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LIGHT.AS - Q1 2019 Signify NV Earnings Call

EVENT DATE/TIME: APRIL 26, 2019 / 7:00AM GMT

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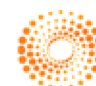

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CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

Alexander Stuart Virgo *BofA Merrill Lynch, Research Division - Director*

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

Daniela C. R. de Carvalho e Costa *Goldman Sachs Group Inc., Research Division - MD & Head of the European Capital Goods Equity Research Team*

Joseph Zhou *Redburn (Europe) Limited, Research Division - Research Analyst*

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

Lucie Anne Lise Carrier *Morgan Stanley, Research Division - Executive Director*

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

Martin Wilkie *Citigroup Inc, Research Division - Director*

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

PRESENTATION

Operator

Ladies and gentlemen, welcome to the Signify Earnings Call Q1 2019. (Operator Instructions) I would now like to give the floor to Robin Jansen, Head of Investor Relations. Mr. Jansen, please go ahead.

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

Thank you, and good morning, everyone. Welcome to Signify's earnings call for the first quarter results 2019. With me are Eric Rondolat, CEO of Signify; and Stéphane Rougeot, CFO.

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

Our press release and the related slide deck were published at 7:00 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. - Chairman of the Board of Management & CEO*

Thank you, Robin. Good morning, everyone, and thank you for joining us today. So let's go immediately to Slide 4 with the main elements of our performance in the first quarter.

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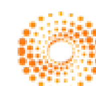

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Comparable sales declined by 3.3%. LED-based sales increased by 3.6%, now accounting for 73% of our revenues. We continued to make good progress in reducing our cost base. Excluding the impact of currency movements, our adjusted indirect costs decreased by EUR 39 million or 170 basis points as a percentage of sales. As a result, LED, Professional and Home improved their margins in the quarter, while Lamps was able to sustain its margin above 20%. Overall, our adjusted EBITA margin grew by 80 basis points to 7.8%, despite 130 basis points of negative impact from currencies.

Our net income, as you can see, more than doubled from EUR 20 million last year to EUR 44 million. We're all pleased with our free cash flow of EUR 55 million for the first quarter, which was EUR 44 million higher than last year, when excluding the EUR 17 million positive impact from IFRS 16.

I pursue that we now move to Slide 5, where you can see the usual snapshot of the financial performance of our growing profit engines, namely LED, Professional and Home businesses. Overall, our growing profit engines showed positive comparable sales growth of 1.1%, which was mainly driven by solid performances in Home and LED.

The adjusted EBITA margin of our growing profit engines improved by 210 basis points to 6.7%, with each business group contributing to the improvement despite currency headwinds. The growing profit engine substantially improved free cash flow compared with last year, and we were able to more than compensate for the decline in free cash flow in Lamps.

Let me now provide you with more details for each of our 3 growing profit engines, starting on Slide 6 with LED. So comparable sales declined by 0.2%. LED lamps showed a solid performance, while growth in LED electronics slowed down in Europe.

We continue to see price erosion slowing down on a sequential basis, and the adjusted EBITA margin improved by 230 basis points to 11.9%, mainly as a result of procurement savings and lower indirect costs.

On the next slide, Slide 7, you can see some of the business highlights. As for this quarter's LED, so let me zoom on the launch of TrueForce Urban in Europe, which is a launch that we use to replace conventional high-intensity discharge lamps. They not only create a pleasant and safe atmosphere in outdoor environments with LED retrofit, but they're also easy to install, create 80% energy savings with a payback period of less than 2 years.

Another innovation that I would like to highlight for this quarter is the launch of the world's smartest outdoor LED driver, which enables connect-ready and connected outdoor lighting. So the driver has a low inrush current due to IntelliStart, a driver-integrated feature, which is enabling a maximum number of light poles on a single circuit breaker. This driver also features integrated energy metering, with an accuracy of 1%. In addition, it allows high surge up to 10 kilovolts, specifically designed for tough environmental conditions.

Let's move on now to Professional, on Slide 8. Comparable sales declined by 1.5% due to a lower level of market activity in Europe and China, partly offset by a solid performance in the Americas. The adjusted EBITA margin remained stable at 5.3%. Continued indirect savings more than offset the negative impacts of currencies and mix. The mix was negative due to lower market activity levels, specifically in Europe.

