointed out there, there are, I would say, more uncertainties. Actually, if we could see shifts from Q2 to Q3, as stated, there no clear exact pattern which actual concerns us, but it's too easy now to comment. And all in all, for the full year, so we still see it. Even if the degree of uncertainties continues to be high, we feel confident with this range of 5% to 10%.

Raghav Gupta-Chaudhary

Q. Very clear. Good to hear that the start of the year's been good. If I can follow on a little bit from that and focus on Europe, when I look at the regional outperformance, Europe clearly the biggest region in terms of sales for you guys has been holding you back relative to the other regions. What can you tell us about what you're experiencing in Europe that's different from what you're seeing elsewhere? Is it quite simply, outside of Europe, you're catching up and kind of gaining share? I'd just really quite like to understand what is happening in Europe. Can we expect the growth rate there to accelerate? That's kind of the crux of question. Thank you.

Rolf Breidenbach

A. Yes, when we look at our booked business, when we look at the capacities we are currently building up and the new launches which will come, we not only expect, but we also try to shape an over-proportional growth in Asia and NSA due to the fact that we would like to more balance the different markets. As you said, Europe is dominating. And therefore, we have a focus on our growth in the 2 other areas. With regard to Europe, we see a very solid, with regard to the market development, also over-proportional growth in the months to come.

Raghav Gupta-Chaudhary

Q. But as far as kind of the model exposures are concerned, you don't have any concerns about the relatively low outperformance that you've got in Europe compared to Asia? I appreciate what you're saying in terms of how you're trying to shape the business. But when you kind of think about your heritage and kind of I guess your production facilities largely in Europe or kind of the majority being in -- or skewed towards Europe I should say, just trying to really understand if the underutilization is -- and the pressure on gross margins is coming from weaker orders in Europe and kind of weaker utilization in the European plants and what you might be able to do to correct that.

Rolf Breidenbach

A. So the answer is no. So our European plants are very well utilized, with the exception, for example, of our plant in Lithuania, which is currently just started production. So the growth rate in Europe is shaped. That means we cannot do everything. And we have, as I said, asked ourselves where do we spend our resources, with regard to investment, with regard to people, of course also with regard to acquiring new business. And therefore, we have and will have a special focus on China and NSA. Of course, we will continue doing good business in Europe, but this growth rate is nothing we do not had expected, therefore, nothing which concerns us and nothing which is not in line with our strategy.

Raghav Gupta-Chaudhary

Q. Okay. If I can ask my second question, on free cash flow, clearly, very, very strong generation, free cash flow generation for the year. From what I can see, it appears to be from a working capital perspective helped by kind of a shift in payables. Can you talk a little bit about the working capital opportunity, if there is any, in terms of inventories and receivables and any kind of anecdotal evidence you can provide about the shift that's being made on that side, please? Thank you.

Bernard Schäferbarthold

A. We see the potentials on the -- especially on the receivables side and on the inventory side. In the inventory -- on the inventory side, you have seen an increase of around EUR125 million. Partially, as I commented, it is related to tooling, which is basically special somehow. But the rest is higher production materials. On one hand side, we have higher production materials because also the volume has increased. But on the other side, we also see that, with the ramp ups of new facilities, first of all, you need to stock these new facilities. And you have some inefficiencies also before really they are then fully utilized. And same also accounts if you have new production ramp ups. Then normally, we also take safety buffers also with additional stock, so also to secure the ramp ups. So with so many ramp ups at the same time actually, we see there potentials also to reduce the level of stocks overall. Same accounts for the receivable side, where there are still the level of overdues we have seen improvement, but is not at the target level. So we will continue to work on and hopefully see improvements. And also, on the payables side, if you look on -- what are the days basically, the DPO number we are looking at, we are getting better, but by far not at the target level we are looking at. So this I mean by continuous improvement and strong focus on that. So in all 3 relevant working capital areas, it will -- we will see further improvements in the next 24 months.

