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# EDITED TRANSCRIPT

LIGHT.AS - Q3 2018 Signify NV Earnings Call

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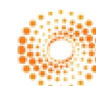

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## PRESENTATION

**Operator**

Ladies and gentlemen, welcome to the Signify Earnings Call Q3 2018. (Operator Instructions)

I would now like to give the floor to Robin Jansen, Head of Investor Relations. Mr. Jansen, please go ahead.

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**Robin Jansen** - *Signify N.V. - Head of IR*

Thank you, and good morning, everyone, and welcome to the Signify Earnings Call for the Third Quarter Results 2018. With me are Eric Rondolat, CEO of Signify; and Stéphane Rougeot, CFO.

In a moment, Eric will take you through the third quarter business and operational performance. Stéphane will then tell you more about the financial performance in the third quarter, and Eric will end today's presentation with the financial outlook and conclusion. After that, we will be happy to answer your questions.

A press release and related slide deck were published at 7 a.m. CET this morning. All documents are now available for download from our Investor Relations website. A full transcript of the conference call will be made available as soon as possible on our Investor Relations website.

With that, I will now hand over to Eric.

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**Eric Rondolat** - *Signify N.V. - CEO & Chairman of the Board of Management*

Thank you, Robin, and good morning, everyone, and thank you for joining us today. I propose that we go immediately to Slide 4 with the main elements of our performance in the third quarter. Comparable sales declined by 3.2% due to high base of comparison in the third quarter of 2017 and more challenging market dynamics in several geographies.



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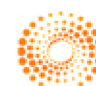

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As you see, we continued to make good progress in reducing our cost base. Excluding the impact of currency movements, our adjusted indirect costs decreased by EUR 58 million, or 260 basis points as a percentage of our sales. As a result, all business groups, except Home, were able to improve their margin in the quarter. Overall, our margin, therefore, improved by 150 basis points to 12%, despite a negative currency effect of 60 basis points.

We are also pleased with our free cash flow of EUR 64 million, which is significantly higher than the minus EUR 5 million reported last year despite the following fact: we had a EUR 17 million higher restructuring payment this quarter, and at the same time, the cash flow in Q3 2017 included EUR 21 million of real estate proceeds. The improvement in free cash flow was mainly driven by a reduction in working cap.

Sustainability is core to everything we do. And we are, therefore, pleased with our recent achievements and recognition we've received on this front. We have achieved carbon neutrality for our business in the United States and Canada. We have been named industry leader in the Dow Jones Sustainability Index for the second year in a row, and Sustainalytics moved us up to the industry leader position in a group of 43 electrical equipment companies.

Let's now move to Slide 5, where you can see a snapshot of the financial performance by business group. A solid comparable sales growth performance in Lamps and LED electronics was offset by a high base of comparison, most notably in Professional, Home and LED lamps and a more challenging market dynamics. In the last column, you can see that Lamps, LED and Professional significantly improved their margins despite currency headwinds.

Let me now provide you with a bit more detail for each of our 4 business groups, and let's start on Slide 6 with Lamps. Our comparable sales declined by 11%, which is better than previous quarters, driven by higher sales ahead of the halogen bulb ban in Europe that came into effect on the 1st of September; a solid performance in consumer lamps, such as CFLi and HID outdoor and certain specialty lighting categories, such as digital projection. We estimate that the conventional lamps market continued to decline faster than our Lamps business in the third quarter, and we have continued to gain market share.

Lamps delivered a very strong margin at 24.6%. This is about 500 basis points higher than last year, and it is driven by the exceptionally strong CSG performance and lower indirect costs.

Let's now move to LED on Slide 7. Comparable sales declined by 1.9%. The comparable sales trend in LED electronics continued to improve, while the CSG of LED lamps reflects a relatively high base of comparison and a soft level of activity with retailers in Europe and also in the U.S. Also, LED lamps faced an ongoing shift to private label, most notably in North America and a more challenging environment in China.

All in all, the adjusted EBITA margin improved by 130 basis points to 12% as a result of continued improvement in procurement savings and lower indirect costs, which was partly offset by price erosion, which we also see slowing down.

On the next Slide, Slide 8, you can see some of the business highlights of this quarter for LED. Let me zoom in on the launch of our Interact Ready Master Connect LEDtube. Its networking technology enables wireless integration with a variety of control devices, such as sensors and switches. Through dimming, occupancy sensing and daylight harvesting, these tubes deliver 50% more energy savings, thanks to the Master Connect technology. This also works seamlessly with Interact Pro, our intuitive dashboard and app, which brings additional benefits to our customers through connected lighting.

In the third quarter, we also launched an innovative controller for outdoor luminaires. So this controller that you see on the slide adds connectivity and sensing to outdoor luminaires and allows customers to remotely install a very accurate on-and-off switching and dimming scheme that can then be easily controlled with the use of a smartphone. The settings can be saved in a profile that can then be applied to other nearby luminaires to quickly and easily create a virtual group with the exact same behaviour.

Let's now move on to Professional on Slide 9. Comparable sales grew by 0.4% on the back of a high base of comparison in the third quarter of 2017. Sales performance also reflected a lower level of market activity, most notably in Europe and China, and a slowdown in medium- to large-sized





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projects in the U.S. Adjusted EBITA margin continued to improve with an increase of 130 basis points to 11.7%, mainly driven by lower indirect costs.

There are a couple of business highlights that we would like to bring to your attention on the next Slide, Slide 10. For example, this quarter, we launched Interact Hospitality, which enables hotel guests to personalize lighting, control the temperature and make room service requests at the touch of a button. The smart system also lets hotel staff know if a room is occupied and have them to respond quicker to guests' requests, providing useful information to improve the guest experience, optimize operations and save energy. The first commercial implementation of this smart system takes place at the Swissotel the Stamford in Singapore, which has more than 1,200 rooms.

