REFINITIV STREETEVENTS

EDITED TRANSCRIPT

LIGHT.AS - Q4 2020 Signify NV Earnings Call

EVENT DATE/TIME: JANUARY 29, 2021 / 8:00AM GMT

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

CORPORATE PARTICIPANTS

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

Francisco Javier Van Engelen Sousa *Signify N.V. - CFO & Member of Board of Management*

Thelke Gerdes *Signify N.V. - Head of IR*

CONFERENCE CALL PARTICIPANTS

Andreas P. Willi *JPMorgan Chase & Co, Research Division - Head of the European Capital Goods*

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

George Featherstone *BofA Merrill Lynch, Research Division - Research Analyst & Associate*

Joseph Zhou *Redburn (Europe) Limited, 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 - MD*

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

PRESENTATION

Operator

Ladies and gentlemen, welcome to the Signify Fourth Quarter and Full year Results 2020. (Operator Instructions)

I would now like to give the floor to Thelke Gerdes, Head of Investor Relations. Ms. Gerdes, please go ahead.

Thelke Gerdes - *Signify N.V. - Head of IR*

Good morning, everyone, and welcome to Signify's Earnings Call for the Fourth Quarter and Full Year Results 2020. With me are Eric Rondolat, CEO of Signify; and Javier Van Engelen, CFO.

In a moment, Eric will briefly touch on the key operational and financial takeaways for the full year 2020. Javier will then follow with a review of the company's performance in the fourth quarter. After which, Eric will give you some more details on the full year 2020 to then end today's presentation with an outlook for 2021. After that, we will be happy to take your questions.

Our press release and the presentation were published at 7:00 a.m. this morning. Both documents are available for download from our Investor Relations website. The transcript of today's conference call will be made available as soon as possible on our Investor Relations website.

And with that, I would now like to hand over to Eric.

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

Thank you, Thelke. Good morning, everyone, and thank you for joining us today. I propose that we go immediately to Slide 4 with the key operational and financial takeaways for the full year 2020.

LED-based sales represented 80% of total sales compared to 79% in the previous year. We increased the installed base of connected light points to 77 million, illustrating once again the growing interest for this essential part of our business.

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Our adjusted EBITA margin increased by 30 basis points to 10.7%, and we further decreased our costs by 9.1% or EUR 166 million. As we did in 2019, we continue to focus on structurally improving our working capital. And together with our profitability improvement and the consolidation of Cooper Lighting and Klite, this allowed us to generate solid free cash flow of EUR 817 million.

On January 13, we announced an extraordinary dividend of EUR 1.35 per share. And in addition to this, we proposed to pay a regular cash dividend of EUR 1.40 per share over 2020. In addition, we also reduced our debt by EUR 350 million, lowering our leverage from 2.7x to 1.7x, which is in line with our commitment.

We also have made steady progress with the integration of Cooper Lighting and Klite. Both acquisitions are delivering synergies ahead of plan.

And finally, we are very pleased to have successfully completed our Brighter Lives, Better World 2020 sustainability program, including the achievement of carbon neutrality for all our operations across the world. We have now embarked on a cause to double our positive impact on the environment and society by 2025.

And with this, I will now hand over to Javier, who will discuss the company's performance for the fourth quarter 2020.

Francisco Javier Van Engelen Sousa - *Signify N.V. - CFO & Member of Board of Management*

Thank you, Eric, and hello to everyone. It's my pleasure to present our fourth quarter 2020 result this morning. You will see that while our fourth quarter is traditionally our strongest quarter, our Q4 2020 results are a further testimony of our robust financial profile in still adverse market conditions.

On Slide 6, we highlight that installed base of connected light points increased by 8% EUR 71 million in the third quarter to 77 million in quarter 4.

LED-based sales represented 82% of total sales. Total sales reached EUR 1.9 billion, an increase of 18% over 2019, reflecting the consolidation of Cooper Lighting. As illustrated on the right, comparable sales growth still declined by 5.9%, yet it showed a sequential improvement from minus 8.3% in the third quarter and minus 22.5% in quarter 2. This improvement was mainly driven by our Digital Products division and by early signs of recovery in both China and in some parts of Europe.

Adjusted indirect costs were down EUR 18 million or 3.9%, excluding FX effects, changes in scope and provisions for the reimbursement of employee contributions.

As shown on the right, adjusted EBITA margin increased by 20 basis points to 13.4% on a strong base of quarter 4 2019. This was mainly driven by gross margin improvement.

Net income increased by 39.4% to EUR 137 million, driven by a higher EBIT and a lower effective tax rate due to a onetime noncash tax benefit resulting from the revaluation of deferred tax assets.

Finally, the free cash flow further increased from a high base of EUR 308 million last year to EUR 332 million this year. This as a result of profitability growth and a continued structural working capital improvement.