There are a couple of business highlights that I would like to bring your attention on Slide 9. Let's start with Prime Delica. So we enabled that customer to grow healthier and safer crops for 7-Eleven customers in Japan. Through research, we helped Prime Delica to develop an optimal light recipe to increase vitamin levels and the nutritional value of lettuce.

This slide shows the vertical farm facility in Japan, a year round supply of high-quality lettuce, spinach and coriander, while reducing up to 90% on water consumption. Increased automation also resulted in reducing time from seeding to harvesting from 70 days to 39 days.

A second innovation that I would like to highlight is that we let our customers experience light before they buy it with our virtual reality app. So customers can now step into a virtual world and to visualize how lighting can transform their fashion store. Very accurate. We've been wondering enable retailers to immerse themselves in a virtual fashion store and see firsthand how lighting can make shop windows more dynamic to attract shopper's attention and draw footfall into the store. It enables retailers to sample different lighting design and find the right lighting for their store.

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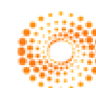

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Let's now turn to Slide 10, and talk about Home. So Home reported an increase in comparable sales growth of 24.4%. This was on the back of the low comparison based in the U.S. in the same period last year, while we experienced strong demand for connected offers in Q1 2019. The adjusted EBITA margin of minus 6.1% represents a substantial improvement compared with last year, and includes a significant negative impact of currencies.

Also for Home, we would like to share a couple of business highlights that you see on Slide 11. So we are especially proud of Hue's contribution to the 11 iF Design Awards that we won earlier this year.

First of all, we won an award for the redesign of Philips Hue app 3.0, which enables users to control and personalize their lighting. Also, 4 of our connected luminaires also won iF Design Awards.

I also want to highlight that we launched the Gentle Sleep & Wake feature. So this provides you with the ability to use voice commands with Google assistant to activate sleep and wake light effects using the Philips Hue functionality. So it represents this very first integration of the Philips Hue Sleep & Wake up feature, with a digital assistance platform.

Let me now move to our cash engine, Lamps on Slide 12. Comparable sales decreased by 17.9%. We believe that this decline is lower than the market decline, resulting in continued market share gains. The adjusted EBITA margin remained solid at 20.5%, as a result of ongoing indirect cost reduction.

Let me now turn to Slide 13 to briefly talk about the acquisition of WiZ Connected. So as you know, in the past year, we have successfully developed our smart lighting Zigbee-based offer, the Philips Hue for the Home. It has been market-leading from the very beginning till now.

Additional technology platforms, based on Wi-Fi, have emerged in the past quarters, and we believe that in the long run, these 2 platforms, Zigbee-based to Wi-Fi-based, will occupy complementary spaces on the market. We, therefore, decided to invest, to be present in both.

WiZ Connected, based in Hong Kong, has successfully developed the Wiz Wi-Fi-based smart home connected lighting ecosystem, which is currently offered in Europe but also in the U.S. So this acquisition enables us the expand our connected lighting offer for the Home and reach a larger customer base, which will strengthen our leadership position in connected lighting. 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 first quarter 2019. Stéphane, to you.

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

Yes. Thank you, Eric. Hello, everyone, and let's now turn to Page 15, where you can see the adjusted EBITA page. As you can see here, the adjusted EBITA gross margin as a percentage of sales decreased by 90 basis points in the first quarter compared to last year. And as we mentioned in the press release, that includes the major currency effect of 140 basis points. You can see also that the impact of price on the gross margin was lower than in the preceding quarters and is almost fully offset by the ongoing savings that we manage in our cost of goods sold.

The indirect cost base has decreased by EUR 39 million compared to the first quarter of 2018 outside of the ForEx effect. And overall on the profitability, we had a negative ForEx impact, which was -- mainly goes by the adverse swings in several emerging-market currencies, like Indian rupee, Indonesian rupee as well, Chinese renminbi and also the stronger dollar.

Based on the spot rate that we have seen at the end of March, we expect that the currency impact on the adjusted EBITA margin for the second quarter will be much smaller, probably around minus 20 basis points. And we also confirm that for the full year of 2019, at this stage, we see a negative ForEx impact of around minus 50 basis points.

Looking at our cost, which, as you know, is a very important area of focus for the company. We've taken a lot of initiatives into 2018 and also at the beginning of 2019. And as you can see, we are still able to reduce in a meaningful way, our cost. And that has resulted in a EUR 39 million currency comparable indirect cost savings in the first quarter and this is an 8% reduction year-on-year.

