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PRESENTATION

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

Good morning, everyone and welcome to the Signify Earnings Call for the Fourth Quarter and Full Year 2018 result. With me are Eric Rondolat, CEO of Signify; and Stephane Rougeot, CFO. In a moment, Eric will start with a welcome and introduction, after which Stephane will take you through the fourth quarter financial performance. As usual, Eric will then tell you more about the highlights for full year and will end today's presentation with the outlook and conclusion. After that, we will be happy to answer your questions. Our press release and the 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 this conference call will be made available as soon as possible on our Investor Relations website. With that, I will now hand over to Eric.

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 straight to Slide 4. So first, I am pleased with the solid progress we've made on the transition from conventional to LED and connected lighting Systems and Services. In 2018, our LED-based sales grew by 2.5% on a comparable basis to 71% of sales, and our installed base of connected light points increased from EUR 30 million at the end of 2017 to EUR 44 million at the end of 2018. We delivered on our financial objective to achieve a margin within the range of 10% to 10.5% in 2018. Our adjusted EBITA margin improved by 50 basis points to 10.1%, which includes a negative currency impact of 50 basis points. This margin improvement, on the back of a declining top line, clearly reflects our relentless efforts to simplify the organization and reduce our indirect cost base.

Our adjusted indirect cost decreased by EUR 224 million on a currency comparable basis, which is a reduction of about 10%. In line with our outlook, we generated a solid free cash flow of EUR 306 million, last year's free cash flow of EUR 403 million included both a net real estate gains of EUR 52 million and EUR 40 million lower restructuring cash out. In 2018, we returned EUR 462 million to our shareholders through dividend and share repurchases, with including the proposed dividend for 2018, we would have returned EUR 1.1 billion to shareholders as since our IPO in May, 2016.

As you know, sustainability is going to be my next point and is at the center of what we do, and we are very pleased with the progress we've made towards achieving on our sustainability targets for 2020. For example, we target to be capital neutral in 2020, we reduced our CO2 emissions by 43% in 2018, and we are now carbon neutral in-line with our markets. One market conditions are challenging, and we continue to focus on new growth platforms to strengthen our market leadership and progressively improve our growth profile, and we are initiating additional concrete actions to further simplify and optimize our cost.

All in all, we are confident to have built a solid foundation to deliver in 2019, on medium-term financial targets that was set at the time of the IPO.

Let me now go to Slide #5.

It is a very important slide for us. So today Signify is the leader in LED lighting and in connected lighting Systems and Services. We have been building this new worldwide leader focusing on growing profit engines, in line with our strategy to move to LED and connectivity, developing new growth platforms and creating new Systems and Services business models. As you can see on this slide, already, 77% of our sales in 2018 came from our growing profit engines, which also have improved their adjusted EBITA margin by 500 basis points to 8.6% since 2015. They now contribute to 66% to the profit versus 31% back in 2015. On the other hand, our cash engine, namely the Lamps business group, increased its leadership, optimizing cash to fund growth. Let me now hand over to Stephane, who will tell you more about the financial performance for our fourth quarter in 2018.

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

Yes, thank you, Erik, and good morning, everyone. Let's now move to Slide 7. And here you can see a snapshot of our Q4, 2018, financial performance for what Eric has just described, which are our 3 growing profit engine. So when you look at the performance of the growing profit engine in Q4, it reflects an improved top line performance in LED compared to the third quarter, while at the same time, Professional and Home suffered for the high comparison base in the fourth quarter of 2017. Compared to the end of 2017, we clearly saw a deterioration of the market conditions in various regions, and most notably, in China and in Europe. However, you can see in the last column that looking at the profitability for LED, we were able to deliver a significant improvement of this margin, which is now 14.4%, while Professional and Home were able to maintain strong margin, relatively close to the level of the fourth quarter of 2017 despite lower sales. Altogether, our growing profit engine delivered an adjusted EBITA margin of 12.4%, and this is an increase of 140 basis points compared to last year, and this is also despite negative currency headwinds. Let me give you a bit more details for each of the business groups. Starting on Slide 8 with LED. As you can see here, our comparable sales increased by 0.2% in the fourth quarter compared to last year. This is a sequential improvement, and this is due to LED Lamps, where the volumes continue to grow, and we saw also the price erosion slowing down. Our LED electronic business sustained its positive comparable sales trend. Looking at the margin, the adjusted EBITA margin improved by 460 basis points reaching 14.4%, mainly as a result of indirect cost savings. Turning to next page, Slide 9.

You can see here some of the business highlight of this quarter for LED. Let me highlight one of them on the glass filament decorative range expansion on the left-hand side of the slide. This is our new range of decorative LED glass filament bulbs. They capitalize on the trend for vintage-type bulbs, which we see everywhere. And they come in very classic shapes, and they come under premium, which of course, is great for our pricing and profitability. They use the latest LED technology, and they are around 80% more energy-efficient than the conventional light bulb, and they last 10x longer. On the LED electronic side, we have launched a new emergency driver solution in Europe, and this is a driver that is designed to secure light in case the normal main voltage is failing. And in that case, the driver immediately switches to battery mode in order to light up a little object for example, escape routes. Let's now move to BG Prof. on Slide 10. Here, as you can see the comparable sales declined by 6.9%. We all remember that the fourth quarter of 2017 was a very high comparison base, and the growth last year was 10.4%, which reflected, at that point of time, a strong market activity in various regions and also, as you remember a large-scale project in the U.S. In the fourth quarter of 2018, we experienced market conditions that were more degraded compared to the end of 2017 as we have commented along the year and most notably, in China and in Europe, more recently. The adjusted EBITA margin remained solid at 12%, which is almost the same level as the fourth quarter of 2017 as the indirect cost savings largely offset the impact from lower sales volumes.