Raghav Gupta-Chaudhary

Q. Great. Thank you very much.

Operator - -

A. And your next question comes from the line of Henning Cosman.

Henning Cosman

Q. Hi, good morning. Thank you. As a first question, please, can we discuss the dynamics of the EBIT margin between the divisions? I'm afraid, Dr. Breidenbach, you're probably going to say you're not guiding on divisions. But I was just hoping directionally to discuss that a bit because, of course, you're still talking about capacity underutilization in the automotive OE division. My understanding is you regard that as temporary to some extent. So if that would go up, would that imply that the other 2 divisions would go down? That's the sort of directional indication that I'm looking for as a first question. Thank you.

Rolf Breidenbach

A. Yes, I think, of course, I do not now dare to say that we are now guiding on the margins of the different divisions. But allow me to, again, comment on the development of the automotive market. We see these challenges with regard especially to the raw material and also with regard to the investment into R&D. On the other hand, challenges we had in the last quarter, like the FX topic and also these contributions from the joint ventures, here, we see a kind of improvement or less insecurity. And therefore, the margin in automotive, yes, is in a high focus of the management. We have these launches. We have these new plants. And we have this raw material on the one hand and, from our perspective, the necessary investment into R&D. And yes, therefore, it's a focus. It's a challenge, but we are quite optimistic, especially with regard to countermeasures, design-to-cost, redesign-to-cost, to get a satisfying development.

Henning Cosman

Q. Okay. Great. That's helpful. Thank you. And just with respect to the products, think it's great that you commented a bit as to which product categories are driving the growth in the 2 business units within automotive. Can you just comment a bit on the successes you're seeing in the driving assistance systems, maybe not only as far as contribution to your current sales growth is concerned, but also in the RFQs and the success that you're currently seeing? I'm thinking of radar, camera, lidar, these kinds of products going forward.

Rolf Breidenbach

A. Yes, with regard to the positioning of our product portfolio in the area of automated autonomous driving, we did from our perspective a huge step into the right direction in the last fiscal year. As you know, we are so far the market leader with regard to 24Ghz with rear applications, blind spot, line detection, warning and all these functionalities behind of that. In the last fiscal year, we now get the first huge order in for the 77Ghz technology. Here, we are talking about, I would say, the core order of one very important European OEM in the 3-digit million area. This will be the basis to also roll out our 77Ghz technology now also to other OEMs. So this we see quite positive. It shows that HELLA is an established player in the radar technology and radar product market. And yes, as I said, this was very, very encouraging for us. The same is true for our camera software business. Here, we could get the the next 2 orders in. It shows that our model of offering camera software, let's say, step by step is accepted in the market. And we also see here a good future and for our, let's say, autonomous driving product portfolio. And perhaps a last comment, perhaps we mentioned that we have sold our shake sensor, which is also in this area of autonomous driving, to one European customer for road detection. Now the next customers and functionalities for these sensors could be sold. So this would be another important driver of the growth in autonomous driving. The special, let's say, growth factor also is and will be all the activities we are doing in the energy management sector, especially with regard to the 48 volt area. We were very successful with regard to our DC/DC converters. We see again an acceleration of the penetration of this technology, especially in Europe. We were informed that now also this technology will be introduced to the, let's say, high-volume midsized cars in Europe. One of the bestselling cars, the next generation of one of the bestselling cars in Europe will be equipped with this technology. And it shows to us that we are working in the right area. And we are offering the right technology. We are more than competitive. We think that we -- we are sure that we are one of the market leaders in this area. Perhaps we are the market leader. This is very difficult to assess. But at least in Europe, I'm sure we are one of the top 3 players with regard to these DC/DC converters. And we were also encouraged to go further with regard to battery management systems. We acquired the next 3-digit million project from one of our core customers in this field. And therefore, with regards to energy management on the one hand and driver assistance systems on the other hand, we did huge steps to improve our strategic positioning in both fields, which from our perspective will be important growth fields in automotive worldwide.

Henning Cosman

Q. Yes, that's really interesting. Thank you very much. Can I also ask you then on the lighting side how dynamics are going there for similar comments basically, so for example, what penetration rates are like in LED technology, how they're cascading down to more midsegment cargos and what your exposure is there and so on and maybe how pricing is developing as well as it -- I don't want to say commoditized, but as the technology becomes more standard?

