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PRESENTATION

Operator

Ladies and gentlemen, welcome to the Signify Earnings Call Q2 and Half-Year 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, Sara. And good morning, everyone, and welcome to the Signify Earnings Call for the Second Quarter Results 2019. With me are Eric Rondolat, CEO of Signify; and Stéphane Rougeot, CFO.

In a moment, Eric will take you through the second quarter business and operational performance. Stéphane will then tell you more about the financial performance in the second quarter. Eric will end today's presentation with the key takeaways for first half 2019 and the financial outlook for the year. 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. Both 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, and good morning, everyone, and thank you for joining us today. Let's go to Slide 4 with the main elements of our performance in the second quarter.

Comparable sales declined by 6.1% due to lower levels of activity, most notably in Europe. We also faced some country-specific developments in a few markets that are non-recurring, which I will discuss in more details later.

Our LED-based sales increased on a comparable basis by 0.2% to 77% of sales, and our installed base of connected light points increased from 47 million in Q1 to 50 million in Q2, this quarter.

We continue to make good progress in reducing our cost base excluding the impact of currency movements. Our adjusted indirect costs decreased by EUR 37 million or 60 basis points as a percentage of sales.

As a result, our adjusted EBITA margin improved by 60 basis points to 9% including 20 basis points positive impact from currencies. Our net income improved by more than 70% to EUR 50 million. And finally, our free cash flow amounted to EUR 121 million, which included a positive impact of EUR 17 million from IFRS 16. And this high amount of free cash flow in the second quarter is mainly driven by a higher income and also by the phasing of payables and receivables at the end of the quarter. We estimate that this phasing impact represents around half of the free cash flow for the second quarter.

Let's now move to Slide 5 where you can see a snapshot of the financial performance of our growing profit engines, LED, Professional and Home.

Comparable sales growth of our growing profit engines was minus 2.3%. We experienced a lower level of market activity most notably in Europe, and we were impacted by non-recurring developments in Saudi Arabia and India, mainly in Professional.

Our growth platforms, connected systems, IoT platform services, horticulture, solar and LiFi, showed solid momentum with increasing project wins most notably in horticulture and solar. The adjusted EBITA margin of the growing profit engines improved by 200 basis points to 8.5% with all 3 business groups contributing to this improvement.

Let me now provide you with more details for each of our 3 growing profit engines, starting on Slide 6 with LED. Comparable sales declined by 1.8%. LED lamps delivered a solid performance while LED Electronics continued to be impacted by lower customer demand most notably in Europe.

In LED lamps, we continue to see a slowdown of price erosion on a sequential basis. The adjusted EBITA margin improved by 140 basis points to 12%, mainly as a result of ongoing procurement savings and lower indirect costs.

On the next slide, Slide 7, you can see some of the business highlights of this quarter for LED. We launched several LED products in markets around the globe starting with our UniversalFit TLED, which is now available in the U.S. and Canada. This new product is compatible with any ballast, making replacement of fluorescent tubes easier than ever before.

In China, we launched the flagship dual zone Ceiling luminaire. This new luminaire combines distinctive patented industrial designs with dual zone technology allowing for both uplight and downlight simultaneously.

And then in Europe, here, we launched best-in-class drivers for linear applications. The luminaire addresses the increasing demand for sustainable lighting as it has a very low power consumption in standby mode and built-in metering and diagnostics.

Let's now move on to Professional on Slide 8. Comparable sales declined by 5.6% due to a lower level of market activity in Europe most notably in countries like Germany, Italy and the Nordics, while the Americas and China delivered a robust performance.

The CSG in Q2 also reflected the negative impact of some non-recurring events, of which the SASO re-certification in Saudi Arabia and elections in India, represented the vast majority of this impact. Excluding the impact of these non-recurring events, we estimate that the CSG, of course, would have been around minus [1%] (corrected by company after the call). This effect is expected to partially reverse in H2. And within our end-user segments, we noticed softening demand for public and outdoor project most notably in Europe.

For the second half of the year, we have secured a solid order backlog and project pipeline, most notably in the Middle East and in façade lighting in China while we anticipate Europe to remain soft.

The adjusted EBITA margin of Professional improved by 40 basis points to 8.8% as procurement and indirect cost savings more than offset the negative impact of price and mix. The mix was negative due to lower market activity levels in Europe.

There are a couple of business highlights that we would like to bring to your attention on Slide 9. First, I would like to highlight the progress we're making on leveraging lighting infrastructure to enable connectivity. In the past quarter, we introduced Trulifi, which provides the fastest commercially available LiFi systems. This new range comprises Trulifi-enabled luminaires providing wireless connectivity at speeds of up to 150 megabits per second over large spaces such as meeting rooms and office floors. The Trulifi range also includes a fixed point-to-point system with speeds up to 250 megabits per second, which basically is acting like a wireless cable, ideal for connecting devices. And we know that LiFi solves also reliability and security issues encountered with radio frequency wireless systems.

Additionally, we continue to make good progress in our growth platforms. For instance, in solar, we realized our first solar street lighting implementation in Western Europe by installing Philips SunsStay street lights in a park in Seville, Spain. This installation underscores both Seville's commitment to sustainability, and also our own.

Let's now turn to Slide 10. Home reported an increase in comparable sales of 19%. So we enjoyed a strong performance in Europe driven by robust demand for our new connected office. The adjusted EBITA margin of minus 7.8% represents a substantial improvement compared with last year. The level of profitability in the second quarter reflects low fixed cost absorption and relatively higher costs to prepare for the high season in the second semester.

For Home, we would also like to share a couple of business highlights with you on Slide 11. In the second quarter, we added a Bluetooth offering to the Philips Hue ecosystem further strengthening our smart home lighting offer. This new Bluetooth offering enables direct client control from a smart device. It was launched in the U.S. and Canada at the end of Q2 and will be launched in Europe in H2. And more Bluetooth-enabled products will be introduced later this year and in 2020.

We also added Lutron to the Friends of Hue program. So Lutron introduced a smart dimmer in the U.S. that fits over legacy wall switches. It is fully compatible with the Philips Hue system and can be set up in the Philips Hue app. This way it allows consumers to control the Hue lights directly from the wall using the existing switch points.

Let me now move to our cash engine lamps on Slide 12. Comparable sales decreased by 20.3%. We believe that this decline is lower than the market decline resulting in continued market share gains. The adjusted EBITA margin remained solid at 19.5% as a result of ongoing indirect cost reductions.

Next, to our focus on organic growth, we have also announced 2 acquisitions to accelerate in key growth areas. So let's now turn to Slide 13. We announced this morning that we have agreed to acquire a 51% stake in Klite, one of the leading providers of high-quality, cost-efficient LED lamps and luminaires based in China. Klite has been one of our main suppliers of LED lamps and luminaires for many years. Next to what they sell to us, they generated around EUR 250 million in sales to thirds in 2018 serving global customers including global brands, major do-it-yourself and retail customers.

With this transaction, we will bring additional scale and innovation power to Klite allowing it to generate further cost efficiencies and enhance its product development including connecting lighting offerings. This will strengthen Klite's position to serve branded and private-label customers with innovative and cost-efficient products. It will allow us to deliver cost-efficient innovations to customers faster, including connected lighting offers.

Overall, this transaction reinforces our position in the supply chain of LED lamps and luminaires market and will enable us to capture value from the growing private-label segment.

On Slide 14, we highlight an acquisition we made in the second quarter. So we have expanded our business in agricultural lighting by acquiring 2 market leaders in the design and manufacturing of animal-centric lighting systems: Once, a company based in the U.S.; and iLOX, a company based in Germany.

These tailor-made lighting systems improve the quality of life for livestock. For example, by reducing the stress of animals, which leads to healthier and enhanced production for the farmer. Both companies have solid relationships with key customers and a well-established sales organization in the United States and also in Europe. Through this acquisition, we accelerate our business development cycle compared to organic growth, generate growth in the nascent and rapidly expanding market for animal-centric lighting. And we get access also to strong intellectual property and a solid installed base.

On the next slide, Slide 15, I would also like to take a moment to update you on the integration of LiteMagic, an acquisition we made about a year ago in China. So LiteMagic offers a complementary portfolio of luminaires and control systems for the mid-segment of the city façade lighting market. The integration went very well. We achieved the targeted sales and portfolio synergies by developing an offering for around 25 countries outside of China. LiteMagic generated double-digit sales growth in the first half of 2019.

Cost synergies are also well underway. Bill of material reduced as per our objective, and we have identified opportunities to improve productivity further. We have also reduced working capital, which was 8% better than planned. And as part of the post-merger integration, we successfully completed the integration of people within 100 days after the acquisition, and IT and reporting readiness within 1 month. The total PMI costs were 25% less than budgeted for.

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 second quarter of 2019.

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

Yes. Thank you, Eric, and let me now turn to Page 17 where you see our usual adjusted EBITA bridge. As you can see, the adjusted gross margin as a percentage of sales decreased by 20 basis point to 37.7% in the second quarter of 2019, and that includes positive currency effect of 20 basis point. You can also see that the impact of price on the gross margin was very similar to the last quarter and is largely offset by the ongoing savings in cost of goods sold. As far as the indirect cost base is concerned, it decreased by EUR 37 million compared to the second quarter of 2018 when you exclude the impact of ForEx.

And finally, what we see based on the current spot rates at the end of June 2019, the currency impact on the adjusted EBITA margin for the third quarter would be around negative 40 basis point. And then for the fourth quarter, it would be positive leading to an overall impact on the full year 2019 of around minus 30 basis points. So overall, lower than what we had in the first half of the year.

If you turn to the next page, you can see the evolution of our indirect cost base. As you know, we've taken a lot of initiatives and they resulted in EUR 37 million of currency comparable indirect cost savings in the second quarter of 2019 compared to a year ago, and it represents an 8% reduction year-on-year. The ForEx negatively impacted the adjusted indirect cost base by around EUR 9 million, and we are quite satisfied with the evolution of our indirect cost base since the beginning of 2017, as you can see on the right-hand side. We show the development of our indirect cost on a last 12-month basis, and we've been able to reduce the indirect cost base by EUR 425 million over a 2-year period, which is a reduction of 280 basis point as a percentage of sales. So we continue to execute many initiatives in order to further decrease the indirect cost base, and Eric will tell you more about that.

Let's now take a look at working capital. In the second quarter of 2019, on Slide 19. Compared with the same period of last year, the working capital decreased by EUR 191 million and amounted to EUR 503 million at the end of June, which represents 8% of sales. The decrease compared to June 2018 included the impact of the phasing of payables and receivables that we talked about earlier during this call, and which we estimate represents around EUR 60 million of the working capital reduction at the end of the quarter. Overall, the working capital performance reflects our continued focus on improving working capital since several years.

Let's now take a closer look at our net debt position on the following slide, page 20. Our net debt increased by EUR 76 million compared to the end of March 2019, and that's mainly due to the distribution of our dividend of EUR 164 million during the quarter. Next to the profit, we generated in the quarter and also the change in working cap that I have just mentioned, you can see the other items in the bridge that had an impact on our cash, and therefore, our net debt. The net CapEx was EUR 27 million in the quarter, and the net change in provision was EUR 24 million. And next to that, we paid EUR 26 million for tax and interests.

All in all, as you can see, our net debt position amounted to EUR 865 million at the end of Q2, which represents a net leverage ratio of 0.9x adjusted EBITA.

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. Let's move to Slide 22 where you can see a snapshot of the performance of the group profit engines in the first half of the year.

So while the CSG was minus 0.7%, the profitability increased by 200 basis points year-on-year with each business grew contributing to the improvement. They account for 60% of our adjusted EBITA in the first half of 2019, which is a significant step-up compared with the previous years.

Let me now briefly zoom in on the overall performance of H1 on slide 23. So despite lower levels of market activity in certain geographies, we have been able to improve our adjusted EBITA margin by 70 basis points to 8.4%, which includes a negative impact from currencies of 60 basis points compared to the first half of 2018. So we are satisfied with the continued savings on procurement and indirect costs. As you can see, our currency comparable indirect cost decreased by EUR 77 million or 120 basis points as a percentage of sales compared with the first half of 2018.

We had a significant underlying improvement in our free cash flow in the first half of 2019, also when excluding the positive impact from IFRS 16 and the phasing of payables and receivables that we have commented previously.

Before I move to our outlook for 2019, I would like to give you an update about our Road to Excellence, our 5-year transformation journey on slide 24. Our Road to Excellence program helps us to transform at a fast pace, achieving unequaled customer satisfaction and organizational excellence. As part of this journey, we have introduced Project Horizon. This company-wide project includes a significant number of cross company opportunities that will further strengthen our execution capabilities and is expected to drive top line growth, reduce our cost base and free up working capital between now and the end of 2020. For example, we are leveraging in- and external insights to optimize pricing, and we reduce the complexity of the product portfolio, which will result, among others, in improved portfolio profitability. We're also optimizing our receivables and payables policies while using local- and global-best practices, which has already started to result in working capital reductions.

In addition, we have a strong focus on improving our execution capabilities and organizational health. We are developing a culture centered around speed, collaboration and accountability with the aim to achieve higher employee engagement and increase our effectiveness and efficiency in execution.

With that, let me now move to the outlook. So we reconfirm our outlook for 2019. We expect our growing 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 21% to 24% on a comparable basis. For total Signify, we aim to reach an adjusted EBITA margin in 2019 within the target range of 11% to 13% as set at the time of the IPO in May 2016. We continue to expect the restructuring P&L charge of between 1.5% to 2% of annual sales. 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 floor for questions, which Stéphane and I are happy to answer.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Benjamin Szekeres from Goldman Sachs.

Benjamin Szekeres - *Goldman Sachs Group Inc., Research Division - Analyst*

I've got a question on on your acquisition of your stake in Klite, and then a follow-up on capital allocation. But firstly, I know that you've mentioned that you expect to deliver some cost efficiencies and it could help capture growth in the private label segment. But I guess what I'm trying to gauge is whether you see this more as a top line driver or perhaps something that, in the future, will help you improve margins by optimizing your cost base. And in relation to this, if you could quantify any of the benefits or impacts that you might expect from this, that will be much appreciated.

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

Yes. So let me take you through this at a bit of distance first. So at the beginning of the transition of the lighting industry moving to LED, we were mostly outsourced especially when it comes to LED lamps. We now see that the markets and the environment are stabilizing in terms of development of new technologies and new components. So we felt that we had to strengthen our control over the end-to-end supply chain. So you have to see behind this acquisition, a fundamental strategic move in how we perceive the competitive landscape, and we had to do that combining and joining forces with a company that we know that has very high level of quality. And also capacities to design and to innovate around the offers that are not only LED lamps, and also LED luminaires. It will be both bringing top line and margin since we want Klite to continue to sell to its customers. Klite has a vast portfolio of existing customers, [branded] (corrected by company after call) but also private label customers, that have been very loyal to them over the years. That has to continue, and that has to expand.

We also believe that we are, with our own sales forces all over the world, reaching also different types of customers and private label customers, and we think that now having that association with Klite will allow us to be at Signify even more competitive in front of those private label customers. Moreover, we got to be able to develop technology together with a company, which is basically ours, and especially around connected lighting.

So as you can see, there are a lot of different elements behind this acquisition that are fundamentally strategic. Some of them are about development of technology, some others about driving top line to external customers and to our customers, and also an increase of the margin moving forward or at least this will be a positive driver for the margin as we will have less stack-up margin buying from a supplier because that supplier basically becomes our own company. So I hope that I have been, Benjamin, quite exhaustive in my answer, but there are many different aspects behind the acquisition of Klite.

Benjamin Szekeres - *Goldman Sachs Group Inc., Research Division - Analyst*

That's great. I appreciate the color. And my follow-up would be on your capital allocation. Ahead of 2Q, you've mentioned you would be looking at M&A and then depending on that, you might explore other avenues, for instance, maybe potentially returning cash. So how do you think about that now that you announced this stake in Klite?

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

Yes. So Benjamin, of course, our capital allocation policy has not changed, and we still aim at returning money to our shareholders through our dividend, and that generally takes around half of our free cash flow. I mean it's 40% to 50% of our net results and generally around half of our free cash flow. And we have always said that we want to use the rest of the free cash flow to fund non-organic opportunities that will help us to strengthen the growth and the profitability profile of the company. And if we do not find those opportunities, of course, we would return money to shareholders, which we have done a lot over the last 2 years. Now you noticed that we have stepped up on the nonorganic opportunities. We've announced 3 since the beginning of the year, 2 that are relatively small and 1, which is larger like Klite. So we're going to continue to look for nonorganic opportunities that fit our strategy, and we've been very clear on the acquisition criteria and areas. And then in the course of the second half, depending on the pipeline that we have, we will figure out at the end of the year what we do with the rest of our capital.

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 for Andreas this morning. I have 2 questions, please. My first one is a follow-up on Klite. And I'm wondering if you can give some indication of how much Klite sales is coming from Signify and how much from your competitors in LED and Professional businesses. And then I have a follow-up.

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

So when we are talking about EUR 250 million, it is sales to third parties, so that is excluding the sales from Klite to Signify. And within this EUR 250 million, we are not specifically commenting at this point in time how much they are selling to other lighting companies. But when we did the acquisition, it's because we believe that we can further expand that path like we do with OEMs all around the world, and this is something that is totally taken into account in our post-merger integration plans.

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

And my follow-up is on visibility for projects that you have in China and Middle East in the second half. Are these projects in Professional signed off? And is it in the backlog or still risk depending on the macro?

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

Yes. When we're commenting on these projects, it's because they are orders on hand. So these are orders that we have, so they are in the backlog. So effectively, we're talking here about quite important projects in Middle East and Turkey and well, specifically in Saudi on road- and streetlighting for which we have already taken the orders, and some also quite substantial projects in China in facade lighting and also as a result of the acquisition that we did a year ago in China of LiteMagic. So that has been a very successful integration so far that is generating a lot of fruits on the revenue side. So these projects are already in the backlog.

Operator

Our next question comes from Lucie A. Carrier from Morgan Stanley.

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

The first question is more -- I guess a bit more conceptual, but it seems that the organic growth or rather the organic decline for the past few quarters seems to have accelerated compared to what we have seen at the beginning of the listing and also what was expected at the time of the IPO. And at the same time, the margin is also quite nicely improving. I was just wondering, I mean, are you, on top of the different cost initiatives you're having, do you also have kind of on the background, more selectivity around sales, maybe dropping products which are low margin and which, of course, would accelerate that organic decline but sustained the profitability? So that's my first question.

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

Yes. Lucie, I think the uh, when you look at the pattern in terms of organic decline, organic growth, yes, it has worsened. I think it is also to be linked to the degradation of the end markets, which we are not the only ones to feel. I think many other companies are commenting in the same way. And we've seen, lately, China starting in mid of the second quarter of 2018 and then Europe at the back end of 2018 and continuing to be slow in the first part of this year.

So I think degradation of the end markets for us has 2 consequences that the conventional part is declining a bit faster and LED is growing a bit slower. So this is how I would, from a conceptual standpoint, as you've mentioned it, would comment the pattern and the trends at the level of the top line.

Now are we pruning products that are not profitable from a gross margin standpoint? Not really. We have an action part of our Horizon plan, which is to look very selectively at how we price our offers to make sure that they are well priced on the market. But we are not systematically pruning, having a negative impact on the top line, but a positive impact on the margin. That's not something that has a material impact on our growth.

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

The second question I had was maybe a follow-up on Professional. Can you maybe help us to understand what has happened precisely in Saudi and in India in the second quarter or more generally in the in first half? Because you mentioned -- I mean it's down -- the division is down 5.6%., but without that, it would have been minus 1.5%. So either how big are those 2 geographies now for you or maybe on the other hand, how much decline did you see in these geographies specifically because it seems like a big delta for countries, which historically hadn't necessarily been the majority of the business.

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

Yes. I think that's a good question, Lucie. Look, let me put it this way. So first of all, my bad, I've made a mistake, it's not minus 1.5%, it should be minus 1% if you net from non-recurring impacts that have happened in Q2, and that will be partially reversed in the coming quarters. But let me now zoom a little bit more on the 2 that you have mentioned, which is Saudi and India. India, I will start with that one, it's about the elections in India. And before elections happen, there is a slowdown, especially in the public segment. And this is what we have experienced in India before the elections that have taken place in Q2, and that was also to be compared with Q2 2018. That was extremely dynamic in India. So these are the 2 fundamental elements to understand when it comes to India.

Now let's go to Saudi. So Saudi, it's difficult story in the short term, but a very positive story in the longer term. So let me explain what happened there. Basically, the regulation entity in Saudi has decided that products in the lighting industry and many products touching not only Prof, but mostly Prof for us because we are very skewed towards that business group in Saudi. So that entity has asked for recertification of the products in order to be able to sell them, and that has happened at the beginning of Q2. But the point is that, to recertify the products, it takes between 2.5 to 3 months because the tests that have to be made are taking a reasonable amount of time. We need to do those tests only in authorized laboratories. And at the same time, there is a bureaucratic process that we have to follow in terms of getting the accreditation. So basically, at the end of that process, you are getting a number, and that number has to be put on the label of your products. So what happened is that the process took time in such a way that no companies could sell on that market during that period, which is mostly Q2. So it had an impact and quite a massive impact on our sales because it touches a very big part of the portfolio.

Now this is what has happened in Q2, but we see this as a positive event moving forward because in Saudi, those certifications are enforced on the market, which is a very positive thing. We are the most advanced on that market, managing the recertification, and we believe that it will generate further positive sales to Prof. This is why we are saying that, that impact could be partially reversed in the upcoming quarters, but this is what we had to face for Q2. So negative impact in Q2, but we believe positive impact in the coming quarters. And we expect that some of the [competitors] (corrected by company after the call) on the market in Saudi today, which are working more in an informal way, are going to have problems to continue selling. So it's market share that we can potentially take on Prof, but also probably on other businesses, too. So a bit long answer for that one, but just to be well understood, this is what happened in India and this is what happened in Saudi.

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, on your global businesses, I noted that it has been declining for 6 quarters, and it's something like minus 3%. And I understand, within that, you have the licensing income as well as products and brands managed globally, for example, Luceplan. Can you give us some color on that, and what has been driving the decline and what can we expect going from here?

And my second question is on the savings. And if I look at your indirect cost savings, and the year-on-year change of indirect cost as a percent of sales has slowed this quarter. You cut the percentage bps compared to something like 200 bps in the last 3 quarters. I think the program from last year is coming to the end of its cycle. And given that, it seems like you have a new program coming out, the Road to Excellence program. Should we expect the indirect cost savings to reaccelerate in the second half, which gives you the confidence for the full year margin guidance?

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

Yes. So Joseph, let me take those 2 questions. So on the global businesses, you're right, there's been a slight decline in the CSG. In the second quarter, we're down minus 1.5%. And for the first 6 months, minus 1.3%. So it's relatively limited. Now you're right, it's licensing and the few other global businesses that are not sold and going through various regions. So it's not only licensing. In some of the businesses, you can have some projects. Also in licensing, you can have some contracts. So there is not much to read into that slight decline for those global businesses.

On the savings, yes, we are, of course, still quite satisfied with the reduction that we've seen on the indirect costs since the beginning of 2018, and still in the first and second quarter. Now you're right, the overall amount compared to what we have seen in the second part of 2018 is lower. We've taken a number of actions and continue to look at all the divisions including, as you mentioned, through the Horizon program. And indeed, we expect that we will have further acceleration in Q3 and in Q4. And as you know, for us, the ability to optimize our cost base and take many actions as some of the ones we have mentioned on the Horizon page is critical to our ability to get to the right competitive cost base. So yes, that's completely core to not only what we've done in 2018, but what we continue to do in 2019 across the company.

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

All right. Great. And then just very quickly more maybe on the global businesses. I mean what's driving it more? Was it licensing income declining or the products declining?

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

So that we don't disclose for the specific businesses and what's happening in those businesses, so I can't give you any more specifics here.

Operator

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

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

I wanted to come back on the Klite acquisition as I struggle still a bit with the strategic implications. So first of all, I understand that one of the objectives is to bring additional innovation power to Klite and then grow this EUR 250 million into third-party revenues. But it would then -- not really reinforce the competition for your own brands then, and so maybe a bit more color on that. And the second part of my question, as you mentioned already, is that, so far, you were mostly outsourced. Is this really a change in policy? And could we see additional steps in you taking on board more on the manufacturing? Or should we really see this as an exception and that you still, yes, follow more asset-light business model?

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

Yes. Thank you, Peter. Well, let's go back to Klite. Look, competition exists anyhow, so we will not stop competition. But by making that investment of 51% of Klite, we are probably also controlling a major part of the market, since this entity will be producing offers, branded Philips and with the Signify brands, but also we'll be selling products to other companies. So it has to be seen as something fairly similar to what we do in the LED electronics, the driver of the LED module type of the business, and that's a strategy that we have been very successful to implement on that front. Why? Because these customers that are not Signify are going to be benefiting for many things: cost-efficient offers, offers that are innovative, but also offer that are IP compliant. So that business is large, which is the sales of this product outside of Signify, and it needs to continue. That's one of the strategic rationale doing that acquisition. At the same time, and there's another fundamental element, we realized that after implementing the strategy that was mostly outsourced, which was very beneficial when we started the transition in the LED lighting era, we needed now to have more control over the supply chain and suppress our margin stack-up at the level of our suppliers.

Now, are we going to go in additional in-sourcing steps? Well, there's nothing really forecasted of that nature at this point in time. I think this is a major step that we have done today, and on which we are going to build for the future. So I hope Peter that I have been able to clarify a bit more the strategic aspect behind that acquisition.

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

Yes, you did, Eric. And maybe a quick follow-up on Home where you mentioned a strong performance in Europe, but I assume North America is still the largest market for your Philips Hue product. So could you shed some light on the performance in that region?

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

Europe is also very large for the Home business, but Europe has been outstanding in performance when it comes to Home. Northern America has been according to expectation, but below the performance of Europe for Q2.

Operator

Our next question comes from the line of Ji Cheong from Citi.

Ji Cheong - *Citigroup Inc.*

. First one, just to confirm that -- given that you've confirmed your guidance from your non-lamp businesses, organic growth of [2% to 5%] (corrected by company after the call) for the year and given what we've seen so far, so just wondering what gives you the confidence for the acceleration of growth in the second half in order to meet this target. Is it just from the recovery expected from Professional? Or am I missing something here?

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

So Ji, what we said for in terms of guidance is 2% to 5%, and there are few elements behind that, probably 3 elements. So the first one is that we have commented on non-recurring elements in Q2 that will be partially reversed in Q3 and Q4, so this is one.

The second element is linked to the base of comparison. If you look at the performance of the growing profit engine in H1, it was plus 2% in comparable sales growth in 2018, but it's minus 2.4% in the second half of 2018. So we are going now to be compared to a lower base.

The third element is about some of the projects that we have already taken orders from, especially in the Professional part of the business, and we're talking about Saudi and we're talking about China mainly, but also in the LED part of the business where we have secured and we have the orders, quite substantial project in Northern America selling to some important retailers there. So this is why we confirmed the guidance that we had given from 2% to 5% on the growing profit engines.

Ji Cheong - *Citigroup Inc.*

Got it. Just as a follow-up on Home. Can you update us on what kind of pricing trends you're seeing in regards to your Hue products? And has there been any changes seen in the competitive landscape in this segment?

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

So our pricing for Hue has been quite stable. The competitive landscape is evolving more towards WiFi offers. We think that we still have a very strong position in the Zigbee part of the market. So this is why we have done basically 2 things. So the first one is the acquisition of WiZ, which had a fabulous ecosystem WiFi-based, and we believe that in the longer run, there will be 2 existing ecosystems for smart connected home lighting, which is Zigbee on one hand and WiFi on the other hand.

And the second thing that we have also done lately, and we have announced that innovation to the markets in Q2 in Canada and the United States and it will be next year in Europe, which is direct light control for our Hue offers, meaning that you can access your Hue lamp directly from your smartphone. And what is also beautiful from a technology standpoint is that if you reach one lamp, then you will be able to reach also the other lamp through a Zigbee channeling medium, meaning that our offers included dual chip, which is Zigbee and Bluetooth. And it makes the access and the direct access to our lights extremely reliable. The beauty of the offer that we have developed, is that you can start with a [bulb] (corrected by company after the call) that helps you to control directly your light via your smart device, phone or tablet. And whenever you want to move to the full ecosystem adding a bridge, this app will give you a direct bridge to the other app that helps you to have access to the broader ecosystem. So as you can see when it comes to Home, pricing has been quite stable as Hue is concerned and the competitive landscape is evolving. And we evolve with that competitive landscape bringing WiFi offers to the market, but also Bluetooth direct light communication for Hue.

Operator

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

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

Coming back on Klite, I still try to calculate a bit on what the impact will be. If we take into account that this is -- if I'm right, one of your key suppliers before the acquisition, so is it then fair to assume that the internal sales, that the sales going into Signify are at least similar to the third-party sales. And if that is the case or any other amount, what kind of impact does it have on your cost base? So how much of those costs do you take out? And maybe then for the future, is it also a possibility to move some extra, some things that you go to other suppliers that you move to Klite, and therefore, taking out some extra costs?

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

Marc, let me give you a little bit of an insight here, although we don't communicate specifically on the financials of the deal. So yes, we've mentioned the external sales because this is what we are going to include in our accounts, and they will have an impact on our total sales and especially on here on BG LED. And then --regarding the supply -- the supply currently between us and Klite will be eliminated. Now, of course, we can't give you any specific amount, but it's substantially smaller than the external sales of Klite. So it's nowhere near that amount.

When you think of the synergies, Eric mentioned the margin stack-up. So from that standpoint, of course, there's going to be benefits for us in terms of financials. Then we will bring scale and probably more scale to Klite as we grow and expand in LED lamps, in LED luminaires and also in connected offerings. That's going to add scale. And from that scale, there's going to be, in Klite, also more efficiency. There is room to expand. There's going to be more manufacturing efficiency. There's going to be more [raw] (corrected by company after the call) material efficiencies. So there is a meaningful amount of synergies that we believe in the coming years we can bring to Klite, and that's going to help the overall financials on their side, and therefore, also, to some extent, on our side and also through our investment.

So the last element I will mention is that when you look at the impact on our financials and on the bottom line, of course, this will be accretive as of the first year -- first full year, which is 2020, and that will bring additional net profit and therefore EPS accretion as of year 1. Of course, we can't give you more specifics, financial elements, but this is again a transaction, which not only from a strategic standpoint but also from a financial standpoint is positive for the company.

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

Okay. And then as a follow-up, then on the -- coming back on that capital allocation question, the revenues of outside of EUR 250 million and something on top that, that's going internally, would that imply that -- I mean what kind of [inaudible] we should just assume for argument sake around one time. That doesn't leave any room for other capital returns for the remainder of the year? Or am I missing something there?

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

So as I said earlier, middle of the year like that, especially after what we've done in terms of acquisition is not the right moment to discuss capital allocation. We'll discuss that with the Board at the end of the year on the basis of the overall free cash flow of the year and also on the basis of the pipeline of acquisitions, and that will be the right moment to come back and talk about what we do with our capital.

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*

I've got 2 questions, please. Firstly, can you help us understand what's happening inside your working capital? You talked about phasing payables and receivables. As far as I can work out, you're just paying your suppliers more slowly. So you've had a big increase in your payables, a big cash inflow from payables. So maybe you can explain whether that my understanding is correct.

And then secondly on lamps beginning into the second half, we have much more difficult comparables because of the surge last year. So maybe you can help us understand what you think is going to happen to organic growth in the second half of the year. And where the market is going, because you've been talking about growing or shrinking less rapidly in the market, i.e., gaining share on the diminishing market. So maybe you can help us understand where you think the market is going on an underlying basis, ignoring the halogen issues that are distorting the effects in 2018 and '19.

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

Yes. Let me take the first one on the working cap. So it's pretty simple. As you know and as we have mentioned, talking about Horizon, optimizing working cap, and including AR and AP and the payment terms with our customers and with our suppliers is very important for us. And we've done that for a few years, but we believe that we can do more. And we've initiated a number of actions to improve those payment terms. However, I must say the impact on Q2 is not yet very visible, but it will come later.

What we've done also, Peter, is that we looked at how to customize also the payments of the company. Unlike many companies, we've moved from -- in the second quarter, we've moved from paying our suppliers every day and having payments done every day to payments done through a payment factory 3x a month. And one of those payment runs out of the 3 payment runs, the last one is on the last day of the month. It happens that this quarter, the last day of the months were the weekend. And it has happened in the past, it was the case also at the end of March, it was the case, I believe, also at the end of 2018. So sometimes the end of the month or the end of the quarter happens to be on the weekend. And in that case, the wire transfer is shifted to the following day. Previously, it could have an impact, but it was more limited. And of course, it has an impact on our payables, but it also has an impact the other way on the way customers pay us and sometimes we only receive the money the following day.

Here, because we've changed the payment runs, there was a higher amount of payables that we are supposed to be done or that we are scheduled to be done on the last day of the quarter. And because it was the weekend, it shifted to early

July. So because that was temporary, we wanted to be very clear in our communication that out of the overall working capital reduction and out of the payables, part of it was temporary and was just a shift to the other quarter. By the way, again, as I've mentioned, it has impacted payables in a more important way than visible because of those payment terms, but we were also impacted on the receivables side because some of our customers, we were supposed to collect on the 30th of June and we collected only on the third of July. So that is the very concrete explanation for the phasing of receivables and payables. And again, we have estimated the amount to be around EUR 60 million. That is shifting from Q2 to Q3. Now if you take out those EUR 60 million, as you have mentioned, it's still free cash flow generation for the second quarter of EUR 60 million or EUR 61 million, which is a strong performance, and again, it reflects everything that we are doing to improve our working cap. I hope it clarifies for you, Peter?

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

Yes, that's very helpful. I was wondering what was going on. And can you estimate what the full year impact is going to be? How much of your full year cash flow target comes from the change to your working capital arrangement?

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

No. Here, what I've just described is temporary because of the payment happening on the weekend. It's not going to have -- and it's going to reverse because, again, we've made those payments at the beginning of July. So it's very temporary to the end of the second quarter. We've looked at the end of Q3 and the end of Q4, the last day is not a weekend. So the payments and the payments from our customers will happen totally normally. So there's not going to be any impact on the whole year. The impact we expect on the whole year is everything that we are doing to improve payment terms in general whether it's with us suppliers or with our customers.

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

So Peter, let me take the second question on lamps. So if you look at the performance at the end of H1, we had minus 19%. We guided between minus 21% and minus 24%, taking into account the fact that we have a high compare for the second semester and especially in Q3 because this is when the halogen ban in Europe did take place in 2018. So yes, we are forecasting a higher decline, more important decline in the second semester for the Lamps business and specifically in Q3, remaining in the guidance that we have given, which is between minus 21% to minus 24%. So at this point in time, if you look at where the market is going and what is the market dynamic, we believe that the market is declining more between minus 25% to minus 30%. If you were also listening to other companies that are still operating on that field, you will see that their performance is substantially degraded versus ours when it comes to the comparable sales growth. So our objective in the business is very clear, declining but declining less than the market and continuing to increase our market share. We have now about 1/4 of the worldwide market on that business, and we continue to expand on this. Where is the market going in the longer run? It's always something which is difficult to assess. We see, at one stage, that there will be a remaining portion of that business since some customers in specific geography are still requiring and will still be requiring these products, but we have still ahead of us probably a few quarters of continuous decline.

Operator

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

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

Alok Katre from SocGen. Two questions that I had both focusing on the growth. Firstly was -- if you could just talk a bit about how, let's say, the things, or the sales developed through the quarter ex the lamps business, i.e., did you exit the quarter at a higher rate of sales then you went into it? And is that also partly behind the confidence in the second half of the year? Eric, you talked about the comps, the project pipeline, et cetera, but is this also part of how you -- of how the quarter developed, let's say?

And the follow-up question really is a bit on India. I know the elections obviously caused a bit of a slowdown, pretty much in multiple industries, but I'm just wondering whether -- what gives you the confidence that things, let's say, will improve in the second half of the year because the news flow on the ground suggests growth is decelerating rather than accelerating. So I just wonder how much of the growth or how much of the reversal that you hoped is actually linked to the macros versus just specific projects being signed off.

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

So let me take the questions one by one. But let's review more the process on how we are forecasting the business performance over the upcoming quarters. Basically, at the end of each quarter, we have, by markets, what we call, performance reviews and forecast reviews where we would go quite granular by market, by business, understanding what has happened in the previous quarter and forecasting what's going to happen in the upcoming quarters. After this is done with all our geographies and all our businesses, then we use another methodology, which is based on statistics and looking at the data in order to try to have another way to look at the performance and another way to look at the forecast moving forward. At the end of the day, we tried to take reasonable pragmatic, but not over optimistic assumption, neither over pessimistic assumption on the top line in order to try to gauge where the company is going, understanding that from a geographical perspective, as you understand it, also from a business perspective, we have a lot of different trends and different happenings. When that is done, we confirm our forecast, which is pretty much the basis of us confirming today our guidance. It's difficult to define the trend and run rate at the beginning and the end of the quarter because the quarter is not a good measure of analysis of the performance on the longer run. Many things can happen during the quarter, and it's a too short time to find absolute trends. But quarter-after-quarter, we can, and this is the way -- and this is what we use basically when we do our more statistical analysis. So you have also mentioned it, I'm not going to say it again. So the analysis that we have made on the growing profit engines and which I have been describing previously with 3 different elements is what make us say, and that we are confirming today our guidance for the full year on the top line.

When it comes to India, so I think you're right. We see that some of the structural elements underlying the dynamic of the economy of the Indian territory slowing down a bit, but it's still a country which has very decent GDP growth. What has also to be noticed is that we are historically very strong in India. We are the market leading company in all our businesses. So when there is a downturn, we feel it, but we also benefit from the growth and the expansion of that economy, and we're quite confident about being able to do that.

We have, in India, also some specific offers being developed. It is a country where we are close to being totally vertically integrated. Most of what we sell in India, we also produce in India so we are very short cycle there. So we are confident in our capacity to extract value and the max we can from the Greater India territory. Market slowdown is effectively there, but we believe that there's a GDP growth and we should benefit from it.

Operator

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

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

If I could go back, and sorry for that, but if I could go back to Klite, please. I guess my question is we've seen notably in Europe and last year actually in North America before the tariff were put in place that there were some form of floating of new Chinese products from new Chinese players especially on the trade channel including on the luminaires side. When we look at this, a lot of those Chinese companies had beaten third-party providers for existing or established luminaire companies, Western luminaires companies, and they were now selling into the trade channels. So my question is, is there a specific reason why you're not taking this Klite company 100% into your ownership to prevent this company to maybe, at some point also, go on their own to some extent, notably on the private label and disrupt as we have seen, to some extent, some of the price structure in the industry.

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

So Lucie, what you say is true. We've seen that trend and we've commented on it a few times. So why not 100%? Because this is an association. We want Klite to continue doing the business it does, which is selling to private label customers, normally, its big private labels, but also to other OEMs. That part of the business has to continue while at the same time, we will bring also volume and we'll bring more volumes to Klite to continue further, improve its cost dilution and also developing with them innovation especially on smart lighting and connected lighting. So we believe that we're going to have more with them and more cost-efficient offers to also be able to face the trend that you have described previously.

Now we have reacted also to that trend by providing what we call B brand offers, position lower than the Philips brand with a very specific aim to be able to stop these competitors to enter in our markets. To a given extent, I think that will be in -- and we're starting to be quite successful in Northern America in doing so. In Europe, it's more in the making, but we believe that, that strategy is a winning one. So having Philips and our B brand positioned at the right level while at the same time getting more control on the supply chain end-to-end and being a bit more integrated, which will help us to achieve the right level of cost to increase our margin, but also to be able to freely discuss about technology and bring new technology to Klite to make it even more successful. There's one element that I've commented during the call, which is also very important related to Klite. This is a company that will be benefiting from our intellectual property position, meaning that it will have a distinguished advantage versus some other companies that you have mentioned that may not be fully IP-compliant. So we believe that's also for the future, a tremendous advantage that Klite will have.

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

So just -- if I understand well, I guess in the terms of your partnership or collaboration with Klite, there is also specific -- I would say, a specific barrier to kind of prevent the company to have some form of activity, which could be detrimental to you and to your portfolio. Am I understanding this correctly?

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

But you see, with 51%, basically, we are consolidating Klite, so the EUR 250 million sales to third parties. While at the same time, we're also basically deciding with them on what is the strategy and go-to-market. Now the beauty of it is that we had discussions with them, as you can imagine, before making that commitment on both sides, and we are perfectly aligned on the strategy moving forward. And we believe that for them and for us, it's a winning strategy.

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

Understood. Just my last question quickly. You're talking more and more about horticulture, LiFi, solar. Today as well, you've made this acquisition in the animal-centric lighting. Are you able maybe to give us a sense roughly of how much of sales this now is for the company, all of these new businesses.

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

So when we talk about agriculture, it is horticulture, but also animal-centric lighting. And so animals, we talk about chickens, we talk about swine to a lesser extent, but we also talk about fishes. So the vast majority of that business is on horticulture today, but we strongly believe in animal-centric lighting. I think that business has got a very clear purpose moving forward, which is to help to solve one of the issues that the world is going to have in the years to come, which is about food security. And all these different initiatives that we are putting in place are somewhat helping to solve that equation. So when you look at that business today, it's already quite substantial. We're not specifically indicating its size. And within that business, horticulture is clearly the most developed. Then would come what we do for chicken lighting and then probably fish lighting, but the perspectives ahead and the potential to do better, to do more, to generate and create value on those businesses is, seen by me, a very, very interesting perspective for Signify moving forward.

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

In horticulture, 10% of sales, maybe less than 5%. We can not have even an indication?

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

That's a good try Lucie. We don't...

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

All right, fair enough

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

[inaudible]

Operator

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

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

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

Operator

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