Turning here to the business highlights for our Professional activity on Slide 11. For example, this quarter, we completed our largest ever connected architectural lighting project. This is a massive project for the Shanghai municipality, which involve dynamically lighting the city's iconic waterfronts with 3 bridges and above 40 buildings in the financial and tourist districts. We installed more than 50,000 connected light points, along a 1.2

kilometer stretch of the waterfront in Shanghai. This new lighting is expected to save the city between 50% to 70% of its annual lighting cost, when compared to the previous area that was lit by conventional lighting. Our Interact Landmark software is being used to control and manage the light on the building rooftops and also on the 3 bridges. The scale and the sophistication of this project illustrates our leadership as we are able to unlock the potential of connected lighting to transform cities and help them also be more energy efficient.

Let me now turn to Page 12.

Home. Our Home business here reported a decline in comparable sales of minus 2.6%. This was mainly due to the very high comparison base of the fourth quarter of 2017 as the retail partners that we have in the U.S. started to build up inventories in the second half of 2017. As you know, we've taken a number of corrective actions in 2018, and therefore, the performance of our Home business has now returned to more normalized level. You can see that from a profitability standpoint, with the solid level of sales in the fourth quarter and all the actions that we have taken, Home has been able to return to profitability in the fourth quarter, and deliver an adjusted EBITA margin of 8.9%, which is very close to the level that was achieved 1 year ago. So Home is back on track. And I would like here also to highlight a couple of business achievements of the fourth quarter that you can see here on Slide 13. Earlier in the year, you remember that we launched a new range for Philips Hue Outdoor luminaire and light strips, in order to extend the ambience of Philips Hue from inside to the peoples' garden. Earlier this month, at CES in Las Vegas, we build further on this success, and we announced many additions to the outdoor range, including a variety of wall-mounted outdoor fixtures and path lighting as well and also, the battery-operated Philips Hue Outdoor sensor and with this new sensor, it can welcome you into your home with light as you approach. Moving on to Lamps, which we call our cash engine. You can see on Slide 14 that this business, being the world leader in conventional lighting, enables us to leverage the strong commercial synergies that we have in brand coverage and customer reach with all the other businesses within Signify. As a cash engine, Lamps continue to deliver on its last-man-standing strategy, and this resulted in further market share gains in the fourth quarter in 2018 and the strong free cash flow generation for the whole year that reached EUR 308 million. As a percentage of sales, free cash flow was stable at 22%, when excluding the real estate proceeds that we had in 2017 and also, as you can see some higher restructuring cash out during the year. Let's turn to Slide 15 and take a look at the adjusted EBITA bridge. As you can see here, the adjusted gross margin for the group, as a percentage of sales, decreased by 120 basis point in the fourth quarter compared to last year. This was mainly due to a negative currency effect of 50 basis point and also, the impact of the high comparison base of last year. The negative ForEx impact was mainly caused by adverse swings in emerging market currencies that we have seen along the year like the rupee in Indonesia, the Brazilian real, the Argentinian peso, also the rupee in India. You can see also that the impact of price on the gross margin continues to be largely offset by the savings that we've been able to obtain on the cost of goods sold, and we have also benefited, like previous quarters, from the strong reduction of our indirect cost, and Eric will provide more details about all the initiatives that we have taken.

Let's now take a look at the working capital from the fourth quarter of 2018.

So when you compare with the same period of last year, we actually continue to decrease our working capital by EUR 61 million and at the end of the year, our working cap was EUR 536 million. This is 8.4% of sales, and this is even lower than -- the level that we reached at the end of 2017. So that is a very strong performance on the working capital side, and the improvement was mainly driven by the lower receivable.

When you look at the inventories, they were 50 basis point higher as a percentage of sales compared to the end of 2017, and this is mostly due to the negative impact of currency movements. Finally, let's take a look at the evolution of our net debt. You can see here on Slide 17 that the net debt of the company decreased by EUR 148 million compared to the end of the third quarter. This is mainly due to the free cash flow that we generated during the quarter, which was partly used to repurchase the shares and complete our program and during the quarter, we bought for EUR 125 million of shares. Next to the profit that we generated in the quarter and also the decrease in the working cap, which I just mentioned, you can see some other elements in the bridge that affected our free cash flow. The net CapEx was EUR 40 million and also, the net change in provision was EUR 45 million. Next to that, we paid EUR 29 million of tax and interest. All in all, that allowed us to decrease our net debt position to EUR 589 million at the end of 2018 compared to the end of September, 2018. Let me now hand back to Eric, for the highlights on the full year and the outlook.

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

Thank you, Stephane. Let's turn to Slide 19. So as you can see our comparable sales growth of our growing profit engines combined was minus 0.4%, which is on the back of a high comparison base, deteriorating market conditions in various regions, and the nonanticipated temporary decline in Home. Profitability of our growing profit engine increased by 320 basis points over the last 2 years. In 2018 profitability increased by 30 basis points, despite the negative impact of Home of about 100 basis points and a negative impact from currency movements. The growing profit engines, as we call them, already generate a large free cash flow as you can see in the graph on the right side. Free cash flow generation continued to increase in 2018 despite the nonanticipated negative free cash flow from Home. Let me tell you more about our new and promising growth platforms on the next slide.