Rolf Breidenbach

A. Also with regard to LED, we are very satisfied with the development. On the one hand, let's say, it's a general market development. As you said, standardization and modularization become more and more important in this field. So to offer this technology at an affordable price level also for the mass segments, A to C, and we see the penetration which already has started in the last, let's say, fiscal years to continue. And we have got orders in for full LED headlamps in all the segments. But as I said, core functionalities, modular approach, these are currently for us key factors to be successful in this market, not only with regard to growth, but also with regard to profitability. We see currently in addition a very interesting growth field in the area of ambient light. So more and more functionalities are asked. More and more cars are equipped with these, let's say, more complex lighting function in interior. But we also see now the starting of this car body lighting activity. So illuminated brand logos step by step will come. And therefore, this is also a very -- and many other functionalities and products. So car body lighting, ambient lighting on the one hand and LED technology at a standard and modularized product and part level on the other hand, these are one of the main growth fields we see for our company in the future.

Henning Cosman

Q. Thanks a lot, Dr. Breidenbach. Very helpful.

Operator

A. (Operator Instructions) And your next question comes from the line of Christoph Laskawi.

Christoph Laskawi -

Q. Hi, thank you for taking my question. The first one would be rather technical one on guidance. You say, basically excluding restructuring and portfolio effects, the margin is essentially on last year's level. Technically, if you sell the wholesale business with the margin below group average, the stated margin should go up. Could you confirm that this is the right approach to read it, or are there any concerns that you have that actually, on a stated level, once this sale is concluded, the margin also should be on previous year's, so level slightly down on an underlying basis for the other businesses?

Bernard Schäferbarthold

A. Technically, you are right. So basically, we have sold the business, which accounts roughly EUR500 million of sales and EUR35 million of EBIT, which overall, if you do the math, then you are right. On the other hand side, our guidance is also, let me say, roughly at the same level. So the impact overall on a number of 7.1, if you do exactly the math, then you are -- there's not really a very strong impact on that comment, if we look at the, I would say, overall topics we are also working on. In addition, I mentioned that this change in aftermarket will also relate to also a change in the overall organizational structure of our aftermarket business. On one hand side, we will also invest if it comes to the area of digital solutions, some more money also in improving the business going forward. On the other side, we will also reduce people, so that all in all, that was my comment that we feel comfortable also to keep the margin on a very similar level, if we look at aftermarket. But also, there will be also some cost impacts related to the changes going forward now in aftermarket, especially in this fiscal year '18/'19.

Christoph Laskawi

Q. Okay. Thank you. And I'm not sure if I missed it, but could you comment on the cash proceeds and what you're planning to do with them if there's any specific focus currently? Do you want to engage in M&A, or are there other measures you would like to take?

Rolf Breidenbach

A. Yes, we will continue to look at, let's say, M&A opportunities in the market. For 18 months, we have a special team which is screening the market for opportunities with a special focus on electronic sensors, actuators companies as well as of course software companies. We're also looking for companies acting in the area of special applications. And of course, we are involved in a lot of talks and activities. But so far, very often, we think the prices for these companies are too high. And over a mid- and long-term timeframe, the business case does not pay off. So we are willing to buy. We see great opportunities, but so far, especially with regard to the price level, it didn't fit. But of course, we are very active in this field. And many talks and activities going on.

Christoph Laskawi

Q. Thank you. And the last question will be -- sorry to come back to that -- is on auto margin. You highlighted the ramp up cost that you have and the product launches and project launches over the coming quarters. Do we or do you see the headwind from that actually increasing in the coming quarters, or is it more or less the peak behind us because you get more revenue coverage of the fixed cost that you've installed, and the absolute headwind should actually fade out starting now?

Schäferbarthold

A. We do not see that it will increase. So but it's not, I would say, fading out immediately. So we expect that a fade out could start during the year, but more towards the second half of the year, so still the activity level and the supports, especially now in the first half year is still on a high level, but similar to Q4.