Another highlight this quarter is that Navigant ranked us as the world leader in smart street lighting. Navigant estimates the global market for smart street lighting to be worth $837 million in 2018. They expect that annual smart street lighting revenue will grow to nearly $8.3 billion globally by 2027, presenting a CAGR of almost 30%.

Let's now turn to Slide 11 and Home. So Home reported a decline in comparable sales of 1.4%. This was mainly due to a high base of comparison as retail partners in the U.S. started to build up inventories in the third quarter of last year. We have been able to bring the Home business back to a more normalized performance, which resulted in a sequential improvement of the sales level and the comparable sales growth.

We improved the profitability of Home versus the preceding 2 quarters, driven by substantial increase in the gross margin, bringing it back to a more normalized level and by adapting the cost base. We do see that the competitive landscape for the smart home is intensifying with more offerings for the overall smart home category being brought to the market, which is attracting more players who are going after share of wallet.

Given the breadth and depth of our product offering, our high clock speed of innovation and the recent success of the launches like Hue outdoor, we remain very confident of the growth and margin potential of our connected lighting offering for the home.

Also for Home, we would like to share a couple of business highlights that you will see on Slide 12. One that I would like to call out is that we have launched new Philips Hue products for the bathroom, the living room and the garden during IFA 2018, which is the world's leading trade show for consumer electronics and home appliances.

For example, we introduced Philips Hue Play, which is a compact, highly versatile bar that you can position in a variety of ways to create a truly immersive lighting experience. It provides an indirect light effect and can sit horizontally or vertically next to your TV or be mounted behind as a backlight. Furthermore, we have introduced new luminaires for dining, such as the Philips Hue white and color ambiance, Ensis and Flourish. Our Philips Hue outdoor light strips are the latest addition to the newly launched Philips Hue outdoor range.

This is what I wanted to cover regarding the business and operational performance. I will now hand over to Stéphane, who will tell us more about the financial performance for the third quarter of 2018.

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**Stephane Rougeot** - *Signify N.V. - CFO & Member of the Board of Management*

Yes, thank you, Eric. Good morning, everyone. So let's turn to Slide 14 where you can see the adjusted EBITA bridge. As you can see here, the adjusted gross margin as a percentage of sales decreased by 90 basis points in the third quarter of 2018, and that was mainly due to a negative currency effect of 50 basis points and also a high comparison base versus the third quarter of 2017.

The impact of price on the gross margin was lower in the third quarter than in the second quarter and also the first quarter. And it continues to be largely offset by the savings that we get on the cost of goods sold and the positive impact of these savings is increasing, as you can see here, in the third quarter compared to Q1 and Q2.

Overall, the ForEx has negatively impacted the adjusted EBITA margin by 60 basis points again, and that's due to adverse swings in currencies like the Indonesian rupiah, the Brazilian real, Argentine peso and also the rupee in India. Finally, as you can see, we have continued to reduce our cost base in the third quarter with cost savings amounting to EUR 58 million, excluding the ForEx impact.



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Let's turn now to Page 15 and take a closer look at the evolution of our adjusted gross margin. As indicated, the gross margin decreased by 90 basis points and was 39.1% in the third quarter, and that was mainly due to ForEx effect and also a high comparison base. As you can see in the graph, last year, we reached almost an all-time high at 40%.

In Q1 and Q2, which you can see on the bottom of the graph, the change compared to last year was mostly due to lower sales level in Home on top of the ForEx effect, which, as Eric mentioned, we have returned to a more normalized level in Q3, hence the much smaller gap compared to last year beyond the ForEx effect.

On the next page, on the cost savings, you can see the quarterly evolution of our indirect cost savings since last year. As you know, we've mentioned several times the multi-year transformation program that we are executing in order to simplify our organization and reduce our costs, also to improve the customer service and quality to be more efficient, to capture the benefits of our scale and also to save costs so that we can continue to invest in growth.

In the third quarter, all these initiatives resulted in EUR 58 million of currency comparable indirect cost savings, and that represents a 11% reduction year-on-year. And you can see here that the amount of quarterly savings continues to improve sequentially. Year-to-date, we have lowered our indirect cost base by EUR 209 million compared to 2017. And if you take out the ForEx effect, it's already EUR 142 million.

We've continued to implement those initiatives in the third quarter through also further gearing and headcount reductions. And we have actions in place to continue streamlining our processes, consolidate our footprint, reduce our real estate cost, reduce also our indirect material spend and simplify also the product portfolio, which will continue to bring us savings moving forward.

Let's now turn to working capital on Page 17. If you compare to the same period of last year, the working cap has actually decreased substantially by EUR 220 million and amounted at the end of September at EUR 659 million, which is 10.1% of sales. So this is a 240 basis points reduction. This improvement was driven by a substantial reduction in accounts receivable by EUR 188 million and also a reduction in our inventories by EUR 143 million compared to the end of September 2017.

As a percentage of sales, you can see on the right that inventories reduced by 100 basis points and reached 15.2% at the end of the third quarter. You remember that it was very important for us to really better manage our inventories throughout the year. This is what we have done at the end of Q2 and again at the end of Q3. And you will see that it explains the last part of the free cash flow improvement this year compared to last year.

Let's now take a closer look at our net debt position on the next page, Slide 18. Our net debt has increased by EUR 49 million compared to the end of June, and that is mainly due to the repurchase program that we have executed since the end of July. We have bought 4.2 million shares in the open market for an overall amount of EUR 95 million in the quarter.

If you look at the free cash flow on the left part, next to the profit that we have generated, we had the positive impact of working capital, which I mentioned earlier. And you can also see a few other items that impacted our cash and, therefore, our debt position. CapEx was EUR 18 million in the quarter, and the net change in provision was EUR 57 million.