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The ForEx had a negative impact on our adjusted indirect cost base by EUR 6 million. And as you know, we continue to find, develop and execute initiatives across the whole company to further decrease the indirect cost base.

Let's now take a look at the working capital in the first quarter of 2019. I am on Page 17. If you compare to the end of March 2018, the working CapEx actually decreased by EUR 25 million, and is now amounting to EUR 587 million, which is 9.3% of sales. That improvement was mainly driven by the level of inventory, which is lower compared to a year ago, and also by higher payables. If you exclude the impact of currencies, our working cap as a percentage of sales has actually improved by 20 basis points compared to the first quarter of 2018.

Finally, let's take a look at our net debt. If you exclude the impact of IFRS 16, which is EUR 259 million and you now account it in the net debt. Our net debt, without that impact, has improved and reduced by EUR 59 million compared to the end of 2018.

Of course, we generated a profit during the first quarter. We also benefited from the changes in the working capital that I have just mentioned. And you can see also those items in the bridge that impacted our cash and therefore, our debt position. Our CapEx was EUR 10 million in the quarter, lower than a year ago. And the net change in provision was EUR 16 million. Next to that, we paid also EUR 23 million for taxes and for interest.

As mentioned by Eric, our free cash flow in the first quarter was positive EUR 55 million. And at the end of the quarter, our net debt position, including the addition of -- due to IFRS 16, amounted to EUR 789 million.

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

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

Thank you, Stéphane. So let's move to Slide 20 to discuss the outlook. So we are, basically, confirming our outlook for 2019. We expect that we'll grow in profit engines, LED, Professional and Home combined to deliver CSG in the range of 2% to 5%. Our cash engine Lamps is expected to decline in the range of minus 21% to minus 24% on a comparable basis.

For a total Signify, we aim to reach an adjusted EBITA margin 2019 within the target range of 11% to 13%, as said at the time of the IPO in May 2016. We continue to expect restructuring P&L charge of between 1.5% to 2% of annual sales and free cash flow, excluding the positive impact of IFRS 16 is expected to be more than 5% of sales.

With that, I would like to open the call for questions, which Stéphane and I are happy to answer.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we have the first question from the line of Daniela Costa from Goldman Sachs.

Daniela C. R. de Carvalho e Costa - *Goldman Sachs Group Inc., Research Division - MD & Head of the European Capital Goods Equity Research Team*

So my first question, and then I'll ask the follow-up after. Can you update us in terms of your commentary last quarter regarding capital allocation? The likelihood of M&A versus buyback?

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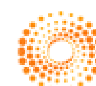

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Eric Rondolat - *Signify N.V. - Chairman of the Board of Management & CEO*

Yes. We would like the exact same comment as what we said previously. And our capital allocation policy is looking at different priorities. The first one is to grow the business. The second one is to eventually return money to the shareholders, and the third one is to improve the balance sheet. So we haven't changed. What we said is, we're looking for opportunities for growth and if they materialize in line with our strategy. And you know that we have a very effective strategy when it comes to M&A. We do it. If not, then in the middle of the year, we would announce additional measures looking at the other priorities. So nothing has changed from what we said at the end of -- well, in Q1 for the full year results.

Daniela C. R. de Carvalho e Costa - *Goldman Sachs Group Inc., Research Division - MD & Head of the European Capital Goods Equity Research Team*

Okay. And then my follow-up on Home. Can you give us some commentary on sell in/sell out visibilty towards the rest of the year in terms of the confidence of maintaining this double-digit growth going forward?

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

So first of all, we are happy in Q1 to be able to confirm that what we experienced in the back end of 2017 and the beginning of 2018 has been resolved. So we have a much better visibility, especially in the U.S. in our major customers on selling out and inventory position. You see that the business has grown globally. Now we are comparing ourselves in Q1 to a lower base last year, nevertheless, we see that despite that, there is growth potential for that business, especially in the connected offers, and not only lamps but also luminaires, we have developed a full family of products around the platform. And we see a very good traction in Q1. We believe that this is going to continue during the year. Now the base will change over time, but we see a good and positive traction for that business moving forward.

Operator

Our next question comes from the line of Lucie Carrier from Morgan Stanley.

Lucie Anne Lise Carrier - *Morgan Stanley, Research Division - Executive Director*

The first question I had was around the visibility you have on the Professional business. I was hoping you could comment a little bit on the orders or tendering activity you are seeing there. And maybe specifically on Europe, considering that it seems to be quite important for your mix. And then I have a small follow-up.