So we are investing heavily in the fast-growing areas of horticulture, solar, and LiFi as these areas all contribute significantly to a more energy-efficient usage of electricity and hence, strongly support our company's contribution to realizing a more sustainable world. Let me start with horticulture. Growers can benefit from our customer-centric approach in which knowledge from the plant specialist, account manager and application engineer are combined to offer the customer the best service. And they benefit, of course, from our market leading products and light recipes. The business results improve as our lights provide growers with better growth predictability, higher crop quality and higher yield. This market is projected to grow by more than 20% per year until 2025. All of our main highlights in horticulture in 2018 was the expansion at Agro-Invest in Russia, where after the successful installation of Phase 1, our customer decided to expand from the equivalent size of 40 to 100 soccer [pitches] . We also see -- I also see great opportunities in solar. Let's have clear in our mind that there are still more than 1 billion people who do not have access to the electricity grid. Solar power lighting provides this access, showcasing the vast potential of this market. Solar is a safe and sustainable alternative to currently used fuel-based resources, both in the Professional, and in the consumer markets.

The market for solar lighting is expected to grow by 20% per year until 2024. In 2018, we sold more than 300,000 solar lights, which approximately 55,000 are related to road lighting. The last growth area I want to highlight is LiFi. In 2018, we were the first major lighting company to LiFi enable some of our existing luminaires. As you know, LiFi provide an extra layer of security versus solution that are based on radio waves as it is based on line of sight. The bandwidth is more than 1000x the size of the radio spectrum used by Wi-Fi. So it can connect many small devices and multiple users. Usage of LiFi is ideal in radio frequency sensitive areas like hospitals, clinics, factories and schools or area with poor or no Wi-Fi connection at all, like for instance, [multi-currency] building. We see a very healthy appetite for LiFi, which is reflected in the fact that since our first pilot with ECAD in France, in the first half of 2018, we now have more than 50 pilots in all corners of the world.

Let's now move to Slide 21. Here, we show the comparable sales growth and adjusted EBITA margin for our growing profit engines and also for our cash engine.

So let me give a few comments. In LED, we had a comparable sales growth for the full year of 0.4%, and improving top line in LED electronics was offset by the nonanticipated decline in LED Lamps. The adjusted EBITA margin improved by 180 basis points to 11.7%. This one mainly driven by procurement savings and indirect cost savings. In Professional, sales declined by 0.4% on a comparable basis. This was mainly due to deteriorating market conditions in various regions, especially in the second half of the year that we talked about earlier. The adjusted EBITA margin in Professional improved by 120 basis points, mainly driven by lower indirect costs. In Home, we had a comparable sales decline of 3.8% in 2018, given the inventory buildup at our trade partners in the USA. The adjusted EBITA margin of minus 8.1% mainly reflects the nonanticipated temporary sales decline, which consequently led to under absorption of the fixed cost base.

In the course of 2018, a set of actions was taken in Home to improve performance, which started to deliver results in the second half of 2018, and as Stephane mentioned, return to performance to normalized level in Home at the end of the year and very specifically, in Q4. On the other hand, our cash engine. Lamps continue to deliver on its last-man-standing strategy, which resulted in further market share gains and a free cash flow of EUR 308 million. Let me now move to Slide 22, where we can see and you can see the evolution of our indirect cost savings. So we are executing on a multiyear-transformation program to simplify the organization. In full year 2018, we lowered our indirect cost base by EUR 224 million on a currency-comparable basis, which is a decline of 10% or 180 basis points of sales. As a result, the adjusted indirect cost base decreased by 170 basis points to 29.8% of sales, keeping the company well on track to further improve the adjusted indirect cost base. The significant reduction of our indirect cost base in 2018 was mainly the result of the transformation initiatives that we explained to you, we were implementing. For example, we reduced the nonmanufacturing workforce by 10% through simplification of the organization, which also resulted in 80% reduction in contingent workers. Furthermore, our indirect material spend decreased by 50 basis points as a percentage of sales. At the same time, we decreased our office space by 12% and improved our direct shipment and digital capabilities.

Let's now take a closer look at our achievements in our 6 sustainability targets on the next slide.

First, sustainable revenues. 79% of our revenues were sustainable in 2018, nearing our 2020 targets of 80%. On a cumulative basis, we sold EUR 1.7 billion LED lamps since 2015. We are the only lighting company in the world that has achieved that level of performance. So as far as we concerned, we have now achieve 87% of our commitment and are thus ahead of track to deliver more than 2 billion LED lamps by 2020. We also target to be carbon neutral in 2020, and we reduced our CO2 emissions by 43% in 2018, and we are now carbon neutral in 9 markets. 100% of our sites should be 0 waste to landfill by 2020. In 2018, we reduced our waste to landfill by 30%. We also want to ensure a safe and healthy workplace for our employees. We reduced total recordable cases by nearly 60% compared to our 2015 baseline. And finally, we had business sustainable supply chain, 93% of our risk suppliers have been audited, already achieving on our 2020 targets. Let's now go to Slide 24, to talk about our intended capital allocation for 2019. So we will propose to pay cash dividend of EUR 1.30 to be paid in 2019. This represents an increase of 4% compared to 2017 and a payout ratio of 46% within the interval of 40% to 50% that we indicated earlier. In line with our capital allocation policy, we will continue to exercise disciplined management of our balance sheet, and we look for a nonorganic growth opportunities, primarily through small- to medium-size acquisition. If in the course of the year, the funds needed for nonorganic growth opportunities are substantially less than the available capital, we will consider other uses of our capital, which includes returning excess cash to shareholders through share repurchases.