This quarter, we made a contribution of $30 million or EUR 26 million to our pension fund in the U.S. in order to reduce the liabilities and also to lower future interest expenses. This contribution was a little bit lower than what we originally anticipated. We thought we would pay $50 million like last year, but we reduced it as we saw the better-than-anticipated equity returns within the U.S. pension funds. Next to that, we paid EUR 50 million for tax and interest.

All in all, this increased our net debt position to EUR 737 million at the end of the third quarter, on the back of a strong free cash flow of EUR 64 million during the quarter, which is substantially higher than the minus EUR 5 million free cash flow recorded in Q3 2017.

Year-to-date, our free cash flow is EUR 57 million higher than last year despite the fact that last year, our free cash flow included a significant amount of real estate proceeds. And also, this year, we had a significant higher amount of restructuring payments compared to last year, year-to-date.



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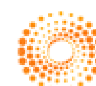

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Let me now hand back to Eric for the final part of the presentation.

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**Eric Rondolat** - *Signify N.V. - CEO & Chairman of the Board of Management*

Thank you, Stéphane. Let's now move to the last slide of the presentation, Slide 20, to discuss the outlook. So as market conditions had become more challenging in several geographies, we expect our comparable sales growth in the second half to be similar to the first half. However, taking into account the solid progress in cost savings, we remain confident that we'll be able to improve the adjusted EBITA margin from 9.6% in 2017 to the lower end of the 10% to 10.5% range in 2018. Based on the prevailing spot rates at the end of September 2018, the currency impact on the adjusted EBITA margin is expected to be around 50 basis points for Q4 as well as for full year in 2018.

On the cash side, we continue to expect to generate solid free cash flow in 2018, which is expected to be somewhat lower than the level in 2017 due to higher restructuring payments, as indicated at the start of the year. Our P&L restructuring cost for the year, I expect it to be around EUR 155 million when also taking into account the costs related to the company name change.

Let me close by saying that we remain very much confident about our longer-term strategy. We continue to invest in growth and innovative offers despite a more challenging macroeconomic environment and to capture the strategic opportunity of smart and connected lighting.

With that, I would like to open the call for questions, which Stéphane and I are going to be very happy to answer. Thank you.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) And we have a question from Dennis Dinkelmeyer from Goldman Sachs.

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**Dennis Klaus Dinkelmeyer** - *Goldman Sachs Group Inc., Research Division - Research Analyst*

And the question first, on your comments regarding the softer macroeconomic environment, and you've mentioned softness in LED. You've also talked about the softness in the U.S. and in Europe. What -- in your view, what's driving this? And what's the outlook for this in 2019?

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**Eric Rondolat** - *Signify N.V. - CEO & Chairman of the Board of Management*

Yes, thank you, Dennis. Just -- so let me try to recap the way we have experienced the Q3 situation from a macroeconomic standpoint. The new elements in Q3 are Europe that was much softer than in the previous quarters. By the way, when you listen to what is being said by other companies, I feel that they see the same trend. Nevertheless, when we compare ourselves to others in Europe, we believe that we do substantially better. Now we always have to understand that when you look at our numbers in terms of comparable sales growth, they always include one part, which is about one-third of what we do, which is declining. So when you look piece by piece and you compare what is comparable towards others, even if we see a market in Europe which has less traction than it used to be, we believe that we'll do substantially better. What we have experienced also in Q3 is a softer market in China. The way we do business in China is multi-fold, but we have a big part of the business which is going through distribution, which is going very granular in all the different provinces of the country. We have found that for these customers that have different sizes, but many of them are small companies, their access to cash was more difficult than previously. And that's a trend that you start to see in China at a broader scale. It reminds me also what happened at the time in 2014 when that market contracted also and we felt the same type of impact. Now we've reacted extremely well, I believe, on that market by making sure that we were strengthening, we're very stable in our commercial policy, not giving extra payment terms and making sure that the inventories of our channel were well positioned, which we didn't do that well back then in 2014. So I think we've learned a lot, and we're managing the situation, I believe, fairly well. But we see that market also contracting. In the U.S., it's less of a new factor. But what we have experienced is that small- to mid-sized projects are softer in general. But linked to another phenomenon is that, in some cases, there's a scarcity of truck drivers, there's a scarcity of people who can manage projects given the situation of





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the employment in the U.S. So it's a kind of a different situation. What we also see in the U.S. is the market for stock and flow, basic products, that market is still semi-dynamic. But this is not where we are the most involved. We are more involved in projects than in stock and flow for products. So we have felt also that impact. Now it's very complicated for me to tell you where this is coming from. What you can see as well as I see it myself is an overall tension in the commercial exchanges between the continents in the past quarters. The tariffs probably are not helping neither, and we see, yes, contractions in markets that we had not seen previously.

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**Dennis Klaus Dinkelmeyer** - *Goldman Sachs Group Inc., Research Division - Research Analyst*

So I've got a follow-up question on the Home division specifically, it's now been 3 quarters of negative growth, negative adjusted EBITA. When do you expect this to come back? What are the level of inventories? You've previously mentioned you'd had a lot more granular data in terms of inventories at your U.S. retailers. I wondered if you could comment on this. And more specifically, you've also mentioned intensifying competition. Now the Philips Hue product offerings are priced at much higher price points than a lot of your products in your other divisions. Now with introduced competition, is there risk that you might have to cut pricing and this will ultimately also dilute comparable sales growth in 2019, you will not be able to reach the level you have previously reached?