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

Lucie, when it comes to Professional, I would say the vast majority of what we invoiced during the quarter, we take also the orders during the quarter, so we don't have a backlog which is significant. Sometimes we have big projects, and whenever they're really material, we announce it. So the visibility that we have ahead in terms of backlog is not that important.

Nevertheless, if we go back to Europe, yes, we had a slowdown in Europe in Q1, but we already had experienced it in Q4. It is also illustrated by the fact that our LED electronics business in Europe has also slowed down, so we see that there's a whole market contraction there.

Look, we hear as much as you do what economists are saying. And they see a potential rebound in H2, we will see. But when it comes to Professional, the way we also look at the business, Q1 and Q3 are high compare and Q2 and Q4 are more modest compare. So when we look at the business quarter-after-quarter, is also how we need to look at it to understand and be able to assess, frankly, the performance.

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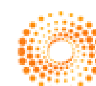

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Lucie Anne Lise Carrier - *Morgan Stanley, Research Division - Executive Director*

And my second question is, you -- and how should -- given sort of the declines around adjustments for IFRS 16. You're also new -- expecting, your positive impact of EUR 10 million on adjusted EBITA for the full year. I was just wondering how much was in the first quarter '19, if any?

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

Yes. Lucie, this is Stéphane. So yes, there was some impact. Approximately 1/4th of the EUR 10 million is relatively evenly spread. And the impact on EBITA is on the price because part of the lease now, they come through the financial interest, and that's where it's moving below the adjusted EBITA line. Overall, amount for the year is EUR 10 million, so you can assume a bit more than EUR 2 million for the first quarter.

Operator

Our next question comes from the line of Joseph Zhou from Redburn.

Joseph Zhou - *Redburn (Europe) Limited, Research Division - Research Analyst*

I have two. First, it's encouraging to see price pressure has eased again this quarter. Could you perhaps elaborate to what extent this is U.S. trade tariffs-driven? And to what extent it is what you see more structurally, perhaps with LED approaching price parity with traditional products and ongoing industry consolidation?

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

Important question -- I don't think it is linked to the U.S. trade situation at this point in time. We see a worldwide trend of a lot of aggressivity on price in some LED lamps. It's also on LED luminaires. Is it structural? I am not too sure. I think, that at this point in time, there's much less that we can extract from the cost, because we've been bringing -- the industry has been bringing the bill of materials quite down in the past quarters and years. So we see effectively aggressivity there.

On our side, what we're doing is that we are segmenting our offers. Meaning that we go from lower to higher functionalities, segmenting clearly the offers with different prices. I'm trying to also specify at the end users in order to make sure that the right offer are selected for the right application.

And so we are fairly confident on our strategy. But it's true that there is still a price pressure. Now the price pressure has declined in the past quarters, as we have said, but it is still there so we're still growing in volume, in unit of products, especially on LED lamps. But it's true that there is price pressure. But we're fighting against it, and I think we have the right weapons.

Joseph Zhou - *Redburn (Europe) Limited, Research Division - Research Analyst*

Okay. And second, we have seen a good level of COGS savings in the last 3 quarters compared to the first half of 2018. And to what extent has those been driven by higher procurement savings versus footprint optimization savings? And also, do you expect the same level of productivity going forward as well? Which I calculate is about 3.5% of sales?

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

Yes. So you're right. Q1 has been a good quarter. And when you look at the vision, you compare the impact of price and the impact of cost of goods sold savings. As I said, it's almost neutralized.

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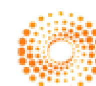

Of course, we've taken actions since now several quarters or even more than that on our footprint, and we will continue to do so on the Lamps business, but also on the Prof business and to a lesser extent LED electronics. So it's partly related to that.

Now procurement is also core to what we deliver in terms of profitability improvement. And it's a mix of negotiation and price, and our teams are spending a lot of time with suppliers to make sure we extract as much as we can. But it's also the innovation, concept, design, everything that we do in order to reduce the cost of goods sold and the bill of material. And the teams are really achieving a lot on that front. We're going to continue to do that so I cannot give you specific indications. But yes, there is still more that we can extract in the way we design our products and in the way we negotiate and get savings from our suppliers.

Operator

Our next question comes from the line of Martin Wilkie from Citi.