Let me now provide you with more details for each of the divisions, starting on Slide 7 with Digital Solutions. LED-based sales accounted for 89% of total sales, and connected base sales represented 22% of total sales. Nominal sales increased by 27.3% as a result of the consolidation of Cooper Lighting. Comparable sales declined by 10.2% compared to minus a 22.4% in quarter 2 and a minus 11.2% in quarter 3 with the Professional segment in many of our markets, such as the Americas, parts of Europe and Southeast Asia, will still remain impacted by the COVID-19 pandemic.

Including Cooper Lighting, adjusted EBITA margin at 11.5% remained robust despite the top line decline, even if it was declining by 60 basis points on a very strong 2019 base.

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

On Slide 8, you can see some of the business highlights, demonstrating the acceleration we are driving in key growth areas like connected lighting, disinfection and solar.

Let me just single out 2 of them. First, illustrating our commitment to health and well-being, the installation of 31 UV-C disinfection upper air luminaires at supermarket, EDEKA Clausen, in Hamburg, one of several installations of UV-C disinfection upper air luminaires. These luminaires effectively disinfect the air and provide both customers and staff with a layer of protection -- with an extra layer of protection against viruses and bacteria. We also provided them with UV-C disinfection chamber to disinfect small objects and shared devices such as hand scans.

Second, our global partnership we reached with Honeywell. By combining our respective areas of expertise, we will further improve productivity and well-being in offices. What we're adding is some of our lighting systems and software, including Interact Office, NatureConnect and UV-C disinfection lighting to Honeywell's Healthy Buildings solutions. This will support the need of any building and future-specific solutions for premium commercial buildings, airports, hospitality, health care, education, retail or stadia sectors. We are -- we already developed and deployed integrated offerings at some customers.

Moving on to Digital Products on Slide 9, showing a strong top line and margin performance during the quarter. The share of connected-based sales grew to 30%, up from 21% in the third quarter, again, reflecting a strong performance of the category. Comparable sales showed a plus 2.5% sales growth, driven by robust performance in the consumer channel, particularly in the connected home category, where we benefited from good sales momentum in a seasonally strong quarter.

Adjusted EBITA improved by 230 basis points to 18%, reflecting the positive impact of cost dilution from comparable sales growth, the positive mix effect of connected home sales and gross margin expansion.

On Slide 10, you can again see some business highlights of the division. Showing our continued investment in consumer-centric innovation as the market shifts to integrated luminaires.

Let me again highlight just 2 of them. Let me start again with our commitment to health and well-being, expanding our UV-C portfolio, both on a product level as well as geographically. We have launched the UV-C disinfection box in china and Indonesia to further strengthen our UV-C disinfection product offering to consumers. This box can effectively disinfect viruses and bacteria from small objects such as keys, cell phones, toys, household items in a matter of minutes, depending on the application. The box contains reflective stainless-steel interior designed to reach any surface of the object, and it allows for multiple objects to be put in the box at the same time. It's equipped with a built-in sensor that automatically switches the box off when the lid is opened.

Still in UV-C, I want to quickly touch on UV-C disinfection desk lamp, which we highlight at previous quarter. This product is now available in more countries in Asia, was introduced in several countries in LatAm and is also available to customers in Europe via Amazon.

A second highlight. We further expanded the LED lamps portfolio with the launch of the Radial Lamp, differentiating the shapes of what we offer. This product with a high average selling price provides an output of 2,100 lumen at 20 watts, resulting in a higher efficacy of 105 lumen per watt. This product is suitable for both the wall and ceiling applications. It was launched on Amazon and soon acquired a 5-star rating and is now also featuring in the top 100. It's appreciated by retailers where we have received multiple repeat orders.

Let's now turn to Slide 11 to discuss the performance of Conventional Products. As a result of the relatively strong performance within a declining market, we estimate that we continue to gain market share, driven by the successful continuation of our last company standing strategy. Similar to Q3, comparable sales decreased by, between brackets only, 11.6% in quarter 4, supported by strong demand for UV-C and horticulture lighting. Adjusted EBITA margin increased by 160 basis points to 18.9%, driven by adjusted indirect cost savings, higher productivity and the positive effect of a lower top line decline.

Let's go to Slide 12 where you can see the adjusted EBITA bridge for total Signify. Despite the high adjusted EBITA margin in Q4 last year, we were able to still improve our adjusted EBITA margin by 20 basis points to 13.4%. The negative impact of lower volume and price erosion was fully offset by cost of goods savings.

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Anticipating your questions on pricing, we have seen a continued slowdown in the price erosion of LED lamps and electronics. At the same time, we have been able to lead price increases in parts of our portfolio, is also in anticipation of component supply shortages and raw material price increases.

Adjusted indirect cost decreased by EUR 3 million in the quarter with overall ForEx impact and on the adjusted EBITA was a negative EUR 12 million.