Christoph Laskawi

Q. All right. Thanks a lot.

Operator

A. And your next question comes from the line of Christian Ludwig.

Christian Ludwig

Q. Yes, good morning. Two quick questions left from my side. First of all, what size or the magnitude of the expected adjustment should we pencil in for your fiscal year '18/'19, question number one? And second question, on the other announced divestiture of your joint venture with Mahle Behr there, is it correct to assume that this will only impact your joint venture result? It has no impact on sales and any other P&L items, correct?

Bernard Schäferbarthold

A. In this -- first of all, to your second question, on the Mahle Behr joint venture, until end of 2019, there will be no change. Starting from January 1st, there will be a change. Today, the business model works that the joint venture is basically only a kind of coordinator. So the products are coming from Mahle Behr, and the distribution is through HELLA, so that there will be then from 2020 onwards a sales impact, which is actually, if we look at the volume, which is in our revenue number. It's EUR160 million. So that will be then a reduction 2020 onwards. On the adjustments, there, it's basically hard now. I would not really like to give an exact range because, still, I would say not all the decisions are taken today. Still, we have the running programs, which is something which is ongoing, especially in Germany, but also related to the changes in aftermarket. As I mentioned, there's also a reduction program ongoing, which at the end will probably lead also to certain cost impacts. But it will -- I do not foresee that there will be very significant numbers, but it could be a bit higher to the numbers we had in the last year.

Christian Ludwig

Q. Okay. Thank you.

Operator

A. And your next question comes from the line of Michael Raab.

Michael Raab

Q. Yes, hi. Mike Raab, Kepler Cheuvreux. Just one single question to make sure I'm getting your wording absolutely correctly right in regard to WLTP. Is it fair to state that, so far, you have not seen any changes in the call-off rates which have been scheduled throughout the rest of this year?

Rolf Breidenbach

A. Any is too high. We see here and there slight changes, but no pattern, which -- and nothing which currently, as of today.

Michael Raab

Q. Of course, always talking status quo. But when you say there is a little bit of volatility here, there, everywhere, does that mean that there are some increases and some decreases which more or less balance each other out?

Rolf Breidenbach

A. That's more or less correct.

Michael Raab

Q. All right. That's been it. Thanks. Have a great weekend.

Operator

A. And next question comes from the line of Florian Treisch.

Florian Treisch

Q. Yes, hello, gentlemen. Two questions, if I may. The first is on your joint venture income. In automotive in Q4, you are back at EUR15 million, if I'm right here. I believe this is back, I would say, to a more normalized level or a level we have seen in recent years if you exclude the recent quarters, which are obviously burdened by the performance in Asia. So my question would be, is that now the time where you would say the headwinds are phasing out, and we are really back on track in Asia also to see better JV income here next year? And the second question is then around the sustainability in your special application business. If I understand you right, Mr. Schäferbarthold, you mentioned that you're happy to see a flat margin development year-over-year. If I remember correctly in the Q1 call, you mentioned that this extremely high margin was more like a one-off or driven by a very one-off-related business here and that 10% is more realistic for the full year. We all now know that you are clearly above the 10%. So the question is a bit, why should it be 11.5% again also next year, given that probably some of these one-offs are out, and you're in the past always stating 10% as a good yardstick? Thank you.

Bernard Schäferbarthold

A. We said roughly 10% on the full year. So certainly, due to the fact that the business volume, I would say, overall 1% on a lower volume, there can be more volatility if you have lower volumes if there are changes. So I said roughly at the same level. So we feel confident that at least 10%. This, in any case, we want to reach as long as there's no, let's say, market disruption, but which we are not seeing actually. This also I want to say. But this then we would not be able perhaps to cover. But yes, it's clear our target to be at least at 10%. But hence, certainly, our target is also not to have a lower margin

than in the year '17/'18. And on the joint venture, as I said, you are right. That was also my comment that, especially since Q3, Q4 last year, we see a solid stabilization and improvements in China, in Korea. So as of now, I would say the situation is okay and with a positive outlook. So I would agree to your comment that we should come back to a more normalized level.
Florian Treisch - MainFirst Bank AG, Research Division - Research Analyst
Q. Perfect. Thank you very much.