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**Eric Rondolat** - *Signify N.V. - CEO & Chairman of the Board of Management*

Okay, a lot of questions. Let me try to take them one after the other one. So first of all, the performance of Home in Q3 is radically different than the performance of Home in Q1 and Q2. It's pretty much in line with what we expected in terms of having that business to return to more normalized levels. In Q1 and Q2, even if we don't disclose specifically the numbers, but the gross margin was extremely heavily impacted for many different reasons that we mentioned previously. In Q3, the margin has come back to normalized levels, and that's a very, very good news. The second point is that the costs for that business that we're following, basically the investments that we had done last year, were very high at the beginning of this year. We've been able also to somehow, especially at the end of the quarter, to have costs that are now also coming back to normalized levels. So when you look at the P&L of Home in Q3, it is showing a clear improvement versus Q1 and Q2. From a growth perspective, we are comparing ourselves to the high base. The story of Home is that the first semester, the comparable sales growth is impacted because there is inventory at our retailers, and you need to have that inventory to go down before you can resume sales. I think that was done or mostly done at the end of H1. Now going to H2, our sales picked up again, but then you are comparing yourself in terms of comparable sales growth to a high base, which is explaining also the negative growth. Now you've picked up something important that we're also mentioning. We have in Q3 bought some studies on the smart home market, not only smart lighting, but home market, and we've learned a few things. And it also confirmed some things that we thought. So let me try to give you a bit of a recap there. So first of all, you have 3 very important angles. The first one is, yes, it's an attractive market, and you get more offers coming for smart lighting. Now when we look at what we offer with Philips Hue at this point in time, we are still unequalled. Now let me tell you, we are not complacent at all. But when we look at what we have on the table and all the innovation that we bring again in Q3, we're still ahead of the pack. But there are a lot of new offers coming on the market. That's number one. How do we fight against that? Differentiation, use cases, bring to the consumers an understanding of what can be done with the platform that we are selling to them. The second point is our retailers. And what we see also is the willingness of retailers to have a more spread turnover for the smart lighting against many different competitors. We see also that happening. So how do you mitigate these factors? Well, it's also by increasing your number of channels and getting different reaches to the market, which we are putting in place. Third, what we also see is that the smart home, more general, beyond smart lighting, is moving in very different directions. And you had in the past quarters a lot of new offers brought to the market with a lot of advertising, specifically on security. So if you are a consumer today and you dedicate EUR 100 to your smart home, before, you had probably less choice and maybe the share of wallet of smart lighting was a bit bigger than what it is today, given the fact that many more offers are coming on the market, coming from very, very different type of industries. Once again, this is a temporary situation where the market needs to stabilize, a way to see what are the offers that are there. And we are intensifying in Q4 our advertising and promotion. So on your point, will that mean that we're going to see a direct impact of that on our margins? We don't believe so. We're continuing to invest in innovation. We continue also to bring costs down for that business. And we will adapt our commercial policy if needed, but not at the detriment of margins. Sorry, I was a bit long, but I think on Home, it needed probably an extensive explanation given the fact that you asked one overall question, but there were a few questions within your question.

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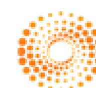

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**Operator**

Our next question comes from the line of Peter Olofsen from Kepler Cheuvreux.

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**Peter Olofsen** - *Kepler Cheuvreux, Research Division - Analyst*

I wanted to ask you about the LED segment. Could you maybe shed some more light on the comparable sales growth that you're seeing for the LED bulbs on the one hand and LED electronics on the other hand? And is there a meaningful difference in margins between the 2 segments? And then I have a follow-up, please.

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**Eric Rondolat** - *Signify N.V. - CEO & Chairman of the Board of Management*

No meaningful difference in margin. As we've always said, I think this is still valid. We see a sequential improvement of the comparable sales growth of LED electronics, and we see a more challenged comparable sales growth on the LED bulb side coming from, let me try to be simplistic, coming from 2 areas: Northern America, private label, so we've been losing market share on the consumer LED lamps business to private label; and also I talked about the Chinese market previously, that's a very important market for us, and we've seen also challenging market conditions for LED lamps in China.

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**Peter Olofsen** - *Kepler Cheuvreux, Research Division - Analyst*

So if I look at the overall comparable sales decline, it's then LED bulbs declining and electronics growing? But could you maybe quantify that, what kind of decline and growth should we think of?

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**Eric Rondolat** - *Signify N.V. - CEO & Chairman of the Board of Management*

Look, I think if you take into account what you just said that LED electronics is growing and LED lamps are declining, you're right. We don't want to give you specific numbers for obvious reasons there.

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**Peter Olofsen** - *Kepler Cheuvreux, Research Division - Analyst*

Okay. And then I have a follow-up on tariffs imposed by the U.S. Could you maybe quantify the headwind that you foresee going into 2019? And could you also talk about your plans to mitigate some of these impacts? Is it mainly increasing prices? Or are there other measures that you can take, like adjustments to your supply chain?

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**Eric Rondolat** - *Signify N.V. - CEO & Chairman of the Board of Management*

Yes, very important question. So last time, when we talked, I did speak about EUR 19 million of full year impact. As you know, there was List 1, List 2 and List 3, which is now confirmed. At that time, List 3 was at 10%. It moved to 25%, so that brings our full year impact to EUR 39 million. And of course, List 3 will start as of the 1st of January 2019. So EUR 39 million will be the full year impact for us. If you look at the impact ongoing in 2018, we estimated it's going to be around EUR 7 million. Now we don't see that to be as a headwind. We're compensating for it, and we do it in 2 different directions. So the first one, increasing price when needed, but also trying to find the right adaptive offers, rework on supply chain and purchasing in order to try to accommodate cost onto that new reality as much as we can. So it's really a global effort, not only increasing prices, but making sure that the impact will be a neutral for us.

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**Operator**

Our next question comes from the line of Sven Weier from UBS.