Finally, scope and other includes EUR 29 million positive impact of Cooper Lighting consolidation, which takes us to Q4 working capital on Slide 13. When we include sales of Cooper Lighting and Klite on a 12-month pro forma basis, working capital improved by 130 basis points to 4% of sales in quarter 4 2020. The improvement was mainly driven by structural changes in receivables, other working capital items and payables. Trade and other receivables as a percentage of sales reduced by 220 basis points to 16.9% when including the sales of Cooper and Klite on a 12-month pro forma basis.

And finally, on Slide 14, we take a close look at our net debt evolution. Net debt decreased by EUR 314 million, mainly driven by strong operational profitability and improvements in working capital.

Next to this, you can see the other items in the bridge that impacted cash and thus our position. Net CapEx was EUR 27 million in the quarter. Next to that, we paid EUR 29 million for tax and interest. Other includes cash used for derivatives, acquisition, new lease liabilities, dividends to minority shareholders and FX effect on cash, cash equivalents and debt. All in all, our net debt position at 2020 year-end amounted to EUR 1.275 billion. This resulted in a reduction of our net leverage ratio from 2.2x at the end of September to 1.7x at year-end, which keeps us well on track to deliver on our commitment to reduce our leverage back to 1x multiple by the end of 2022.

With that, let me now hand back to Eric for highlights of the full year 2020 and the outlook.

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

Thank you, Javier. Let's turn to Slide 16. So despite the 2020 headwinds, Digital Solutions and Digital Products significantly improved profitability and free cash flow. The combined EBITA margin increased by 90 basis points in 2019 to 11.3%, both contributing to the improvement. They contributed 79% to our total adjusted EBITA in 2020 compared to 70% a year ago, and they contributed 82% of free cash flow in 2020 compared to 72% in 2019. As a result, our dependence on the Conventional Products business has further decreased.

I propose that we move now to Slide 17. So in summary, the COVID-19 pandemic impacted our full year 2020 top line while margins were resilient. And Digital Solutions achieved an EBITA margin improvement of 20 basis points. And despite a CSG decline of 14.4%, the EBITA margin expansion was driven by gross margin expansion and the consolidation of Cooper Lighting as well as synergy realization.

Digital Products delivered an EBITA margin improvement of 210 basis points, CSG declined by 8.3%. The top line was not as severely impacted as we saw strong resilience of connected home sales.

And finally, our conventional products achieved a solid free cash flow of EUR 188 million or 19.9% of sales while declining less than in 2019.

On Slide 18, you can see the evolution of our indirect cost savings. In total, we lowered our indirect cost base by EUR 166 million. And if we adjust for FX and scope, it is a reduction of 9.1%. We had a positive currency impact of EUR 26 million. And when adding EUR 361 million coming from scope effects related to the Cooper Lighting and Klite acquisitions, we ended with a total adjusted indirect cost of slightly below EUR 2 billion.

I would like now to zoom in to our sustainability performance as shown on Slide 19, please, yes. So as mentioned earlier, we are very pleased with the achievement of our 2020 sustainability targets. So first, in terms of sustainable revenues, 84.1% of our revenues were sustainable in 2020, already exceeding our 2020 target of 80%. We sold 2.9 billion LED lamps cumulative since 2015, meaning that we overachieved the 2 billion target by 46%.

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

And regarding the sustainability of our operations, we achieved the following targets: We became carbon neutral this year in all our operations across the world; we achieved our target of 0 waste to landfill at 100% of our sites; we also want to assure a safe and healthy workplace for our employees, so we achieved our target of less than 0.35 in TRC, further decreasing it by 31% compared to Q4 2019, we achieved a TRC of 0.22; 99% of our risk suppliers have been audited, well ahead of our 2020 targets of 90%.

In September 2020, we announced that we embarked on a course to double our positive impact on the environment and society by 2025 with the following ambitions: doubling the pace at which we achieved a 1.5-degree scenario of the Paris Agreement, doubling our circular revenues to 32%, doubling our brand of labs revenue to 32% and doubling the percentage of women in leadership to 34%. As a result of all our efforts related to sustainability, we have been recognized as industry leader in the Dow Jones Sustainability Index for the fourth consecutive year, and we have been included in CDP's prestigious A-list for climate change since the IPO.

Let's now move to Slide 20 to discuss our intended and capital allocation for 2021. On January 13, we proposed an extraordinary dividend of EUR 1.35 per share, around EUR 170 million, which is in line with the dividend proposal for 2019 that was withdrawn as precautionary measure in Q2 2020.

For 2020, we proposed to pay a cash dividend of EUR 1.40 per share to be paid in 2021, reflecting our commitment to pay an increasing annual dividend per share. This represents a dividend yield of 4.1% over the closing price of December 31. Both dividends are subject to shareholder approval at the AGM on May 18. So in line with our commitments to an investment-grade rating, we also announced our intention to repay a minimum of EUR 350 million of debt in 2021.

And finally, I would like to turn now to the outlook for 2021, which is on Slide 22. So given the ongoing nature of the pandemic, we remain cautious about the market developments in 2021. But at the same time, we are confident in our ability to adapt to external challenges as we demonstrated it through 2020.