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

This is Martin from Citi. The first question is on your indirect cost savings. You're still above 31%, you're targeting to get to below 29% for the year. Just if you can give us some idea as to the sort of pathway to how you get there? Is it going to be quite second half weighted? But also, it seems that some of these savings so far has been in LED and Professional, should we expect some of the benefits late in the year come in the other divisions? Just a little bit more color on how we should see those savings.

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

Yes. Martin, so yes on a percentage, of course, Q1 being a lower quarter in terms of top line and absolute value. The percentage is always higher in Q1 compared to later quarters, especially the second half of the year. So you can totally expect that, especially in Q3 and Q4, this is where the percentage is going to go, substantially below the 30%. And that's why, overall, for the year, we expect a reduction compared to 2018. So that's one element.

Looking at it by division, yes, every division and every organization is looking at how to optimize cost, how to generate savings, how to bring efficiencies. It's the case in LED, it's the case also in Prof, but people in Lamps and also in Home are doing that.

Now we do that while at the same time making sure we still invest because we have a lot of growth opportunities and we need to invest for those growth both in terms of innovation but also in terms of marketing, in terms of sales. And we do that in Home, we do that also in Professional and to some extent, also in LED.

So you'll continue to see the benefits and they generally flow across most of the business groups, even though it's not even, as you mentioned. So more to come here and many actions that we've been taking also in the first quarter, and that will continue to take in Q2 and later.

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

I have got a follow-up, especially if we're on Home. I appreciate the Home margin is very seasonal, obviously, lower in Q1. It sounded like there was a very big currency impact in Q1 as well. But is the Q1 performance consistent with your 5% to 8% target for the year?

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

So let me answer in the following way, Martin. So we still believe that we're going to be in the 5% to 8% range at the end of the year, despite that negative performance in Q1. So that's one part, one answer to the question. The other one is that the performance in Q1 was a bit lower than what we expected. And we've mentioned a significant currency impact that is impacting the bottom line at this point in time. So for a business, which

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is generating EUR 115 million on a given quarter, we should expect, in the longer run or in the midterm run, the business to generate better than what we've done in Q1.

Operator

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

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

Your -- the guidance to get to 2.2% to 5% organic growth for the year for the growth divisions. If you had 1% in the first quarter, I understand that the returns and impact that comes from certain areas but is not impacting this part. So how do you make that move from 1% to go into the range of 2% to 5%? Is that predominantly in Prof? Or maybe on some of the other divisions as well?

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

So Marc, the detracting element I would say in Q1 was more Prof, and Prof in Europe, as we have mentioned previously. Now if you move along the year, you will see easier base of comparison across the quarters. So the more we go, the easier the base is going to be.

Now when -- before this earnings call, of course, we have our reforecast for the whole company. And when we look at the plans that we have and through the end of the year in all the divisions, we believe that the guidance that we have given is totally achievable.

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

So maybe to clarify. So it's more easily comparable base or it's also that you expect to get some extra traction in the market?

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

It's both. In the markets, we don't know. I mean, let me be clear. When you look at the global world estimates, there's been -- they have been brought down in terms of growth. We think that's in all the regions. We've seen clear headwinds in China, starting from the second semester last year in Europe, it has started in Q4, and all that continues in Q1. So we think that the level of traction that we have on the end markets today is not fabulous. We see things are changing during the year, but we have initiatives in order to find what we call the new growth platforms, it's insistence, it's in LED trade products, where we have clear actions that we are implementing at this point in time. Also, in specific activities like horticulture, like Solar, like LiFi, or 3D printing. So we are also lining up different type of actions in order to gain on growth. And all that I've been mentioning previously is really touching the growth engines, and we believe that we have the tools to achieve more growth during the year.

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

Okay. And then a follow-up is actually on the adjusted EBITA in the other divisions. Quite a step up in the quarter consisting what it is, and what we should expect for the coming quarters?

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

Yes. Sure, Marc. Let me take that one. So yes, Q1 was minus 27, we're usually around minus 25. Now of course, every quarter can be a little different. You can have a few one-off elements. So I don't think you should read structural evolution or structural increase of the costs there. As you probably know, in that BG other, we have a mix of corporate cost but also central R&D and innovation, and as we have mentioned, we are continuing to

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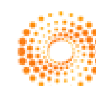

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invest also in those growth platforms. So that is also reflected here. But looking at -- you should not expect that the number in the other is going to increase.