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**Sven Weier** - *UBS Investment Bank, Research Division - Executive Director and Analyst*

First one would also be a follow-up question on the dynamics on the LED bulb business. I think my previous understanding was that the LED bulb business was also a bit weaker in Europe. And if that was the case, could you tell whether there has been a kind of a temporary negative effect from the halogen ban because everybody kind of stuck to halogen bulbs before they are forbidden, and that has maybe temporarily had a negative effect on the LED bulbs? That would be the first.

**Eric Rondolat** - *Signify N.V. - CEO & Chairman of the Board of Management*

We had exactly the same reasoning as yours. And then we went and investigated if that had, had a real impact and a big impact. And I have to tell you that we don't have, at this point in time, documented proof that the fact that many of our customers had to buy more halogen bulbs had a real impact on the LED bulb sales. So that's why we're not mentioning it because we don't have documented proof that it was so. From the first analysis that were made by our teams, it may have had an impact, but it's a limited one.

**Sven Weier** - *UBS Investment Bank, Research Division - Executive Director and Analyst*

But the LED bulb sales vary indeed also in Europe in Q3?

**Eric Rondolat** - *Signify N.V. - CEO & Chairman of the Board of Management*

What we've seen in Europe, as I've said it previously, we've seen that the European market in general had much less traction in Q3 than in the previous quarter. So that also concerns the LED bulbs.

**Sven Weier** - *UBS Investment Bank, Research Division - Executive Director and Analyst*

Okay, good. And second question, just on Professional. You also mentioned that obviously, tough comps had a negative impact on the growth rate, but now in Q4, it's getting even tougher. So should we be expecting a negative growth rate then for Q4?

**Eric Rondolat** - *Signify N.V. - CEO & Chairman of the Board of Management*

Well, in Q3, it's growth for Professional of 0.4% on the basis of a strong compare. Yes, we've grown above 11%, if I remember well, in Q4 last year. So of course, we have a very strong compare in Q4. Anyway, we'll see. We're not specifically guiding on a quarterly basis per business on the growth, but we're confident on the way the P&L is managed in Professional in order to continue the improvement that you have seen so far.

**Operator**

Our next question comes from the line of Marc Hesselink from ING.

**Marc Hesselink** - *ING Groep N.V., Research Division - Research Analyst*

Firstly, on the halogen ban and the impact, so clearly, a positive impact. But could you give a bit more detail on how much of impact that was? And also, how that will go into the next quarters? Will it be then again some extra decline in the organic growth because of that front loading? And then also maybe on the margin side on that impact.



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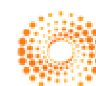

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**Eric Rondolat** - *Signify N.V. - CEO & Chairman of the Board of Management*

So when you look at the improvement that we experienced in comparable sales growth in Lamps, it doesn't all come from halogen. And let me put it this way. There is an impact which is directly linked with halogen, but not only, we've also mentioned that we have seen a great performance in consumer lamps, namely in CFLi in some parts of the world. And that has sequentially improved the CSG. Now we also were comparing ourselves with a Q3 last year in Lamps that were probably the highest decline for the year, above 20%. So you have a lot of different elements that you need to take into account when you look at the performance from a growth perspective when it comes to Lamps. In the next quarters, of course, we're going to get less halogen sales that we used to have. So that part of the business will have a negative impact on our growth profile. But we also need to take into account that halogen was not a mainstream technology for us. We were selling reasonable volume, but that's not for us the biggest technology. So it will have an impact in the coming quarters on the growth, but we believe it is manageable. Once again, we don't look specifically at what happens during the quarter. We look at that on a longer perspective. That's the way we manage that business. The good thing, as we always do, when the business grows, and we're only talking about halogen in Europe, meaning that we still sell halogen in the other parts of the world, but when the business comes down, which is going to be the case in the following quarters, the costs have gone because we have already adapted our industrial base. From a margin perspective, so what is important to understand -- and let me first zoom at the company level and then go to Lamps. What makes the performance in the company in Q3 in terms of operating margin is the performance on cost. And that performance on cost, on indirect costs, is also having a positive reflection in all the different businesses. And that's also the case in Lamps, which is amplified by the fact that the comparable sales growth is much better than the previous quarters and, I have to say, also a bit better than what we originally expected. So from a margin perspective, we keep the guidance that we had given on Lamps even if some of you may feel it's a bit conservative, we said above 16%. But look at what we've done in the past. I think we're capable to do the same after the halogen ban. So this is the way we manage that business, and we are fairly comfortable. So to cut the long story short, in the next quarters, yes, there's going to be an impact of the halogen ban on the top line. But we believe that on the margin, we have been able to compensate by reducing the costs already.

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**Marc Hesselink** - *ING Groep N.V., Research Division - Research Analyst*

Okay. That's clear. And then the other question is on your guidance on free cash flow is somewhat lower. Last year, it was around EUR 400 million; and then for this year, at EUR 300 million. And obviously, you had still that real estate in last year. Can you give a bit more color on what you mean with somewhat lower? Is that EUR 300 million of consensus, is that something that you see as in that range?