Operator

A. And your next question comes from the line of Akshat Kacker.

Akshat Kacker

Q. Thank you. Akshat from JPMorgan. My first question is on the Chinese market. It is obviously an important growth area for you. We are now seeing 2 months of material slowdown in retail sales. IHS is still building around 3% production growth for this quarter. Are you seeing any signs of delays or slowdown in production in the first half of your financial year? That's my first question. And I'll carry on with the others. Second -- yes, I'll just finish off my questions. Secondly is just to confirm that you said net CapEx is sustainable at these low levels. Is that around 6% of sales? And thirdly, just to get your guidance right, you said that you confirm that headwind from ramp ups will not increase this year. You also confirm that equity income from the JV had a 20 to 30 basis point hit over last year. My question is, what is holding you back from increasing your guidance for the group for FY '19? Is it just raw material? Is it WLTP? Just to get some more details around that. Thank you.

Rolf Breidenbach

A. Perhaps I'm going to start with answering the last question. It's exactly what you said. We are not sure how this raw material development on the one hand and our compensation activities on the other hand will, let's say, influence the margin. And of course, our spending in R&D depends on how much opportunity of the markets we'd like to catch. And here, we are currently, let's say -- we haven't decided this. And therefore, these are 2 important elements which can influence the margin. With regard to your first question in the second quarter, please allow me not to comment, but in the first quarter, we see no deviation and a good and constant development. I think Mr. Schäferbarthold will answer the second one.

Ulric Bernard Schäferbarthold

A. On the CapEx, you know that we are guiding around 7.5% of CapEx year-on-year. This basically also we would not change. If you take 2, I would say, aspects in that number again in the 6%, one is the EUR36 million of tooling which is in the inventory, and the other is higher reimbursements of EUR40 million. On the reimbursements, they can be volatilities,

depending on the payment terms we agreed with the customers when the reimbursement happens and how much we have to finance. And on the toolings, which are basically only accounted in the inventories, basically, this, you need to have in mind that you take that together so that, if you take both effects last year, we are not so far away from the 7.5%, so that we would not now adjust that number. Certainly, it could be that it is a little bit lower but around that 7.5% is what we actually see.
Akshat Kacker - JP Morgan Chase & Co, Research Division - Analyst
Q. Perfect. Thank you.

Operator

A. And your next question comes from the line of Julian Radlinger.

Julian Radlinger

Q. So I have 2 regarding free cash flow. I'll just go ahead and ask them both. The first one is another one on CapEx. If we ignore the tooling issue you just mentioned and the customer reimbursements, if I just look at CapEx, what you spend on PP&E, that number as a percentage of sales actually came down this year. And I was a bit surprised by that since since in the last fiscal year, you opened so many plants. Going forward, I understand you have 2 more plants, if I'm not mistaken, maybe 3 more plants that you're opening over the next 9 months or so. And then there's nothing really on the horizon, unless you give us an update, on new capacity additions. So is the investment in PP&E expected to come down as you finish building these plants, or how should I think about that? And then the second question, also related to free cash flow, is the net working capital. I was a little bit surprised that net working capital actually -- as a percentage of sales actually went up in the year, unless my math is wrong. Can you just give us an update on whether you're still expecting a 300 basis point reduction of the net working capital-to-sales ratio over now I guess 2 years last year -- it was over 3 years -- and if that has something to do particularly with these plant openings, which should of course reduce the inventory consumption quite substantially once you ramp up the capacities? Thank you.