Let me now move to Slide 25, and let's have a look at what we've done under our capital allocation policy since our IPO. So since 2016, we have generated a solid free cash flow every year, resulting in a total free cash flow of EUR 1.1 billion. This has enabled us to maintain a financing structure that is compatible with an investment-grade profile. In terms of cash uses, we will have paid cash dividend of EUR 492 million since the IPO, including the proposed dividend over 2018. We considered various small- to medium-sized acquisition opportunities that resulted in the acquisition of the Chinese urban lighting company, LiteMagic in 2018, which enables us to better capitalize on the large and fast growing urban lighting market in China. In 2017, we acquired some small companies, of which Stack Lighting and PointGrab are 2 examples. Next to this, we made EUR 140 million of additional contributions to the U.S. pension fund since our IPO, which reduced our liability and future interest expenses. In addition, we use EUR 68 million since the IPO to repurchase shares to cover performance shares plan and EUR 563 million to repurchase shares for cancellation.

Let's take a step back and have a look at how we improve our financial measures over the last 5 years on Slide 26. The transition of our company is evolving successfully. Our LED-based sales now represents 71% of total sales in 2018, while this was only 26% in 2013. At the same time, we have significantly improved our profitability. Our adjusted profit EBITA margin improved by 370 basis points since 2013. As we are moving to a more asset light business model, we have more than halved our gross CapEx to only 1.3% of sales. And as a result, we have continued to generate a solid free cash flow, which was 4.8% of sales in 2018.

Let me now turn to our outlook and conclusion.

So on Slide 28, you can find our outlook for 2019. So in 2019, we expect our growing profit engines combined, which namely is the combination of the LED, the Professional and the Home business groups, to deliver comparable sales growth in the range of 2% to 5%. Our cash engine, the business group Lamps, is expected to decline at a slower pace than the market and in the range of minus 21% to minus 24% on a comparable basis.

For total Signify, we aim to reach an adjusted EBITA margin in 2019 within the range of 11% to 13% as set at the time of the IPO. Based on the prevailing spot rates at the end of December, 2018, the currency impact on the adjusted EBITA margin for full year 2019 would be around minus 50 basis points, and around minus 130 basis points, specifically, in Q1, 2019. We expect a restructuring P&L charge of between 1.5% to 2% of annual sales. And the free cash flow is expected to be above 5% of sales in 2019. So this was for the outlook. Let me now turn to the next slide, Slide 29.

Here, we show our progress made on achieving our 2019 adjusted EBITA margin of 11% to 13%. We present the slide in a very much identical fashion to what we showed last year at a same period. So as you can see in the period, 2013 to 2018, we improved our adjusted EBITA margin by 370 basis points to 10.1%, which means that we are on track to achieve our 2019 margin target. Our performance in LED illustrates the benefit of our strategy focused on innovation and indirect cost savings. This enabled us to already reach the high-end of our 2019 adjusted EBITA margin of objective of 10% to 12% in 2018. Professional continues to implement its strategy focused on Systems and Services, LED luminaires sales and the continued rationalization of its cost structure. This support the objective to increase the adjusted EBITA margin to 11% to 14% in 2019. Home strategic focus is to realize profitable growth by driving the transition to connected lighting for consumers in and around the house. Its strategy priorities include strengthening the Phillips Hue offering, expand in growth market and broadening the lower cost portfolio to drive volumes. As operational performance in Home has now returned to normalized levels, these priorities are expected to enable Home to be within the adjusted EBITA margin range of 5% to 8% for 2019 as we indicated earlier. The performance of our cash engine, Lamps, reflect the successful implementation of our last-man-standing strategy to increase our leadership in conventional products and optimize cash to fund growth. We feel very confident that the cash engine will again be able to deliver on the adjusted EBITA margin target of at least 16% as we set out at the time of the IPO. Let me now close by saying that we remain very confident about our long-term strategy. We continue to invest in growth and innovative offers despite more challenging macroeconomic environments to capture the strategic opportunities of smart and connected lighting. Well, with that after having talked a lot, I would like to open the call for questions, which Stephane and I, will be more than happy to answer.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Leo Carrington from Crédit Suisse.

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

On the Home division, can you give us an indication of the sellout rate that you saw through the channel? And how do you see the current and evolving demand and competition trends there?

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

Yes, Leo. So on the Home -- so first of all, we have done what we said we would do during the year. We thought that Q1, Q2 and Q3 would be partially impacted and that we would come to normalized level in Q4, at least from the P&L perspective, and that's the case. We have seen the selling out rate diminishing all around the year. Given the fact that--well, this business becomes bigger that there were also other offers going to the smart Home that took part of the pie that we were enjoying previously. And it's also true that competition and alternative architectures are also in place now. We still believe that we enjoy, nevertheless, a very strong market share, but we have an offer, which is the most comprehensive on the market at this point in time, but we are looking also at what is happening on the market in terms of alternative architectures and what some competitive offers also providing to adapt, but the selling out has lowered during the year as we started, I think, to mention it in Q3.

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

Okay. And as a follow-up, can you give us an indication of how you expect margins in this division to progress? Just for both 2019 and beyond, do you -- anticipating to continue to build the development and marketing spends? Or is this spend now at the right kind of level and you can begin to see margins step-on?