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

Okay. So the 25 is a good run rate?

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

Yes. On that range, but every quarter can be a little bit different. But yes, ballpark, this is the way we see it.

Operator

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

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

In the Lamps division, the decline on top line was lower than I expected and lower that is your full year guidance. What do you attribute this to?

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

Well, we are declining less than the market decline. That's a fact, and we continue to gain market share. Now you would maybe remember that in 2018, that business only declined by 11% in Q3 on the basis of the halogen ban. So we are going to face a very strong compare in Q3, and we believe that this is when the 17% to 18% decline that you see now, will probably get closer to what we have given in terms of guidance.

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

Okay. And in terms of the margin, was there any mix effects that you would point to that contributed to the margins? Or as usual, a footprint affect helping maintain margins where they are?

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

Leo, you're talking about Lamps?

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

That's for Lamps, specifically, yes.

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

We know quarter-after-quarter, you can have some mix elements because depending on the activities that we said more or less within Lamps, you can have -- we can have some shift. But nothing major in which is still an adjusted EBITA margin above 20%, pretty much in line with what has happened in the past quarters. Nothing really specific in Q1.

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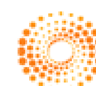

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Operator

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. If we look at the past couple of quarters, we basically see that the cost savings that you are reporting are materially above restructuring charges that you are facing. So how should we look at that? [Are you becoming] (corrected by the company after the call) more efficient? Or should we be seeing those kinds of the currents cost savings are also kind of the affects of previous restructuring charges, i.e., that was a decline in restructuring charges in your P&L that we should also see the cost savings coming down greatly over time? And that's my question.

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

Yes. So Wim, the restructuring charge that we paid in our books every quarter, as you say, is disconnected in terms of timing from when the savings are coming. And number two, it's not just related to the cost below the gross margin, part of that restructuring charge is also for the restructuring that we do on our manufacturing footprint which is above the gross margin. So it's hard to really connect the two. Now when we reduce cost and I'm talking here about nonmanufacturing cost below the gross margin. Part of this can be people related because we are becoming more productive, more efficient or because we let people go in one region and hire in lower cost regions. And in that case, there is a restructuring attached it, but also a number of the actions that we have taken to reduce cost are not necessarily leading or requiring restructuring.

And it can be, for example, reducing the real estate footprint and therefore, the amount of lease that we paid. And so you cannot fully track from the restructuring charge that we take what is the savings that we generate. So yes, a lot of the savings are actually non-restructuring related and are about just being able to spend less money and it can touch many types of cost lines.

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

And what do you say that you have? Enough of this kind of low-hanging fruit less for you to continue the, let's say, trends in cost reductions for the coming, let's say, 2 years?

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

Well, I'm not sure I would call them low-hanging because at some point, as I earlier, they -- I'm not sure exactly where they hang. But what is for sure is that when you look at the cost structure of the company and where we are right now, which is 31% on a full year basis around 30%, we're still above the benchmark and we're still above where we believe we should be as a company. It's related to the amount of cost that we have. It's also related to the amount of revenue that we generate and we have indicated that our goal is to bring that further down. So we believe there are further opportunities. We've put in place many actions, programs, in order to tackle that and bring more productivity, more efficiency, take out cost and we've done that in 2018 and we'll continue to do that in 2019. So again, difficult to qualify how easy it is to do, but that's what we have to and what the whole company is also focused on.

Operator

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

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

First one is on Professional. You flagged strong growth in the U.S., which is kind of positive commentary after some time. Was just wondering why is that still not reflecting in the margins and profits at Professional in a way? Is it just the cost structure in the U.S. which is still a challenge? Or is it

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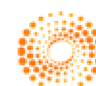

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the product specs and the mix in the U.S. which is not sort of as favorable? Or just simply a case of the volume leverage in Europe more than outweighing what you get in the U.S.? So that is what I'm trying to understand in the context of how important Professional is in a way to get to the targets. So that was my main question and then I'll do the follow-up.

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

Yes. So Alok, on Prof as a whole and in terms of profitability, yes, the improvement trend that we have seen on the top line has translated into an improvement on the profit side in the U.S. So we totally see that. Now overall for the business group, because of the lower performance in Europe, which is a higher profitability region for us, the overall mix was negative and we could not benefit fully from the improvement that we saw coming from the U.S. So that's part of the reason. Now, also, remember that in the margin evolution year-on-year of Prof, of -- of 10 basis points improvement, there is a negative ForEx effect that is also quite substantial. So that also contributes to the fact that the margin didn't really improve as much as it should have given everything that we are doing. But it did improve in the U.S.