Bernard Schäferbarthold

A. On the first question to your CapEx, it very much depends, on one hand side, when the building is built, but on the other hand side, also very often, the most relevant is then the investments then in the machinery and equipment, so in the different production lines, where there, depending on how early also it is agreed when to install that and when the customer wants to have it ready, so that sometimes it's very early. Sometimes, it's more, I would say, towards a start of production. So that really depends on the agreement we have with the customers on samples, on pre-series, which needs then to be produced at certain point in time, so that there is shifts or can happen dependent on when exactly production lines are needed. In addition, if we talk about inefficiencies, then mostly, it's not related exactly at this point in time also with the CapEx spending. So partially, it's -- the spending was before, and then with the ramp ups of the people, before you really have then the volumes and the support, which is also within your experts really to set up such a line to get all parameters right with the low volumes, costs you extremely high amounts of money, so that these efficiencies you can't then exactly see in the P&L. So it's hard really to see how much is then exactly related to production and machinery. And on top, a lot comes also with the toolings, which are needed and which is very different also depending on the complexity of the products, especially also in the lighting business. On the working capital, we stick to the targets. So still, it is what we see and what our target is that we want to reduce and to come to this level of 3%. As I mentioned, on the inventory side, I have given you some comments why it is high. And there, basically, we could do more. But then we would endanger the ramp up of some projects. So it is an operational decision. On the receivables side, I mentioned to you the overdues. This we will tackle. On the other han, we also had a high level of invoicing, especially to the end of the year, also with a lot of tooling invoices we have done related to projects, also which have driven the amount of receivables to a higher level. And on the payables side, we improved. If I look at the year-on-year comparison, we improved the payment terms with our customers by 10 days, measured to contractual terms. Before, you really see that, overall, in the payable number and the DPO number, this takes a certain time. So that is why we are confident that we will see the improvements also now in the coming fiscal year. Still a lot of work to do. Overall, we -- as I said, we stick to the target and will fight hard to it to get to the 3%. But yes, on the other hand side, it's not easy if we grow, especially in China and in the US, where cash has also a very high importance, in both countries, it's challenges.

Julian Radlinger

Q. Great. Very clear. Thank you very much.

Operator

A. And next question comes from the line of Kai Mueller.

Kai Alexander Mueller

Q. Thank you very much. Quite a few questions have already been asked. But just to come back to what you said earlier about, obviously, the ongoing risk of trade tariffs, etc., can you give us a little bit of color how much of your production in the US is actually localized versus how much is crossing the border? And have you got any color in terms of your exposures to those SUVs that are shipped from the States into China? That's the first question. And I'll follow up with another one after.

Rolf Breidenbach

A. Of course, we are not publishing exact numbers to this exposure. But when you look at our operations, so when we are talking about the border between Mexico and US, of course, our main activities for lighting and also for electronics are based in Mexico. Therefore, a significant, of course, proportion of the activities, of the products we are producing in Mexico are going directly to the Mexican plants, but also, we ship some to the US. But let's say, the -contractual situation also with our customers put us into a situation that this will not significantly influence -- negatively influence our profitability situation. With regard to the exposure of vehicles which are shipped from the US to China, you know we are not talking about customer names, but here also, our exposure is limited. And we so far do not see a significant or, yes, a significant influence with regard to our sales or EBIT margin. But this is difficult to assess how this will continue in the future because the exact influence so far is also I think not absolutely clear for our customers.

Kai Alexander Mueller

Q. Okay. Perfect. And then just to come back, question has been asked in a similar way earlier what you're doing with the proceeds from your sale. You've now mentioned a lot of the companies do look quite expensive. If you don't find an attractive target, have you thought about other ways of capital return, such as dividends or share buybacks?

Bernard Schäferbarthold

A. For sure, I would say you can be assured that we look at all what is possible. But what I would not see at this point in time that we would consider a share buyback program.

Kai Alexander Mueller

Q. Okay. But special dividends, something like that?

Bernard Schäferbarthold

A. That's -- I think, generally, you could -- we are sticking to our dividend policy, so 30% on net profits result. So I think that is certainly something which stays, as also with the selloff of these activities, there will be a much higher profit. So that will certainly be then a question for the General Assembly next year because the net profit will then also be by far higher due to that extraordinary income.

Kai Alexander Mueller

Q. Okay. And maybe to follow up on that, you said obviously the Danish and Polish operation is in the process of selling. The Norwegian one couldn't be sold to the same buyer because of antitrust concerns. How's your progress going on with that one? Are you on a clear path to exit as well?

Rolf Breidenbach

A. We are on a clear path to investigate the strategic options. And that is ongoing in a clear, I would say, structural process.