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**Stephane Rougeot** - *Signify N.V. - CFO & Member of the Board of Management*

Marc, this is Stéphane. Yes, so let me elaborate a little bit on that. The reason why we gave the guidance on cash flow, as you highlighted, is the fact that last year, in 2017, we had in particular a few things that we don't expect to happen again this year. You've mentioned real estate, which last year was around EUR 60 million positive impact. And we knew that in 2018, we wouldn't have that much sales proceeds than a much lower amount. So that's the main reason why we knew it would be difficult to deliver the same amount of free cash flow, which was north of EUR 400 million. The second reason is that we have a substantial amount of restructuring this year in terms of cash-out and more than last year, I've mentioned that, year-to-date and will be the case for the full year. And therefore, for those reasons, it was challenging for us to deliver that same amount of free cash flow. Now we've indicated somewhat lower to show that it's not going to be a material and drastic reduction. And we're still looking for a substantial free cash flow, but not at the same level. Of course, I cannot give you anything more specific at this stage. What's very important for us, on top of the value of the free cash flow that we generate, is also to avoid what has happened in 2017, where essentially all the free cash flow were generated in Q4 for the reasons we discussed a few quarters ago. And from that standpoint, where we are today at the end of September is a much better situation. We are already free cash flow positive. And then we still expect a very strong fourth quarter, not as high as last year, of course. We also have, entering into the quarter, a lower level of working cap. But Q4 is also very, but not like every year, in order for us to deliver that guidance.

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**Marc Hesselink** - *ING Groep N.V., Research Division - Research Analyst*

Okay. So if I understand correctly, if I just take like the number of last year, I take out the real estate and I take out the restructuring charge and then I add something because your underlying business is improving, that's the good way of thinking about it?



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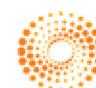

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**Stephane Rougeot** - *Signify N.V. - CFO & Member of the Board of Management*

Yes, yes, to some extent. But again, our goal, as you know, free cash flow for us is very important. So whatever happens, whether we have real estate sales, whether we make a contribution to the U.S. pension, which we did last year and which we are doing again this year, whether we spend more on restructuring, for us this is not an excuse to deliver a weak free cash flow. Now are the numbers always the same every year? No, obviously. But for us, delivering a strong and solid free cash flow in 2018 is very important. We are in a good position at the end of September. And Q4 is important, and we are working to make sure we deliver that free cash flow for the year 2018.

**Operator**

Our next question comes from the line of Leo Carrington from Crédit Suisse.

**Leo Carrington** - *Crédit Suisse AG, Research Division - Research Analyst*

On indirect costs, we've obviously seen very good momentum through this year in terms of the absolute savings amount. Do you think you'll be able to continue this acceleration in savings into Q4? And can you also remind us on how you see your factories for 2019 as well?

**Stephane Rougeot** - *Signify N.V. - CFO & Member of the Board of Management*

Yes, sure. So on the cost side, yes, we are quite pleased with the effect of all the initiatives that we are taking and the fact that there is an increase sequentially is, of course, very good. Now we've never given any indication with that respect. What matters to us looking forward, if you look at Q4, overall cost generally in Q4 are always higher than Q3 because it's a higher quarter also in terms of activity. But still, we expect a substantial reduction of our costs compared to the fourth quarter of last year. I'm not going to quantify how big it's going to be compared to the trend we've seen so far, but we're still going to continue to do that. As you have noticed, year-to-date, we have already delivered a reduction, without ForEx, of EUR 142 million. And of course, we expect on a full year basis that the overall amount of reduction is going to be higher than that. So further reduction to come in Q4. Now we're looking at 2019. And looking at what is it that we can do to continue to take out cost, but it's not just about reducing the cost, optimizing our footprint, reducing the FTEs. It's also about making sure we optimize our cost structure in order to be able to invest and make room for the areas where we want to spend more money, either in terms of technology or in terms of commercial activities and marketing activities. So there is a lot that we are working on right now to make sure we continue the good trend that we've had in 2018 into 2019. There will be, of course, a carryover effect. So a lot of the actions that we have taken in Q1, in Q2, in Q3 and again in Q4 are going to have an impact in Q1, Q2 and Q3 next year. But there is more on which we are working, while at the same time making sure we have room to invest and support the growth opportunity that we see across our businesses.

**Leo Carrington** - *Crédit Suisse AG, Research Division - Research Analyst*

Okay. That's very clear. And as a follow-up, can I ask, in Professional, you mentioned the sliding trends in Europe and China as well as the sort of tricky trends in mid- and large-sized projects in the U.S. Would you say your comments are reflecting the broader market or just your main addressable segments in the market, and whether you've actually seen a loss of share in the remaining segments where maybe you're not so strong?

**Eric Rondolat** - *Signify N.V. - CEO & Chairman of the Board of Management*

Yes, I think the comments that we're making are felt by other companies. I don't think this is something that we only see. I probably would agree with your underlying comment, which is that if we take specifically the U.S. on the stock and flow, which is a product-moving type of business, when I look at our performance compared with others, I think we're losing market share there. But otherwise, when I look at the situation in Europe, which I've been mentioning, in Professional specifically, when we listen to what others are saying, we're doing substantially better. So here, we're not doing market share on the country. I think that we are improving our position. In China, a more complicated situation. This is a Q3 phenomenon.



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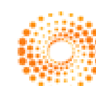

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We're studying it more in details. We -- when we talk about market share, the view that we have is 1 quarter before. So for this, I will -- I don't have such a clear view at this point in time. Probably, we'd be able to comment better by the end of the year.

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**Operator**

Our next question comes from the line of Peter Reilly from Jefferies.

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**Peter Reilly** - *Jefferies LLC, Research Division - Head of Capital Goods of Equity Research*

Can I just take you back, please, to the outlook for the LED lamps business. I understand you don't want to give a number, but you've had, I think, 2 or maybe 3 quarters now where LED lamps has been in decline. We've talked before about the whole issue of the business becoming mature and then rolling over. Do you think you've now reached or passed the peak of the LED replacement lamps business and we're now going into the decline phase on a value basis, even if there's some volume growth, because of the continuing rising penetration of private label?