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

I think Leo, for that business, and especially the connected part, which is pool business spending in marketing activation is absolutely fundamental. It builds the market, but it also educates customers, and this is something that we definitely need to continue doing in that business. The margin expansion that we have experienced over the years is allowing us to do this. So we will continue to do that. Let's remind also that, that business in 2017 was performing at an adjusted EBITA level of 2.3%. You know what happened in 2018, I think that now we're starting from a clean sheet again, and we believe that we can continue to expand the margin in line with the target that we have given in 2019. We will give a new guidance beyond that when time comes in the course of 2019.

Operator

Our next question comes from the line of Andreas Willi from JPMorgan.

Akash Gupta - *JP Morgan Chase & Co, Research Division - Research Analyst*

It's Akash on behalf of Andreas. My first question is on LED margin's driver there. And maybe if you can talk about what was the benefit of your prices relatively holding up against LED chip prices? Which we have seen, at -- declines there accelerating in recent months. And how do you expect this price cost in LED chips to trend in 2019, what you have baked in your guidance?

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

Yes. Let me take that one. So I'll expand on LED profitability, but to your question regarding the price cost on LED chips. Yes, we've seen a number of components for which price has continued to decline. You also remember that for some components there has been more tension. I think what matters to us is that, overall, especially on LED, we've been able to do a good job again in 2018 at extracting savings from the bit of material in the way we negotiate with suppliers, but also in the way we design product and construct savings activities. And that has enabled to really offset the last part of the price decrease. Now, you're right, we have also seen, since now, several quarters a slowdown of the price decline for LED both in LED lamps, but also in LED electronics. And when you put the 2 together, this is also what explain that we've been able to improve the profitability. Now the 14.4% that we have reached in Q4, is also driven by the overall indirect cost reduction that have happened throughout the company, but also specifically in our LED activity. And that has also helped increase the profit compared to a year ago. So it's really a combination of those 2 elements.

Akash Gupta - *JP Morgan Chase & Co, Research Division - Research Analyst*

And a follow-up on EUR 23 million other business income in Q4, P&L. Maybe if you can elaborate where that is coming from? And whether there is any gain that we should be aware of?

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

No. Nothing particular yet. There has been some tax elements that have been settled, which for accounting reasons, because they were related also to some Philips discontinued activities at the time of the separations are booked in the OBI. They don't show up in the adjusted EBITA, and that's why we record them in the OBI and this is also why that we have not included it in the tax line. But again, they are not accounted in the adjusted EBITA, but nothing that is recurring here.

Operator

And our next question comes from the line of Daniela Costa from Goldman Sachs.

Okay, and Daniela seems to have dropped off. So our next question comes from the line of Peter Olofsen from Kepler Cheuvreux.

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

My first question is on the indirect cost savings. We've seen a clear ramp-up in savings since the middle of 2017 to just over EUR 80 million in Q4. Do you think that, that kind of run rate is sustainable in 2019? Or could we see that potentially level-off? And then a question on the free cash flow outlook. Stephane, what do you assume in terms of cash out related to restructuring, will that be broadly in line with the P&L charge? And do you think there is further scope to improve the working capital? And if so, in which areas?

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

Yet, so let me start with the indirect cost reductions. You're right, when you look at the quarterly evolution with all the actions that have been taken at the beginning of the year, and also along the year, we have seen an increase of the indirect cost savings every quarter. I don't know exactly what you mean by trend, but I don't think the trend of the increase, quarter after quarter, is something that we are going to continue, but conversely, we don't intend to level-off or to now be stable on the cost side. We believe that there are further opportunities in terms of productivity, in terms of the efficiencies, in terms of indirect cost -- indirect material spend, that we are working on and that are going to come in order for us to continue to reduce, in absolute value, our indirect cost. So that is something, of course, we are going to benefit, especially, at the beginning of 2019 of the carryover effect compared to 2018 of the cost reductions, but there are other actions that we have taken in the second part of 2018, and that we will take also in 2019 that will allow us to continue and maintain that trend. On the free cash flow outlook, and more specifically on the restructuring from a cash out standpoint, we expect that in 2019, the restructuring cash out is probably going to be relatively close to the level of 2018. And compared to the P&L charge, probably we will have another year where the cash out is going to be a little bit above the P&L charge itself, and that's the way we see 2019 at this stage.

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

And working capital, any scope for improvement there?

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

Cap -- no, you're right. On the working cap as I have mentioned as you can see 8.4% is quite a reduction. It -- even better than the end of 2017. There are still a number of actions that we are taking, both in terms of supply chain that will allow us to improve on the inventory side, but also in terms of payment terms, which we believe can allow us to further optimize our working cap. So we believe there is further room for improvement here, and we are working on that.

Operator

And our next question comes from the line of Martin Wilkie from Citi.

Martin Wilkie - *Citigroup Inc, Research Division - Director*

Yes. It's Martin from Citi. Just a question on the outlook for Professional. I mean, you talked about some challenging markets and highlighted a couple of regions. When you look at the margin uplift that you need next year to get into the range, can you do all of that from cost savings? Does Professional get perhaps a bigger share of indirect cost savings in 2019? And have you assumed stability in the end market to get to that level of profitability? Or do you think that you can get to that margin level just from the cost savings even if we continue to see the challenging markets during the course of 2019?