Kai Alexander Mueller

Q. Excellent. Thank you very much.

Rolf Breidenbach

A. You're welcome.

Operator

A. And next question comes from the line of Marc Tonn.

Marc-René Tonn

Q. Thank you. I think basically most of my questions have been answered. Perhaps a bit coming back to growth in applications and -- sorry, in special applications. You mentioned that you could take a lot of the experience I think you're making in the automotive part to also improve business there, perhaps some kind of -- the growth prospects you see for the current year and what might be the key growth drivers there and particularly also on what the outlook is for the underlying business, how you see the economic framework for your main I think target customer groups in that segment. That would be my only remaining question.

Bernard Schäferbarthold

A. I'm not sure if I got your question correctly because -- so today, what -- where we are actually benefiting most from is that we are doing the application related to our lighting technologies. We are benefiting especially also there from an LED trend. So if you look at, for example, agricultural products, most are using LED applications and lighting systems also today. So there, the penetration is getting higher. In addition, same accounts, for example, we are in the marine business also. And if you look at these cruise ships, for example, it's a very, let's say, good business for us there to have these kind of lighting solutions also in these ships. Where we see we can do even more is in introducing our electronic products in basically the same business areas where we are in. So if you look at the agriculture, there also, if you look at sensors and applications around also there autonomous driving as one example, also energy management as one example, we could or we see a strong demand in this relevant technologies. And that's something which we are, say, not as far as compared to the lighting products. So that is certainly a strong growth perspective we see with a very similar profitability pattern compared to the actual business we have.

Marc-René Tonn

Q. Perfect. And is there some kind of growth which would already, let's say, drive the top line, let's say, to at least the same level as group average or even above group average for the near term? So that means this fiscal year or next fiscal year, or is it something which is more, let's say, long term?

Bernard Schäferbarthold

A. No, it already starts, but certainly from a lower volume, but then hopefully with stronger growth rates. But it's nothing which we see now longer term. So it's clear. It's already started. And we already see that in the numbers. So it should contribute now already this year and even more significant next year.

Marc-René Tonn

Q. Thank you very much.

Operator

A. And your next question comes from the line of Sascha Gommel.

Sacha Gommel

Q. Yes, thank you very much. I actually canceled my questions, but since I'm on, I have one left. Your R&D accounting changed a little bit, and you're becoming a bit more aggressive on the capitalization. I was wondering if you can share your view on how we should think about it going forward.

Bernard Schäferbarthold

A. There's no change in our accounting policy. So still, we are on a very low level of capitalization, so that -- but on the other hand side, you are right that we are a little higher. This reflects basically to a higher order intake we have. So the backlog volume we are working on has increased on a year-on-year level, but even also again has increased also in the last year, so that the share also of specified booked orders, which then is reflected in the overall gross expenses in R&D is higher. And with that, also the share of capitalization has increased a little bit. But basically, that is still -- I would say, without any changes of accounting policy, it has purely to do with the magnitude of our booked business and our order book.

Sacha Gommel

Q. I see. Thank you very much.

Operator

A. And next question comes from the line of Henning Cosman. Thank you. Please ask your question.

Henning Cosman

Q. Yes, thanks. Just real quick follow up. You said the dividend next year would be a lot higher as a function of higher net profits. So I think you must be assuming an extraordinary book gain. I was just wondering if you could quantify that, please.

Bernard Schäferbarthold

A. I was not confirming that the dividend will -- well, there will be an extraordinary dividend. I was only saying that, normally, we stick to the general rule we have and that, certainly, the proposal should be like that. But at the end, it's not us only to decide, and no decision has been taken yet. But it will be consequence to take that decision. Let's put it in that way. And as you're right, there will be an extraordinary gain which, at the end, should be around EUR270 million, EUR280 million.

Henning Cosman

Q. Perfect. Thank you.

Operator

Thank you. And no further questions at this time. Please continue.

Rolf Breidenbach

Rolf Breidenbach: So thank you very much to all of you to having shown the interest in our company and in this call. And thank you very much for raising all the questions. And I wish you a good remaining day and a good weekend. Thank you very much.

Operator

Thank you. And that does conclude our Webcast for today. Thank you for participating. You may all disconnect.

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