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**Eric Rondolat** - *Signify N.V. - CEO & Chairman of the Board of Management*

So I don't think that we have highlighted that LED lamps have been in decline the past 3 quarters, but it doesn't really matter. Let me try to go directly to the question. We're approaching the moment when that market would start to decline. Originally, when you were looking at what -- and people studying the market had said it would be peaking in 2019 or 2020. It may happen a bit before that. I think that we see, though, at this point in time, it's not specifically that phenomenon. I think it's more a contraction in some markets at this point in time, where we see a global macroeconomic and a global commercial environment which is a bit tougher. But we could be in a situation where at the start of decline of the market of LED lamps non-connected, be anticipated versus the original forecast that were -- after 2019. Now Peter, there's another way to look at it. If we put together LED lamps connected and non-connected, this is a market that looks very differently. It so happens that the way we have organized our business, we have the non-connected part in LED and the connected part in Home. Now if we look at the market of LED lamps more holistically, putting together the non-connected and the connected one, it is again a different view that probably will not show the same type of growth because we see a very positive growth of the market of connected lamps. But to your question, I don't think it is happening now, a decline of non-connected LED lamps, but it may be happening a bit faster than what the original forecasts were. We're looking at it at this point in time. There's a lot of different factors to be taken into account. I don't think that we are there yet.

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**Peter Reilly** - *Jefferies LLC, Research Division - Head of Capital Goods of Equity Research*

Right. And if I can ask a follow-up on the U.S. project business. You've been saying for some time now that the small and medium-sized has been relatively soft. And I know you're big in outdoor lighting. In the space alone, you don't give us an actual size of the business. Can you just talk a bit more about what's happening in the outdoor project business, whether you just think there's some soft period you're going through or whether maybe a lot of projects have been done now, a lot of streetlights have been replaced and maybe the market is not saturated, but maybe the conversion rate is slowing? So maybe you can help us understand the trends there, please.

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**Eric Rondolat** - *Signify N.V. - CEO & Chairman of the Board of Management*

Yes. But I think what you say is true. We are more involved and we are stronger in outdoor than indoor, and that's the case also in the U.S. The projects that we are talking about are effectively small- to mid-sized to big-sized projects. And we have seen, since the beginning of the year, that market was softer in the U.S. for many different reasons, not so much because that market is saturated. If we do an analysis of all the streetlight poles that you have on the planet, which is maybe above 300 million, we don't think that more than 15% of that is LED yet. So that leaves a big perspective of what could be LED-ified moving forward. Now I don't have the precise percentage for the U.S., but I would say, okay, let's extend it because a few projects have taken place. And let's say that 20% of the streetlight poles are LED-ified in the U.S., that leaves a huge perspective for future projects. But at this point in time, for many different reasons, and the one that we have seen in Q3 are a bit different than before, is that



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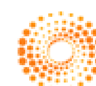

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sometimes, there's a shortage of labor to be able to manage the projects. And that part of the market has been slowing down, I would say, regularly across quarters, sometimes for different reasons, but we see the same pattern.

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**Operator**

Our next question comes from the line of Wim Gille from ABN AMRO.

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**Wim Gille** - *ABN AMRO Bank N.V., Research Division - Head of Research & Equity Research Analyst*

My first question would be on Home. Can you run us through what's happening in the channels, what you see in terms of sell-out? And in association to that, moving into kind of the holiday selling season, do you think that connected lighting will also become a major part of the Black Friday selling activity or advertising activity in the U.S.? So that will be my first question. And then my second question will be on the ambition that you have set per division in terms of margins. Do you still feel comfortable with those 2020 ambitions that you have? Or would you say that a bit of fine-tuning is in order in 1 or 2 of them?

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**Eric Rondolat** - *Signify N.V. - CEO & Chairman of the Board of Management*

So when we think about Home and the channels, so let's go back to the U.S. because this is where your question lies, so we are seeing in Q3 a lower sell-out than in the previous quarters. And I'm not going to come back to what I've said previously, but I've mentioned 3 different elements that explained that. More offers, retailers wanting to also have more offers and other type of industries beyond lighting, and specifically security doing a lot of advertising and coming with many offers to the consumer. Now we still believe that this is a dynamic market. We are participating to Black Friday. We are moving up on our advertising activities. And we still believe that in Q4, it's still going to be a dynamic business. So we are launching new offers, as I've said it previously, in many domains, more functional type of lights in bathrooms, in living rooms, expanding Hue outdoor. We've seen a very positive traction on Hue outdoor. By the way, we are the only company which is offering that breadth of wallet. And in outdoor, no other company has done it yet. So I think we're still very well positioned, but we need also to adapt to a market which is changing and evolving. When it comes to our margin ambitions, they are not for 2020. They are for 2019. And at this point in time, when you look at the progression of the company, back in Q2, when we confirmed our guidance for the year for the operating margin for the whole company, you see that now at the end of Q3 and year-to-date, we are in a position where we are above last year in terms of operating margin at 9.2%. And we're confirming that the company is going to achieve the guidance that we gave for the year, but being at the low end of the interval that we give. That was between 10% to 10.5%. Then that positions us well to be able to do the next transition to the guidance in 2019 and do a calculation that I've done myself. You look at the impact of Home, which is not a good performance for 2018 for all the reasons that we have mentioned previously. So if you look at that business, it's going to have a very negative impact on our whole profitability for 2018. Let's imagine, and we're working hard on that, that we are going to have a good Home business in 2019, so we will not have the negative impacts that we had this year. If you do just that and you look at the improvement that should come just from that business being fully normalized, you will see that, that brings us already very close to the mid-term guidance that we had given for the company overall in operating margin. So that's just a proxy to show that what we had given at the time of the IPO, which seemed very ambitious by many, is something which is going to be at reach, especially after the performance in 2018. As a consequence, if we reach the objective for the whole company in 2019, we also believe that we are well positioned to do that for the individual businesses. I think we're already there for Lamps, and we are already there for LED. We have a great progression for Professional that need to continue to materialize in Q4 and next year. But if you move the progression of Professional in the past 2 years, after the Saudi situation 3 years ago, that was a bit more complicated for us, has been according to expectations. And for Home, we said 5% to 8%. At this point in time, we have no reason not to maintain that because we believe that's what Home should be able to deliver, I would say, "cleaner," without what we have experienced in H1 this year.