For 2021, we are expecting positive comparable sales growth, the level of which will depend on the recovery pattern in our markets. In addition, we also expect to continue to progress towards our mid-term adjusted EBITA margin objectives of 11% to 13%. We have already launched structural cost adaptation plans aiming at making our central organization leaner. Through these measures, we are aiming to bring our indirect cost to the benchmark 25% to 29% level in the mid-term.

Free cash flow, following 2 years of significant structural working capital improvement, is expected to exceed 8% of sales. As guided for the mid-term, this includes a higher initial cash outflow for cost restructuring and continued post-merger integration activities.

With all that, I would like now to open the call for questions, which Javier and myself will be happy to answer.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Martin Wilkie at Citi.

Martin Wilkie - *Citigroup Inc., Research Division - MD*

It's Martin from Citi. The question is really just a clarification on your margin guidance. You talked about progress towards the mid-term target. But just to clarify, do you think you can get inside or above 11%? And in terms of the uncertainty around that, is it largely linked to the volume outlook, as you mentioned, still uncertain because of the pandemic?

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

Martin, it's exactly what you've said. We expect to further improve the operating margin, but there's still a level of uncertainty on the end markets. I mean you see it -- as we see it, still a lot of volatility. And now depending on the opening of the open markets, we think we can do more or less on the top line, but also on the bottom line. So it's directly linked to our capacity to grow the company.

Martin Wilkie - *Citigroup Inc., Research Division - MD*

And just as a follow-up, in terms of other moving parts, you mentioned about pricing and raw materials and so forth. Is that going to get worse as the year progresses? Or do you feel that the price increases that you put through can offset any ramp-up that you've seen in steel and other electronic costs and things like that?

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

So what we see is that at this point in time, there is a shortage because with the pandemic, at the level of the industries that were -- and generating and extracting raw material and also some of the other manufacturing industry of components, they're underinvested and/or they didn't continue to invest, let me put it this way, because of the crisis. and as one part of the business, especially on the consumer side and connected products, as we see a step-up in demand, the chain and the whole supply chain was not ready. So we have been seeing increase in raw material, shortage to some components. We don't believe that this will last over the full year because we see now these industries resuming their investment in some specific domains.

Now the issue is, if you want to increase your capacity in chips, I mean you cannot do that in the space of 2 weeks. So it's probably more 6 months. So we believe that moving forward, these different manufacturing industries will be able to go back to the required level in order to supply the demand. But we have probably like time here of about, yes, maybe 6, 6 to 8 months where they need to rebuild capacity.

So in the meantime, we have recorded increase in raw material, and we have already taken measures from a pricing perspective to be able to maintain our gross margin. So that has already been implemented in all the countries where we operate with different schedules. But it's all already done.

Operator

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

Andreas P. Willi - *JPMorgan Chase & Co, Research Division - Head of the European Capital Goods*

I would like to follow up from what Martin just asked because on the margin target, I'm still not 100% clear what you exactly want to say with the guidance. When you say progress towards the target range, given you were very, very close already to that target range in 2020, so if you just could explain again what the thinking really is. Is the minimum 11% for 2021 or not?

And then on the raw material cost question follow-up. Could you give a bit more information, particularly for the Digital Solutions business, what the important raw materials are, what the percent of sales is there and the price increases you think you have to make as a percentage point to keep these gross margins flat in 2021?

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

Thank you, Andreas. We had 10.7% at the end of 2020. The lower end of the range that we have given for the mid-term is 11%, which is 30 basis points more. So this would be exactly the same progression as the one that we have done in 2020 if we were achieving the bottom end of that interval.

Now you've been following us for many years, so you know that our P&L is also very sensitive to the top line, but we've been also demonstrating that we can still improve 7 years in a row the profit even when the company is declining. Now what we are indicating is that we will further progress and improve our operating margin, the extent of which will directly depend on what we can extract in terms of top line. And so you've seen the progression in the past years. I mean you can count, depending on when the top line is going to be on the progression that can be similar for 2021.

When it comes to Digital Solution, it's the metals, aluminum, copper. The plastics are also touched in terms of raw material price increase. We believe that we have already done what is necessary to be able to protect our gross margin in terms of price.

Andreas P. Willi - *JPMorgan Chase & Co, Research Division - Head of the European Capital Goods*

And what about the steel exposure, particularly for outdoor lighting?

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

Yes. That's also another metal where we have a substantial exposure, not only for outdoor because we use also steel in indoor fixtures. Yes, we have an exposure to steel also, but we are, at this point in time, operating the necessary -- so it's not only price increases because you know that we have regular negotiation sessions with our suppliers. During these negotiation sessions, normally, we can extract costs. And probably that this year, we may not be able to extract costs. Maybe our costs are going to be stable. So we're going to do what's necessary at the level of our price management to make sure that we can safeguard the gross margin.