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

Sure. If Europe is still a challenge, so just wondering in a way how the mix needs to evolve in a way to get to those targets. I mean -- because Europe is probably still a tough market environment, right?

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

Yes. Europe is still a tough market environment. Once again, I say that in Prof, the compares are high in Q1 and Q3. They're a bit more favorable in Q2 and Q4. Once again, I would come back to the question -- to the answer I've given previously. We have plans in trade insistence, horticulture, and Solar, and to find a new growth opportunity in order to retrieve the -- so the case in Europe. Now when we look at Europe, we are also -- I think we have a strong leadership position in that geography. We'll to see how the economy goes.

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

Okay. Fair enough. The follow-up that I had was a bit on the nonmanufacturing cost. Thanks for the explanations on the SG&A side of things. I was trying to sort of look at the R&D spending as well, the adjusted R&D. And that's come down quite a bit, quite substantially over the last several quarters now. I was just trying to reconcile that with the new growth avenues you've talked about, which then would suggest you knew but not of investments. So what's the confidence it can extend to us that the investment in the future pipeline is not being deferred even if temporarily the R&D costs going down is a bit surprising in a way not percentage of sales but an absolute numbers as well.

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

Yes. Question understood. Alok, this is a part of something that we had described in the past. We had a very, very strong plan in order to improve the efficiency of our R&D in order that -- for given an amount spent, we will be delivering it more. And this is something that has taken place in the past 3 years, and we still have today very concrete plans in order to push that further, which basically helps us to continue to be extremely innovative, which helps us to continue to deliver ideas on buttons. Which also helps us to bring to the market very innovative offers and also new offers and adapt existing offers, while spending less. So this is a totally conscious move that we are doing. It's not hampering our innovation capability at all. We are capable to do today the same if not in some cases, more with less.

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

Okay. And you're taking summary targets, right? For the basis -- don't remember having heard that.

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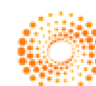

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Eric Rondolat - *Signify N.V. - Chairman of the Board of Management & CEO*

We haven't given any specific guidance from that. You've seen a decline in over the past years, but we have not, so far, given a target for this.

Operator

Our next question comes from the line of Alexander Virgo from Bank of America Merrill Lynch.

Alexander Stuart Virgo - *BofA Merrill Lynch, Research Division - Director*

Just a quick clarification on what's actually driving the growth. Forgive me, if I missed that earlier on. But a couple of your peers, I think, have talked about the U.S. being weaker and projects being deferred. And obviously, it's been a fairly mixed environment for the last 12 to 18 months. So I wondered if you could just elaborate a little bit more on what you're seeing in the various components of your U.S. business? And why that gives you the confidence as you look forward over the next 9 months, I suppose.

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

Yes. Alexander, we've seen the same thing. We've seen the early signs of cooling of the construction market which has been quite dynamic in the past quarters. But we are extracting today also a lot of growth in the U.S. on the distribution of the stock & flow part of the business, which was not an area where we were strong previously. So we have built up the adequate offers and connected to right customers in the right fashion in order to get the fairly good level of traction on that side. On the product side of the business, and projects, it's true that it's quieter than it used to be. But also extract our growth in the other part of the business.

Operator

And we'll last question from the line of Joseph Zhou from Redburn.

Joseph Zhou - *Redburn (Europe) Limited, Research Division - Research Analyst*

Just on Professional, and you're talking about U.S. margin being better than by growth. What about the other regions, Europe and the Rest of the World? How has the margin progression been year-on-year?

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

Joseph, the margin has been satisfactory in all regions, we were specifically mentioning U.S. because the America -- as you know when we grow, as we said previously, our P&L is very leveraged. So immediately when we grow, it brings a positive impact on the bottom line, and that's what we experienced in Q1 again. But the other regions are doing fine. We know also how to maintain margin when the volume are lower-than-expected. We've done that over the past year and we still can do that now.

Operator

Thank you very much. And I would now like to return the conference back to our speakers.

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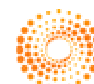

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Robin Jansen - *Signify N.V. - Head of IR*

Yes. Thank you, operator. 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 additional questions, please don't hesitate to contact the IR team. 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, and you may now disconnect your lines.

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