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

Yes, Martin. I think that's a very good question on Professional. When you look at the performance in Q4, with a lower top line than Q4 the same period the previous year, we've been able to achieve the same adjusted EBITA as a percentage. So we have clearly brought the break-even point down. So that P&L is extremely leveraged. So multiplying immediately translates to the bottom line. There were very strong actions that we implemented during the year in terms of cost reductions, not only at the level of that business, they also benefited from the cost reduction that we did also at the level of the group. I believe, that with 2019 in order to go where we want to go, we need to have both. We need to have the continued improvement of the cost base, and we also need to have some top line positive traction. The 2 are going to be necessary. Once again, when you see what we doing in that business, it's not only LED luminaire where we've progressed a lot, it's Systems services, but also the new growth platform that we have been mentioning, and that we have plans to develop and to deploy, once again, providing growth in 2019. I've talked about horticulture, I've talked about solar, and they are tangible projects coming on for the year in 2019. So we need both, we need growth, and we need to continue improving our cost base.

Martin Wilkie - *Citigroup Inc, Research Division - Director*

And for that top line traction, so it's much more about your own product offerings as opposed to assuming that we suddenly see a reflection in the underlying markets, which obviously, still remain a little bit questionable as to whether we see some underlying improvement quite yet?

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

Well, on the traditional parts of the business, this is why I'm mentioning the new growth platform, we were taken back -- at the back end of the year by end market that had been so far very strong. I want to talk about greater China started to degrade in Q3 and continued Q4. And Europe, I mean if you look at Europe in Q4, 2017, that was a very, very strong geography for us for Professional. In mostly all of the country, except for the U.K., and though we've seen at the back end of the year in Q4, Europe really slowing down. So what happened is that projects were either canceled or delayed. Now, after having said all that, we have a plan for 2019 on which we are executing. And we believe, we have the capabilities from a top line perspective and also, from a cost reduction perspective to achieve at the midterm target that we have indicated.

Operator

Our next question comes from the line of Athira Pradeep from Goldman Sachs.

Athira Pradeep - *Goldman Sachs Group Inc., Research Division - Research Analyst*

I just had a quick follow-up on something that you already mentioned. You mentioned that your sellout in the Home division is decreasing. So what is making you confident on your top line assumption of 2% to 5% without Lamps? Given that your sellout in the Home has decreased and also, given recent construction trends that you've mentioned like in Europe and China?

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

So first of all, if it has decreased, it's still dynamic. And when it comes to Home, we also are betting on the geographical expansion that we are forecasting. There are 4 key markets for us, where we have already launched the product and where we believe that we could also have interesting growth prospects. We're talking about Indonesia, we're talking about India, we're talking about Japan, we're talking about China, where I think that we are, at this point in time, at the very beginning of the S-curve. So there is so much that we can do there. So that's another source of growth for us for that business.

Athira Pradeep - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Okay, great. And just a quick follow-up on your FCF guidance. Could you be able to ascribe your other FCF parts? Which is you haven't ascribed it to either Lamps or non-Lamps. What else is excluded from your divisional FCF breakdown?

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

Yes, as you know, we bought our 4 BGs, and then we have a segment that is other, which is negative EUR 87 million in terms of adjusted EBITA. If you take the nonadjusted, it's minus EUR 137 million. And this is mainly corporate cost that don't have to be, and should not be allocated, to the business groups. And as well as some core research activities. So it's a mix of those elements, and this is what we report every quarter. In addition to that, we have all the tax, interest, some pension contribution that are not related to the business group people. So all these elements are in other and in terms of free cash flow, this is what they were present. And we didn't think we should then make an exercise to try to allocate all that to the BGs because this is unrelated to the performance of the BGs in terms of free cash flow.

Operator

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

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

Looking at the sales growth outlook for 2% to 5% for the growth businesses. Like for the separate divisions, what do you think that will drive that? Because you need to acquire some improvement versus what we have seen in 2018. I can understand that in the Home segment you have an easy comparable base in the first half of the year, but especially in Professional, do you have like order intake those kind of numbers to make you confident that you indeed go back to that higher growth level?

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

So I have (inaudible) must explain the -- on Home the geographical expansion. On Profs, yes, we see some potential projects and we see also that traction on the trade part of the business in some geographies, which is moving in the right direction. And I will [insist] , once again, on some of the new growth platforms that we talked about, systems, services, horticulture, where we are lining up interesting projects for the year. Also solar, and we may comment in the coming quarters about some project wins that could be quite substantial. So we have a plan today to achieve the year -- and to get to these levels. Now, we are also depending on the end-market microeconomics. It's been a very complicated world to do business in, in the past quarters. But we believe in what we're developing today that offers a redifferentiated promise to our customers and help us to win on daily basis against competition. But yes, it's not going to come from the usual business where we do exactly the same thing. Now we have to find and we have found a new growth avenue that we're currently developing.

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

Okay, thanks. And the other one is your comments on potential buybacks later in the year. How do you think of that? Is that driven by where your balance sheet is? And now at 0.9 x net EBITA, in the first half of the year, you have the cash-outs for the dividend. Is that the way you want to remain around that onetime level? And then in the second half of the year, when you get the cash-in again in the fourth quarter, you are thinking again on buybacks? Is that the way you think about it?