Operator

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

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

I was hoping maybe you could give us some indication around current trading. And kind of related to that, how are you thinking in terms of growth scenarios, I would say, for your 3 division, considering that you haven't kind of given a range for the group in terms of growth? How should we think about the potential of recovery in the 3 businesses?

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

Current trading, maybe not, but I can give you a view of how we see at least the first quarter. I think we need to navigate on a short horizon at this point in time and maybe also the second quarter. So what we see today from a geographical perspective, and then I will talk more about the divisions. But from a geographical perspective, we are seeing a recovery in China. And we already experienced that in Q4. And China was very severely hit for us in the first wave. Also, our manufacturing plants in China, this is where we also -- we're doing the first step of integration of Klite, and our factories had to stay closed for a few months. So the start has been very difficult in China during the first wave.

We think that China today doesn't really have a second wave, and we have seen a sequential improvement in our business in China. And that's valid, I would say, on all our businesses and for the 3 divisions.

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

If we go to Europe, Europe has seen sequential improvement over the quarters. And Q4 has shown a very different pattern by business. We had a very strong consumer business, and we had a professional business still impacted by the pandemic. Now if we try to project on the country of China, we see on a path of recovery also moving forward. We are more cautious when it comes to Europe because you have seen as well as we do the measures that have been reinforced from a pandemic standpoint in Europe that probably are going to cover, we believe, partly, if not completely, Q1.

So cautious in Europe, especially when it comes to the Professional business. What we've seen, we've seen that projects were delayed. New projects were not really coming to life because of the situation that we are facing here. Probably with a slight difference between South and North Europe, South Europe being more touched than the northern part of Europe.

Now let's go to the states. So the states, we're not touched at the beginning of the crisis. But we have seen softness in U.S. on the Professional side since, I would say, the middle of Q2 and has continued throughout. You see what is happening also in the states and the statistics of the pandemic. And we think that geography will be probably also affected in Q1 and maybe also partially in Q2.

So we're seeing ahead a first semester, which is still troubled, Europe, U.S., recovery in China and some parts of Asia. We don't see recovery today in India and Indonesia, which are also big, big geographies for us because the pandemic is hitting very hard in Asia also. So we see a troubled first semester, and we expect that with the measures that are being taken at this point in time, when it comes to vaccination and so on that we should be able to see the light at the end of the tunnel and have a better H2. But the situation is very volatile. The vision and the visibility we had 1 month ago is different than the one we have now, and probably it's going to be different from the one that we're going to have 1 month from now before everything stabilizes.

So in a nutshell, we see a good China, a recovering Europe, a recovering U.S., but with maybe a bit of a longer time lag. And from our businesses -- from a business perspective, much stronger on the consumer side of the business is what we see moving forward then on the Professional side.

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

And then my follow-up maybe on that, how much visibility do you have in terms of whether your distributors and distribution channels have restocked? And how much that restocking or move you may have seen at the end of 2020 is kind of matching underlying demand at the moment?

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

I think the -- both on Professional and on the consumer side, the level of inventories are quite low and probably even more on the consumer side because of the extra demand. There has not been a massive restocking. I think a lot of our distributors have also taken the advantage, so-called, of the crisis to be able to destock. So the stock in the channel today is, if we compare to the average we had previously, it's still at a much lower level.

Operator

Our next question comes from the line of Daniela Costa of 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*

I'll start with one and then do a follow-up. But I wanted to understand if you could give us a little bit more color on exactly how many UV-C sales you had? And what do you have in terms of the pipeline also based on the capacity increases you had done? And related to that, if you have seen in terms of inquiries about UV-C, any changes post the vaccines?

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

Yes. Daniela, so on UV-C, let me confirm a few things. So first of all, we're not giving a specific number for our UV-C business for competitive reasons. We've explained that already. But what we said during Capital Markets Day is that all these new growth platforms business were amounting to about EUR 250 million, and they're growing a bit or substantially more than the average.

Now let's go back to UV-C. We have indeed a capacity today, which is, in fact, more than 8x what it used to be at the beginning of 2020, probably closer to 10. We see a very strong traction on the sales of light sources. So that has always been the case, and it's clearly continuing.

We have seen an expansion of our sales to the consumer to consumers. So we have released many products like disinfection box, which is the size of a small microwave, where basically you can disinfect small objects. I mean we're talking about keys, phones, toys, things of that nature. We have started to sell in Asia at this point in time, and we see a good traction there. We talked about also the desk lamp for consumer usage with sensors that would avoid the desk lamp and the lamp to be turned on whenever there is a human presence. That has done very well when we launched it in Asia and in Middle East, and now we are selling it in Europe.

On the Professional side, so we have a lot of wins. But it's a much longer commercial cycles because we really need to educate a lot of customers, which is probably a hurdle to start the business, but it's a good hurdle to have when the business has started because it's going to be also complicated for competition to be able to do it. It needs a very good understanding of the technology and its reach, and this is what we have trained our sales force centrally and locally at doing. But we see still inquiries, and the funnel is growing with wins in different type of environment, especially on the retail environment. We talked about a very interesting one, which is EDEKA, a German retailer, where basically we've sold that around 30 upper air disinfection luminaires in its food retail shop in order to provide to the consumers a safe and a clean space. So that is also happening.