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**Operator**

We are now approaching the end of the call. We will now take our last question from the line of Alok Katre from Societe Generale.

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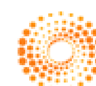

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**Alok Katre** - *Societe Generale Cross Asset Research - Equity Analyst*

Alok Katre from SocGen. Firstly, in terms of a follow-up, on the manufacturing costs, obviously, we've seen some really good reductions in the year-to-date. Just wondered if you could just explain how much have you realized in the P&L versus how much have you achieved in terms of the actions, i.e., how much is pretty much in the bag, what yet to hit the P&L in the coming quarters versus, let's say, your original target of reducing non-manufacturing cost by about 4 percentage points of sales? So that was the follow-up. And then my main question, really, is just stepping back and saying, clearly, you're struggling with in terms of growth and its macros of different factors. But if you look at the next couple of years or so, what can you do and what are you sort of planning to do in terms of getting the sales up? And how confident are you that you can do this given the macro situation that exists? Because clearly, I guess, if we are just to believe in your longer-term EBIT improvements and cash flow, you need to see some sales improvement, if not massive.

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**Stephane Rougeot** - *Signify N.V. - CFO & Member of the Board of Management*

Yes maybe, Alok, let me take the first one on NMC, indirect cost. So if you look at Q3, with the EUR 458 million that we have delivered, this is 28.7% of sales. And that is a substantial reduction, 230 basis points compared to last year as a percentage of sales. So, we're really heading now much closer to where we should be in terms of the target we gave, which is between 25% to 29% of sales. If you look at year-to-date, the first 9 months, we're at 30.9%, which is 140 basis point reduction despite the lower sales. And again, as I've mentioned, we expect moving forward in Q4 and later to continue to benefit from the actions that we have engaged and also to benefit from new actions that we are engaging. Now to your question, how much is already in the bag compared to what is in the P&L. As I've mentioned, there is a carry-over effect that is going to continue to impact us favourably in Q4 and in at least in the first part of next year and, to a lesser extent, later in 2019. But again, we are not stopping. On every quarter throughout the organization, we find opportunities. This is really how the overall company is now geared up. And therefore, there is more to come. And yes, we are comfortable that we're going to get now into the range that we gave in terms of NMC as a percentage of sales. And we are pretty satisfied with the speed and the progress that we are making on that front. So I'm not going to be able to give you a very quantified answer on how much is to come. But yes, for sure, there is more to come.

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**Alok Katre** - *Societe Generale Cross Asset Research - Equity Analyst*

Sure. So you should be pretty much close to the 27% on a full year -- or let's say, at the midpoint, which is 27%, on a full year basis in 2019? Is that pretty much based on whatever actions you've taken so far? Or like you said, do you need a bit more new actions in Q4 or Q1 next year to sort of reach that?

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**Stephane Rougeot** - *Signify N.V. - CFO & Member of the Board of Management*

So yes, I guess, it's a nice try to make me give another guidance for NMC for 2019. And positively, I'm not going to do that. But what matters to us is really the dynamic and how much we're improving, and we'll further improve in 20 -- in Q4, for sure.

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**Eric Rondolat** - *Signify N.V. - CEO & Chairman of the Board of Management*

The second question, Alok, on the most strategic viewpoint, after the IPO, we had basically, including 2016, 4 years to continue the turnaround that we have started 3 years before that, which is basically changing 90% of the portfolio of the company and creating 2 new business models. And we have the objective in 2019 to bring the company to a level where we would be double-digit profitable. And we would have repositioned our businesses in the right way, meaning smaller but well-managed Lamps business and LED business that would be double-digit profitable. And then the clear 2 new profit pools are for us, as we described them at the time of the IPO and even before, which are Home and Professional. I think that we've done that turnaround, and that's the most important thing for us. And we're very, very focused on achieving that guidance that we gave for 2019. Now are we struggling with growth? What we need to understand is that when you look at the comparable sales growth of Signify, you need to take into account that only one-third now, but much more before, of our business is made of a business which is declining double-digit and a business which happens to be the most profitable. So having been able to increase our profit despite that was part of the challenge. If you look at the other activities, despite Lamps, they are growing. So we're creating weapons for the future. And these weapons are what you see today,





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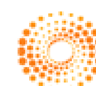

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but also what we are preparing for the future. So you may have heard that we talked about horticulture, we talked about solar, we talked also about LiFi. We were the first company in the world to fully commercialize and offer LiFi for offices. That offer has been launched at the end of the first quarter worldwide. We start to have projects and pilots all over the world. This is picking up extremely well. So we are also preparing the growth for the future. Now moving forward, less impact of the Lamps business, which is declining on our overall portfolio, and the other businesses relaying with their growth -- the overall growth of the company. That's what we said should happen. Now we will give, in the course of 2019, a new guidance for the years to come. And this is where we're probably going to be a bit more precise on all these different dimensions.

**Operator**

Thank you very much. And I would like to return the conference call to the speakers.

**Robin Jansen** - *Signify N.V. - Head of IR*

Yes, ladies and gentlemen, thank you very much for attending today's earnings call and for taking part in the discussion about our results. If you have any additional questions, please do not hesitate to contact Investor Relations. We're happy to answer your questions. And again, thank you very much, and enjoy the rest of your day.

**Operator**

Ladies and gentlemen, this concludes today's conference call. Thank you very much for attending. You may now disconnect your lines.

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