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

Well, we've always said that we wanted to be investment grade and that's the leverage for us. Had to be around 1. So that has been systematically our position. Now, we have always said that in terms of capital allocation, priority is for growth, but in order to find growth opportunities, nonorganic growth opportunities, we have been extremely selective. And if you go back at what we did in 2018, we did exactly that. We concluded some inorganic moves. We've talked about small ones and one a bit more substantial in China, and then we were left in the middle of the year with excess cash, we decided to return it to the shareholders. So I think we have a very consistent capital allocation policy, but one thing which is clear, we would like to find opportunities for growth in organic. If we find them, we will invest in them. If we don't find them, cash is not going to burn our hands to spend it. We're very selective, we're very disciplined. So far I think it has worked. The acquisition we've done in China, of LiteMagic, has been a very good one for us so far. It has also helped us to close the famous big project that Stephane has come commented about -- on the Shanghai Bund. Just imagine it's 40 buildings and 3 bridges with lights and completely connected and synchronized. And that technology has helped us to do that. Now, we're looking at that technology not only for what can be achieved in China, but there are some complementary elements in what that acquisition is bringing, that we are now selling outside of China. So this is what we're doing. We're looking at the right opportunity. If the right opportunity comes, we invest. If not, if we have excess cash along the year, we will return it back to the shareholders.

Operator

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

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

Can you give us a bit more color about what's happening in the Lamps business. It has been declining for some years at a high teens rate. You're now talking about low 20s in 2019. And, obviously, the part of your story has been to harvest the golden tail. What's happening with the business? Is the rate of decline going to keep on getting worse because the business is it going into more of an accelerated downturn as LED lights replace more and more the traditional light bulbs? So why is growth rate getting bad? Is it the start of a longer-term trend of the business that goes into an accelerated decline?

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

Yes, Peter. Specifically, in 2019, it's also linked to halogen. If you remember, halogen ban happening in the course of 2018. So we had inventory buildup and it increased the sales of the business in 2018. So we're going to have the negative impact of this probably in 2019. That's why the decline rates -- we see decline rates higher. That's especially the case in Europe. Otherwise, with those rates of decline, we're still declining much less than the market, continuing to gain market share. So very specifically in 2019, it's because of this.

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

Okay, and if I could just follow up on the outlook on the LED. You've got a very significant fall in the growth rate from 13% in '17 to about 0 in 2018. Can you give us a bit of an update on what the structure of LED looks like now? How much is the traditional declining or traditional LED lamps that have may be sold into (inaudible). How much is LED electronics? And obviously, the mix must have changed quite a lot over the last couple of years. That will help us to understand the medium-term outlook if you have a bit more color on what's happening in that business today?

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

Yes. The mix hasn't changed dramatically. We're still -- more than 1/2 of what we sell in that business is LED lamps. And the rest is LED electronics. So that hasn't changed dramatically. To your earlier questions, what we see in LED lamps at this point in time, is the start of the shift from people buying LED lamps to integrated luminaires. That's happening. But as far as LED lamps market is concerned, in volume, we still see growth in quantity of products. But price erosion and mix, meaning that we see customers buying more and more cheap LED lamps. We have a decline in terms of quantity and we see -- that's what we see at the market level at this point in time. It doesn't mean that the market is in decline, at least, in quantity of products, not yet. So you would remember that the people doing marketing of LEDs were saying 2019, 2020 would be the pickup of that market, at least, in quantity of products. That's what we also see.

Operator

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

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

Wim Gille, ABN AMRO. My first question is on the Lamps business based on your reply to your previous question about why the declines are accelerating. Is it fair to assume that the acceleration of the declines in 2019 is completely attributable to the fact that you have a relatively difficult comparable base due to the halogen ban in Europe? And should we be modeling more for the usual guided range of 18% to 22% declines as of 2020 again? And as a follow-up related to this, in your cash flow guidance, according to the outlook, you're going to make at least 5% in cash flows in 2019. This loosely translates into a modest increase in the free cash flow for 2019. If I look at your cash cow coming down quite significantly in 2019, where should we basically see the acceleration of the cash flow generation come from? Is it from your LED Professional and Home business, or is it, let's say, a reduction in the cash drag from other segments?

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

Wim, to your first question, we see it exactly as you've mentioned it. We've modeled it in the same way.

That's what explained the high decline in 2019. Then we go back to a more normalized '18 to 15% to 20% decline. After that, there is just one caveat. Is the potential ban of halogen in another geography like the Americas that is going to be decided later that may have an impact, but we will talk about that when we know.

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

Yes, and on your free cash flow question. Yes, you're right. The free cash flow guidance that we give, which is now expressed as a percentage of the total sales. If you apply purely the 5%, you end up with probably slightly more than what we've done in 2018. Now, we have indicated at least 5%. So our ambition is to be able to deliver more than that. And to your more specific point around what's going to drive that? You're totally right. It's going to be in the 3 growing profit engines. Because as you saw, they don't just generate profit increase, they also generate quite a substantial free cash flow and it's increasing. You saw the increase in 2017 -- sorry, in 2018 was plus EUR 47 million to pick out the real estate of 2017 in those 3 BGs.

In 2019, especially given that Home was negative in 2018, yes, we believe there is potential for significant increase of the free cash flow of the 3 BGs. And that's true for Home and I think it's true as well for Prof.

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

So the other cash flow for the minus EUR 372 million, that is going to stay broadly flat or is that going to come down as well?

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

Well, it's a bit difficult to say. It's going to depend first on taxes because a substantial part of that is the tax that we pay. So that's one element. The second element is as you know in here, we still have our pension cash-out especially the part that we contribute to the U.S. pension fund and we said that in 2019, we would complete the overall contribution providing another EUR 50 million of contribution. So we expect that one is going to stay there and that is the last one that we intend to make. So later on, that one will go away and it will improve the free cash flow. And then finally, the other segment, when you look at the adjusted EBITA, you can see that year-on-year, in 2018 versus 2017, there has been an improvement that's also because of our indirect cost reductions, which impact not just the business group but also the segment other. And we expect in 2019 to also improve there and to translate that into cash. So all in all, yes, I hope that these other segment in terms of free cash flow will also improve.

Operator

And our next question comes from the line of Sven Weier from UBS.

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

Just quickly following up on Peter's question regarding LED, the breakdown between the components and the Lamps. Can you just remind us about the difference in profitability? Are they both around the same margin level? That would be the first question.

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

Yes, Sven, as we've have said on an on, at the same level of operating margin.

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

Okay, and then the other one, just a housekeeping one on CapEx. Any guidance on CapEx for '19?

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

Well, we spent, in terms of CapEx, EUR 75 million in 2018. This is about 1% of sales. So we intend to stay within that percentage. We may do a little bit better but no major change there.

Operator

Our next question comes from the line of Alok Katre from Societe Generale.

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

Just one quick follow-up. In terms of the Professional side on the growth, when you're talking about the 2% to 5%. I mean, clearly, Europe and China are quite weak. The comparison base that you have in the first half of the year is a bit tougher over there. So just wondering -- and obviously, you talked about the LED dynamics, so just wondering on the 2% to 5%, is it really then dependent just on Home coming back in? And how large, therefore, in that context is horticulture and solar, the stuff that you're talking about in terms of the new growth avenues. So that's the follow-up and then I have one main question.

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

Yes, Alok, when we say 2% to 5%, it's the growing profit engine, which is the combined growth rates of Home, Professional and LED. So as it comes to what's going to happen along the year, of course, we start with a lower base of comparison of Home, but we expect also Home to perform all year long and bring its fair share of growth would be that the growth potential here in the market in which we are plus the geographical expansion is clear. In Professional, I know we're not giving an indication of how much the horticulture and solar can bring, but it can be quite material. We're talking about markets that are sizing respectively for horticulture and solar, EUR 600 million and EUR 2.7 billion, both growing at rates of 20% to 25%. So these are interesting opportunities, in which we have also, from a technological standpoint, taken a clear step ahead by developing adaptive solution with light recipes for horticulture or fully integrated street luminaire, the solar panels, the batteries and the lights. [So we are seeing the same frame] . So we have taken, we believe, some steps ahead against competition there. So -- and we are working on tangible projects. So I think for Professional, we cannot really distinguish the semesters in terms of base of comparison, weakened for Home as I mentioned previously and we see the whole lot including LED to -- growing back to 5% for the full year.

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

Okay. And then just the main question. I mean, I noticed that you now demarcate the Lamps and the non-Lamps business. Just wondered what was the thinking there in terms of doing it at this point in time because a lot of the dynamics that you talk about have been in place since the IPO. And the Lamps, in a way, to me it seems it's almost being put into a quasi-discontinued operations type of structure. So just wonder how we should read that and think about that?

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

Well, we have given an indication, Alok, that you wanted which is also the cash flows that were not indicated previously. We thought that at this point in time, we needed to show that what the future of the company is based on? Which are the growing profit engines? They are not only delivering top line over the years, they're not only delivering profitability over the years, but they're also delivering a cash, which is today superior than what our cash engine Lamps is providing. So we wanted also to put a strong emphasis on that part of the business. Now we continue to manage Lamps the way we've been managing it. It's not a discontinued operation. It's a very lead operation in what we do. But we believe that this is a business, which is basically made to generate cash, continue to increase its market share. We've done that along the years and we're going to continue. But where we are creating the future of the company? And this is what we want also you to focus on, is on the new or the growing profit engines. This is why we've done it that way. Giving you also more information so you can appreciate the contribution to the overall performance of the company of these growing profit engines.

Operator

We are now approaching the end of the call. We will now take our last question from the line of Annabel Asquith from Morgan Stanley.

Annabel Asquith - *Morgan Stanley, Research Division - Research Associate*

I just had a follow-up on the Professional free cash flow. You mentioned that the profit engines have increased free cash flow by EUR 47 million. Can you give any further granularity on which division that was driven by? What's the split, and how that might change in 2019?

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

Yes, that becomes, of course, quite granular. Yes, we've seen -- I think what we hinted to is the fact that given the performance of Home in 2018, it has remained negative in 2018. And we've hinted to the fact that we expect this to change in 2019 on the back of more normalized performance in Home, which is exactly what we have seen in the fourth quarter, and we expect now to be able to enjoy that throughout the year 2019. So that part is an important driver for the improvement. For the rest, those divisions are -- the 2 of those divisions are generating a substantial amount of free cash flow, and we expect both of them to continue to improve their free cash flow.

Annabel Asquith - *Morgan Stanley, Research Division - Research Associate*

Okay, great. And then just another question on the European luminaires. Can you give us some more color on the trends between volume and price you've been seeing and how much that has changed throughout the year?

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

For the pricing of European luminaire?

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

Yes.

Annabel Asquith - *Morgan Stanley, Research Division - Research Associate*

Yes, pricing and volume?

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

Yes, so Q4 level of activity was not as strong as a year ago, but I would say, overall, as we have seen in our trade business in Europe has been performing decently. On the price, yes, we've been pressured with the entrants on the low-end range by Chinese. That puts some pressure on price, but this is also different type of segment. So it's also more in the mix. So that's how what we've seen along the year but nothing in particular in the fourth quarter.

Operator

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

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

Thank you. Ladies and gentlemen, thank you very much for attending the call and for asking your questions about our results. We notice that there might be one or 2 questions left in the queue and we will call those people back. And for the other ones, if you have any additional questions, please do not hesitate to contact us and 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.