Have the inquiries gone down after the vaccine? Well, not really. We don't see that. The way we are positioning the UV-C technology at this point in time, it's not only for COVID, it's in general to make sure that the spaces are clean. And we think it will survive the pandemic because this pandemic will leave sequels in our behavior. So, so far, we haven't seen that the traction was going down because of that. But we understand on the Professional side that it needs a lot of education and a lot of efforts to get to a sale, but it's progressing.

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

And I wanted to follow up on the margin, but more in understanding the margin range, the 11% to 13%. In the CMD, you had a slide with the bridge on the margin where the starting point was 10.2% to 10.6% for 2020. And then you would pay 50 basis points of the employee solidarity afterwards. You've obviously already paid that 50 basis points. And even the base was higher than the 10.2% to 10.7%. It was probably more like 11.2% if you adjust for the solidarity. So you have a much higher starting base. You seem to be comfortable that you're going ahead of planning the Cooper synergies. Your medium-term growth views, medium term have not changed. And you're confident that you will preserve the raw material to pricing mix to keep the gross margin flat. So why is the 11% to 13% still appropriate if the base was so much higher? What's the incremental headwind that has come? Or is it just -- yes, just understanding sort of if that view doesn't change given the base range.

Francisco Javier Van Engelen Sousa - *Signify N.V. - CFO & Member of Board of Management*

Daniela, Javier here. Thanks for the question. It's obviously a question that we've also carefully looked at. And if you refer back to the Capital Markets Day, go back to the dynamics we explained there. We indeed talked about range of 11.13 (sic) [11% to 13%]. And if you look at the internals, how we were going there, we said there's a change in dynamic on how we're going to be able to increase profit margin over time. We basically said it in the past, it was a lot of gross margin-driven and cost savings-driven. And then we talked about the future, which was mainly going about dilution through top line and maintaining gross margin. This is where, I think, still out there, what Eric said before, that's where we are also looking for 2021, '22 and why our gross margin progress is very much linked to our top line growth. And as we said, that's where there's still a couple of scenarios.

So yes, we have good news, and we think that despite all the circumstances, we will definitely keep on improving. But that improvement will, to one extent, have less dependency on gross margin. As we just talked about, the dynamic of pricing raw materials shortages and our pricing dynamics,

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

I think, holds us good for a stable gross margin, which means that, therefore, the margin progress is going to come more through the dilution of the top line. And then some of the cost savings will be kicking in more only about the second half of the year.

So are we perhaps a bit more cautious? Perhaps we are. We see the dynamics, especially on the raw materials happening. We hope to compensate those. So perhaps we're slightly more cautious in view of what we see in terms of both raw material price increases and also more uncertainty on the market. But the direction is still very clear. The margin is still there, 11% to 13%. Eric talked before that. Obviously, if you look at our year-on-year progress, you can expect us to keep on seeing a similar progress and hopefully get to within the range when we see the top line coming up.

Operator

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

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

And my first one is a very quick follow-up, which is on the inventory level, really. I think you have had very strong sales in Philips here and other connected lighting products. And what is the inventory level like in the channel for that business? And do you think the strong sales can sustain into the coming year? Do you see any headwinds or tailwinds going into 2021?

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

Joseph, the inventory level is low in our -- at our retailers for the connected home business. The development we've seen in the sales at the back end of the year has consumed a lot of the inventory. So if you look at the historical levels that these retailers had, it's much lower at this point in time, which is a good sign for the sales moving forward. Now the way we position our offers for the long term, you need to understand that we have very well segmented the market, we believe so, with the position of Q and the position of WiZ, which is the smart home connected offers that we have invested in, especially with the WiFi technology. And basically, they are covering the market targeting different categories and different segments of consumers. And both offers have found best spot on the market, and they've been progressing extremely well. I'm also very happy with the progression we had with WiZ that was quite strong in 2020.

So these offers are very well positioned from a consumer target perspective. And we see them growing in the future because what has also happened during the pandemic is a much higher level of education and a much level -- higher level of understanding from the consumer base about the connected offers. And those connected offers are really helping to develop the business because they offer so many use cases for the consumer that has been an accelerated learning about connected. So our base has increased.

And you know that for our business, it's the acquisition of new customers, but it is also increasing the base. When you buy, for instance, Philips Hue, well, you have different types of light sources and you can increase those light sources. And this is what we see. We see that when consumers enter in our platform, they can enter with 3 or 4 light sources. And that average number of light source per customer is increasing. So what we have done during the pandemic, we've not only done that, but we've also increased our bridge of penetration, which will link to also future sales. So yes, we're quite positive on this business also moving forward.

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

That's very helpful. And then next, I wanted to ask about your partnership with Honeywell. And why Honeywell? And how did it come about? And also who initiated it? I'm quite interested in hearing a bit more about this partnership.

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

Yes, joseph. Well, we had a long-standing relationship with Honeywell where basically we also found, between the 2 companies, a common approach when it comes to productivity and healthy workspaces. So we were -- we are both moving in that direction. And then what we decided to with Honeywell is to bring our connected lighting system in their technological environment.

So you can imagine a building being made of 4 verticals: one is GAC, another one is fire, a third one would be security and the fourth one is lighting. And Honeywell has the capacity to manage at a high level all of them. And what we want to do with them is to bring to them and to the global ecosystem the lighting part from the light sources, the fixture, the control devices, the software, Interact Office in office spaces in order to be able to offer a complete ecosystem. So we're working also with Honeywell at the technological level between our software platforms, but we have -- basically, it goes through APIs. So a lot of information from our system. Interact Office can be brought up to the higher-level system of Honeywell.

Let me give you just a very simple explanation. Our system is -- knows the presence and the motions in the rooms. So that's an information that we can send at the higher level -- at the level of the Honeywell platform for them to decide whether they're going to activate HVAC or not in those rooms. So things like that are currently being made.

What is interesting also is that the philosophy is technical, but also with the purpose. We want together to make workspaces healthier and workspaces more productive. There is in this agreement, and we have started to work on projects together, also a strong move towards including health features as UV-C lighting upper air disinfection in both spaces. So basically, we are playing the role of the connected lighting functions in a global Honeywell environment.

This is totally part of our strategy. I think we also talked about that, Joseph, at an earlier stage. Our strategy is not to go beyond lighting. Our strategy is to stay in lighting. But in lighting, we want to do everything up to the system. And then we can connect to higher level system that are doing more than lighting. And we do that in the professional space. Honeywell is a good example. But I would say we also do that in the consumer space where our connected platforms would be totally and seamlessly connectable to Amazon, to Google, to Apple, to smart thing of Samsung and to Ocean Connect of Huawei. So at the end of the day, we are connecting to the high-level platforms. And we do that both in consumer and in the professional space.

Operator

Our next question comes from the line of George Featherstone at Bank of America.

George Featherstone - *BofA Merrill Lynch, Research Division - Research Analyst & Associate*

First of all would be for free cash flow this year, would you expect to make any further working capital improvements that would be a tailwind to free cash flow?

Francisco Javier Van Engelen Sousa - *Signify N.V. - CFO & Member of Board of Management*

George, Javier here. Look, good question. You've seen our performance in the last 2 years. We've made some structural improvements in terms of all the elements of working capital. So if you look at the last 2 years, the cash we've generated through optimizing inventories in days, also in receivables, especially as we work on overdues, has been very important. And our payables also with the integration of Cooper Lighting and Klite, which have generated significant cash flow, has really helped us in the last 2 years to get to a percentage, which today we think is already a pretty good percentage.

So are we expecting to see more benefits? We are working on that. But for sure, it will not be to the same extent as what we've seen in the last 2 years. We've also indicated that, therefore, the 12.7% of sales that we have achieved in 2020 is not what we expect to see going forward. We do expect to be above 8%, which is still a healthy number compared to where we came from.

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

The areas of opportunities that we still see is, I think, that as we keep on digitizing, I think there are still opportunities to further look in inventories. On receivables, we have really gone down to level of overdue, which is extremely low, even if you look at it in a pandemic situation where more customers are having potential problems. So some improvement to come, we think so, but not to the extent of what we have seen in 2029 -- 2019 and 2020.

George Featherstone - *BofA Merrill Lynch, Research Division - Research Analyst & Associate*

That's great. And then, I guess linked to that, with the cash flow improvements that you've seen and the deleveraging that's happened from a capital allocation perspective, M&A seems to be now part of the agenda again. What are the key areas on a product portfolio perspective that you'd look to kind of -- to get involved in there from an M&A perspective?

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

M&A -- we'll only consider bolt-on M&A at this point in time, priorities on deleveraging, as you've mentioned it. We have 3 domains. One is luminaires, probably that would come from consolidation in places where we want to increase our market share. And that's one. Second, technologies around systems and services that would be complementary to ours. And what we've done also in the past, thirdly, is digital business models that would help us to improve, for instance, our online sales, things of that nature. So these are the 3 domains where we would look.

Operator

Our next question comes from the line Sven Weier.

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

Sven from UBS. Two questions from my side. The first one is on Digital Solutions. You already -- and regarding the revenue outlook you gave. You already mentioned, obviously, the impact of the pandemic, and that should obviously gradually ease during the year. But I was more curious how you reflected the non-resi starts that were quite, quite weak throughout last year and the impact of that. That probably will increasingly have an impact. Do you think the reopening and this one will balance each other out in the course of the year? That's the first one.

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

Sven, so the non-resi construction is about 50%. It's impacting 50% of our sales. And if you were going more into details, I think it's 15% for the new and 35% for the refurbishment market. So we have seen that market effectively, diversely impacted depending on the final end segments, but it has been impacted. And it's a market that has some inertia going down, but also some inertia going back up. You need the whole supply chain to be back in place. You need people to make finally the decisions of investments. So we think that we need to have a stable economy for a few months, if not a few quarters before this actually resumes to historical levels.

It is 50%, but it's also only 50% of our business. And then if you were making the accounts, you have probably around 26%, which is depending on infrastructure investments and public. And the rest, about 24% is around residential and consumer. So at the end of the day, we're depending on many different end segments. But yes, we see that part of the business quite hit. And I think it's going to take a bit of time before it goes back to historical levels.

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

Okay. And the second one is on the EBIT bridge and the indirect costs. And I think you were mentioning that if you exclude the reimbursement, the indirect cost was down EUR 18 million in Q4. It was down EUR 22 million in Q3. I was just wondering, if I'm not mistaken, part of the reimbursement

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

you booked already in Q3. And I was just wondering if the EUR 22 million adjusted was also adjusting for that? Or would it have been even higher? So really kind of getting a sequential stir on the underlying indirect costs and what do you think is the outlook for 2021.

Francisco Javier Van Engelen Sousa - *Signify N.V. - CFO & Member of Board of Management*

Yes. Sven, I'll take that one. You've looked at the numbers well. So you're absolutely right. If you compare the EUR 18 million that we have for the adjustment also for the repayment, there was indeed a smaller part also in Q3, which the EUR 22 million did not include. So if you do a sequential improvement, you would indeed see that we go from slightly above EUR 22 million, probably closer to EUR 30 million to the EUR 18 million. If you look at the sequential improvement, therefore, what you've seen is that we had indeed at the start of the year higher savings also with the flow-through of 2019. As we go in the second half of the year, also with higher volumes in the second half of the year, we see that, that savings has come down, as you said, sequentially from about EUR 30 million to EUR 18 million if you put on a comparable basis.

As we've talked before, that decline is still there. We see some opportunities still in 2021. But we also know that if you look at the cost decline we've seen, it's not been sufficient in order to compensate for the total top line decline. Therefore, the percentage has come up, and therefore, we have special savings programs coming into 2021 we've already started enacting and we started communicating those.

Operator

And our final question comes from the line of Marc Hesselink of ING.

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

Yes. First question, could you elaborate on the impact from the close of light channels and more towards online? Is your market share in online better than it is in off-line? And is there also brand value more important in the online channels versus the off-line channels?

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

Marc, I would not be able to answer on the market share. Things have been so volatile and developing so much lately. But what we see online and off-line, our position, especially in connected and smart connected home is, worldwide, very strong. And I think if we look at off-line and online, there should not be a major difference in terms of market share there.

The brand is very important for the consumer business, I would say, both online and off-line. I don't see a major difference. What we -- what is interesting is I believe that in online, you can create a brand faster, but you need also 2 resources. And you need to do a pool and you need to do an investment, which is higher in order to get a traction because there's also many opportunities to find brands online.

So this is what we're doing at this point in time. We have basically an approach. And I'm going to focus on the consumer business of 2 brands, Philips Hue and WiZ. And we are creating a very strong market pool. So in these businesses, we don't invest in promotions or things of that nature. We really invest in creating the market. So there's a -- these are business with high gross margin. So part of the cost to run this business is to create awareness. And we see at this point in time that we can go faster online in terms of creating a brand and having recognition, but we also need probably to invest a bit more than what we would have to do off-line.

But from a market share standpoint, look, I'm going to keep the answer like that. Maybe Thelke will have a closer look at it. But I would say that we have a strong market share worldwide, and I don't think I see -- I don't see a major difference between on and off-line.

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

Okay. That's clear. And final short one. Your pension and medical deficit, do you have an update on that?

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Francisco Javier Van Engelen Sousa - *Signify N.V. - CFO & Member of Board of Management*

I see -- let me take that one. But again, let's take perhaps off-line. But in general, the biggest pension deficit that we were looking at was the U.S. one. In the last year, we've looked at the deficit. And we had always a target to be between 95% and 100%, and we've reached that. So at this point in time, we feel comfortable with the accruals we've taken and the reserves we have for funding that deficit. And that's the most important point in our numbers.

Operator

Thank you. And I'd now like to return the conference call to the speakers.

Thelke Gerdes - *Signify N.V. - Head of IR*

Ladies and gentlemen, thank you very much for attending today's earnings call and for taking part in the Q&A. If you have any additional questions, please do not hesitate to contact Philip or myself. We are happy to take your questions. And again, thank you very much, and enjoy the rest of your day.

Operator

This now concludes our conference call. Thank you all very much for attending. You may now disconnect your lines.

DISCLAIMER

Refinitiv reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES REFINITIV OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2021, Refinitiv. All Rights Reserved.

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV