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PRESENTATION

Operator

Hello, and welcome to the Signify First Quarter Results 2021 Call. (Operator Instructions)

Just to reminder you, this conference call is being recorded.

I'll now hand the floor to our speakers. Please begin your meeting.

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

Good morning, everyone, and welcome to Signify's Earnings Call for the First Quarter 2021. With me are Eric Rondolat, CEO of Signify; and Javier van Engelen, our CFO.

In a moment, Eric will briefly touch on the key operational and financial takeaways for the first quarter 2021. Javier will then follow-up with a review of the company's performance in the first quarter, after which Eric will end today's presentation with the outlook and closing remarks. After that, we will be happy to take your questions.

Our press release and presentation were published this morning at 7:00 a.m. Both documents are available for download from our Investor Relations website.

The transcript of this conference call will be made available as soon as possible on our Investor Relations website.

And with that, I will now 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. So let's start on Slide 4 with the key operational and financial takeaways for the first quarter of 2021. So we increased the installed base of connected light points to 83 million from 77 million in Q4 2020, further illustrating the growth of our connected lighting activities. LED-based sales represented 82% of total sales compared with 79% in Q1 2020.

Our first quarter performance illustrates the execution of our strategy as we report growth driven by our connected businesses and growth platforms. We achieved EUR 1.6 billion in sales, representing a nominal growth of 12% and a comparable sales growth of 3.2% driven by our connected businesses; the recovery in China as well as an improved performance in most of Europe, India and the Middle East.

Our adjusted indirect cost decreased by 120 basis points to 31% of sales, while our adjusted EBITA margin increased by 290 basis points to 10.8% driven by gross margin expansion, SG&A efficiency and operating leverage. Net income increased from EUR 27 million to EUR 60 million, and our free cash flow increased to EUR 168 million from EUR 122 million (sic)[EUR 112 million] in the previous year driven by profitability and working capital management.

On the next slides, we will discuss the performance per division. Let's move immediately on Slide 5 to discuss the performance of Digital Solutions. So LED-based sales in Digital Solutions were 92% of the whole division sales. Nominal sales increased by 24.1% as a result of the consolidation of Cooper Lighting in March last year. Comparable sales declined by 1.8%, which was driven by headwinds from component shortages, continued lockdown on the Americas. We also saw a recovery in China, the Middle East, India, and a partial recovery across Europe. The adjusted EBITA margin was solid at 9%, a 230 basis points increase versus last year, which was driven by continued gross margin and cost management.

On Slide 6, you will find a few of our business highlights from our Digital Solutions division, which show our continued progress in servicing our professional customers. Let me focus on some of them. So the first highlight I'd like to discuss is the partnership we reached with the NHL across North America. We will support more than 4,800 ice rinks, transition to sustainable connected lighting, thereby improving their carbon footprint while reducing energy consumption and operational costs. It illustrates the increased attention in the U.S. for switch to green and digital technologies as part of the commitment to climate action.

We also expanded the application areas of our aquaculture lighting to Yellowtail fish, also called Kingfish. Our aquaculture lighting system helps the farmer to improve energy efficiency and reduce the stress levels of fish to optimize feed conversion and reduce costs. In this specific case of Kingfish, this even resulted in a 30% higher output than the facility was originally designed for. This illustrates our commitment to food security and our Brighter Lives growth objective. Lastly, as part of our commitment to safety and security, we installed LiFi at the World Forum in the Hague. The guests can now enjoy safe, secure, reliable and high-speed connectivity through light.

Let's move now to Slide #7, and to Digital Products, which showed a continued strong growth as well as a solid adjusted EBITA margin. So comparable sales grew by 15.7%, mainly driven by our consumer segment and in particular, the connected home and LED lamps and luminaires categories, while the recovery speed in the professional segment was slower. The adjusted EBITA was 14.2% of sales, an increase of 530 basis points over last year. This increase was driven by the sales recovery and the resulting operating leverage, a solid gross margin and the higher contribution improvement from connected home offers.

The next slide, this is Slide 8, shows a few business highlights from the Digital Products division, all illustrating our commitment to customer-driven innovation. Our 10-liter UV-C disinfection box available to consumers in Europe, Korea and Vietnam completes our range of offerings. It can effectively disinfect viruses and bacteria from small objects such as keys, cell phones, toys and household items in a matter of minutes. It contains a reflective stainless steel to reach any surface of multiple objects at the same time. The box switches off automatically when the lid is open.

And as you can see also on the slide, we extended our Philips Hue connected ecosystem with 2 outdoor lights to personalize gardens and porches, a new switch module that can make existing light switches smart and a redesigned Philips Hue dimmer switch that offers intuitive wireless controls without choosing the app.

Moving to Slide 9 to talk about our third division, Conventional Products. It has achieved an adjusted EBITA margin of 20.6% driven by an improvement of comparable sales growth to a negative 6.1%. This sales performance was driven by the continued strong traction in our consumer segment and horticulture lighting. The adjusted EBITA margin increased to 20.6%, which is a 300 basis points improvement over last year. This performance is a result (technical difficulty) operational efficiencies.

On the next slide, Slide 10. We want to discuss the performance of our Brighter Lives and Better World 2025 Program. In the first quarter, we started to make progress against our ambition of doubling our positive impact on the environment and society until 2025. So we reduced carbon across our value chain by 18 million tonnes, while we set ourselves a 2025 target of 340 million tonnes reduction. Our circular revenues were 19%, which is 3% higher versus our 2019 baseline of 16%, while our target in 2025 remains at 32%. Brighter Lives revenues were at 23%, which is 7% higher already than our 2019 baseline. And we set our 2025 target at 32%.

Our percentage of women in leadership position increased from 17% in our 2019 baseline to 24% in this quarter. Our target for 2025 is 34%. Another highlight, which I would like to mention is the recognition we received from the CDP Awards 2021, which recognize us as a leader in climate action.

And with that, I would like to hand it over to Javier, who will discuss the financial performance.

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

Thank you, Eric, and good morning to everyone. Let's go to Slide 12, where we discuss the adjusted EBITA bridge for total Signify. The adjusted EBITA margin improved by 290 basis points to 10.8%. This performance was driven by the following drivers: first, higher sales, which also helped us dilute our cost base in combination with; number two, an improved sales mix, which is mainly attributable to the strong connected home sales. Continued softening of price erosion, largely offset by price increases that were implemented during the quarter to compensate for inflation of raw materials and components is the third driver.

Next, an improvement of our cost of goods sold mainly related to (technical difficulty) gains achieved throughout 2020. Following by indirect cost increase by minor only EUR 4 million. The next element is scope and other changes related to the consolidation of Cooper Lighting in March last year, which added EUR 17 million to our adjusted EBITA. And finally, ForEx had an adverse impact of around EUR 3 million.

Let's now take a look at Q1 working capital on Slide 13. The where we include sales of Cooper Lighting and Klite on a 12-month pro forma basis, working capital improved by 260 basis points to 3.5% of sales in Q1 2021. This is the result of sustainable structural improvements across receivables, payables and inventories. Other working capital items added EUR 48 million to our working capital at the end of Q1 2021.

On the next slide, Slide 14, we discuss our net debt evolution. We started the year with a net debt position of EUR 1.275 billion. And a net debt-to-EBITDA ratio of 1.7. At the end of March, our net debt position stood at EUR 1.141 billion, translating into a net debt-to-EBITDA ratio of 1.4. This reduction was mainly driven by the strong operational profile and the continued improvement in working capital.

Next to this, you can see the other items in the bridge that impacted cash, and thus our debt position. Net CapEx was EUR 16 million in the quarter. Next to that, we paid EUR 22 million for tax and interest. Other includes cash used for derivatives, acquisitions, new lease liabilities, dividends to minority shareholders and FX on cash, cash equivalents and debt.

Versus 12 months ago, just after the acquisition of Cooper, our net debt was EUR 1.810 billion, and our net debt-to-EBITDA ratio was 2.7. We have considerably reduced our net debt through a strong operational performance and structural improvements in working capital, leading to a high cash conversion. We're well on track to deliver on our commitment to reduce our leverage back to 1x multiple by the end of 2022. Please do note that following the proposed dividend payment in May, our net debt-to-EBITDA is expected to slightly increase in Q2 and then to further decrease again in Q3 and Q4.

In terms of capital allocation (inaudible) we mentioned that we refinanced EUR 350 million of our long-term debt with short-term loans with a maturity of December 2021. Therefore, we are now fully committed to repaying EUR 350 million of debt in Q4 2021, in line with the initial intention that we announced in January.

With that, I would like to hand it back over to you, Eric, for the final part of the presentation.

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

Thanks, Javier. Let's move to Slide 16, where before we move on to the outlook, I would like to discuss the significant potential that some of the green economic recovery plans, which we have seen globally, hold for the lighting industry. So the European Union agreed upon the European Green Deal with a total green growth and recovery budget of EUR 1.8 trillion to be spent during the period a 2021 to 2027. So with proposal for projects being filled -- filed as we speak, first impact on the EU Green Deal is expecting in the second half of the year, and initiatives are expected to extend towards 2027.

This drive for a green and digital recovery creates a significant business potential in all of our business segments. To tap into this, we launched, at Signify, the Green Switch program, which is aimed at helping local governments allocate their funds wisely. So we have already seen some local governments create what we would call Green Deal inspired projects of which we would like to highlight 2 wins in the first quarter. One in Poland, where we will install and 9,000 connected Street light points. And another one in Netherlands, which is focused on the sustainable lighting in homes where we supplied 300,000 LED lamps to 35,000 households in the municipality of [Enschede].

In the U.S., the American Jobs Plan was announced, which includes a planned spending of $2.3 trillion on infrastructure during the period 2022 to 2031. This infrastructure bill has a heavy emphasis on climate mitigation through green infrastructure and low-carbon technologies. Congress is expected to sign in August or September, after which the funds are foreseen to start to become available towards the end of 2021, so we believe.

In the Rest of the World we see similar economic recovery initiatives, although there is no major infrastructure funding yet. In the run to COP26 later this year, we also see a clear trend in the rest of the world to explore similar initiatives aiming at carbon neutrality.

And finally, I would like to turn to Slide 17 for the outlook for 2021. So we are seeing signs of an economic recovery in a number of our markets, and are expecting the continued vaccination rollouts and easing of lockdowns to have a positive effect. We are confident that both the easing of lockdowns and the announced stimulus packages will drive an upswing in demand for our professional portfolio in the second half of the year. And we are particularly well positioned for green initiatives taken by governments around the world and are seeing increased traction. At the same time, our supply chain performance is being challenged by component shortages, which are impacting us in the first half of the year (technical difficulty) to extent in the second half of the year as production capacities are expanded.

Based on our current visibility on these macroeconomic and external development as well as our first quarter performance, we now anticipate a comparable sales growth of 3% to 6% for the full year 2021. In addition, we expect our adjusted EBITA margin to be in the range of 11.5% to 12.5% for the year. We continue to expect free cash flow to exceed 8% of sales. And as Javier just mentioned, we have also refinanced EUR 350 million of our long-term debt with short-term loans, which have a maturity of December 2021, we are thereby committed to repaying the EUR 350 million of debt in the fourth quarter of this year.

I would like now to conclude this presentation by saying that our operational performance in the first quarter is the result of a rigorous execution of our strategy and the adaptive measures we took in 2020 as we reported growth driven by our connected businesses and our growth platforms.

And well, with that, I would like 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 George Featherstone of Bank of America.

George Featherstone - *BofA Securities, Research Division - Research Analyst & Associate*

My first one would be, in terms of the resi market, how would you compare demand levels to pre COVID? And also in terms of what you've seen in Q2 so far, how would you characterize the demand?

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

Yes. George, I would say, in general, it's very complicated to say what is pre COVID, what is post COVID because COVID is still ongoing. What we have seen, nevertheless, is a very strong traction on our consumer business compared to the professional business, which is still pretty much hit by lockdowns all around the world. And nevertheless, what we see -- and it's pretty much based on the comparison we have with Q1 last year. We see a recovery in China, but from a very low base. We see a good performance in Europe and especially the northern part of Europe, comparing to a base which is a bit better, but still there were a lot of (technical difficulty) 2020. And when it comes to the Americas as well, Q1 2020, they had not entered in the crisis, and they are at this point in time. So we see a market which is a bit softer.

So there's a direct connection, as we've said on and on between the lockdowns, the economic traction and our professional business. The consumer business has moved to online much faster as we commented also in the previous (technical difficulty) experienced a strong traction, which is also the result of -- well, partially the result of what you see in the performance of our Digital Products business.

George Featherstone - *BofA Securities, Research Division - Research Analyst & Associate*

And maybe turning to the U.S. market, there's been more positive commentary from some of the other nonresidential construction exposed industrial companies recently. What are you seeing in terms of activity levels and project activity on the tendering side, particularly in Digital Solutions and Cooper?

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

So you had, George, an additional phenomenon in Q1, which is the weather conditions in the U.S. that have paralyzed our supply chain during 1.5 weeks because it happened in places where we have factories. Cooper has factories there. So that has also an impact on the performance in Q1.

Now what we see we saw that there was a high level of traction on the undifferentiated products, stock and flow. This is not where we are the strongest. We are stronger in the specified part of the business. Now what we see, we see a clear renewed traction in projects listing. So the positive thing is that we've seen along the quarter a progression -- a positive progression after January and February that were quite soft. So we see that market rebounding. We look at the economic forecast of 6% to 7% growth, GDP for U.S. for the full year, and I think we will benefit from that. But once again, we are comparing the U.S. to reasonably a strong (technical difficulty) Q1 '20 compared to the other geographies that had already entered the crisis.

So when we take a bit of distance, we see that the businesses and the connected part of the business has been performing extremely well in the U.S. in Q1. And the prospects are, from an economical standpoint, I believe, are good. We see also a first a sign of attraction of the incentive plan, especially when it comes to infrastructure, and I would say street lighting connected or nonconnected, but we see a lot of projects being thought of by many municipalities when it comes to street lighting. And that's a direct consequence of the incentive that has been -- or that are going to be voted.

George Featherstone - *BofA Securities, Research Division - Research Analyst & Associate*

My final question would be, clearly, as a company, you've made significant steps on ESG, and now more ambitious targets to 2025. And we're seeing an increase in focus on these areas from other companies as well. In terms of your own customers, is there any sense that increasing focus from them on ESG is driving demand to Signify, particularly within the LED and connected lighting offers?

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

I would say, yes, but it's beyond that. I think it's commonly understood that LED and connected bring a substantial level of energy efficiency. And this is part of the reasons why there was such a transfer from 1 technology to the other one. If you take some distance, you realize that it didn't take more than 8 years to go from 1 technology, which was close to 100% to another technology, which is now close to 100%. So we've moved from 80% conventional to 80% LED. So that's understood by customers in general.

Now when we bring other elements to the picture, which are also fundamentally serving sustainability. And I'm not only talking about energy efficiency. I'm talking about workspace optimization. I'm talking about improving the productivity of people at work. I'm talking about improving safety conditions in industrial workspaces, whether they are manufacturing plants, or warehouses. So all these elements start now to be taken into account by customers who have had the right level of education on LED. And now they're getting another level of understanding and knowledge about what are the additional benefits that our systems can bring beyond energy efficiency.

And so this is something we are very much stressing and very optimistic because we see customers more and more understanding it. We're talking about customers at this point in time where basically, they look at the optimization of the usage of the shop floor and the productivity of the people in that same space and the increased safety condition as the #1 reason to move to connected lighting. And of course, they're getting on top of that, the energy efficiency. So all these elements are now much more vivid. We were talking about that. We've been talking about that for many, many years, but that's the right moment where we see a great traction, a great understanding from our customer base. And that's, frankly speaking, not only reassuring, but it's good to see because all these elements are conducive to improving sustainability.

Operator

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

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

I have 2 questions, please. The first one is if you could help us to better understand the price cost dynamics. It sounds like that was not a material headwind or tailwind in Q1. Looking at your guidance for the full year, is it right to assume that you would -- you imply or expect to continue to basically offset some of the price increases, particularly in Digital Solutions for raw materials with price increases? Is that the base case for your expectations for the year? And what would be the price increase that you need in Digital Solutions just to mechanically offset the impact of steel and other materials for the year?

And the second question on Digital Products. Maybe you could give us some indication on the business performance for connected home lighting versus the rest in that business? And to what degree connected home lighting, you have seen restocking and kind of stay-at-home consumer spending versus underlying traction for that technology. Maybe where are we in that business relative to kind of the normalized trend line we have seen in recent years?

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

I think Javier, you can take the first question. I'll take the second one.

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

Yes. Andreas, Javier here. On the pricing cost equation, we'll go back to what we also said in previous calls is we separate 2 dynamics that we see in the market. Number one, we always talk about the ongoing price erosion. And again, in this quarter, we have seen that the underlying price erosion is again further softening. So we've seen that trend happening in last year, and we see the same trend continuing in Q1 where there seems to be more discipline and rigidness of the people to not take prices on the basic business.

Then the second part of the question is what do we see with the temporary impact we see on increase in raw materials. And as you've observed, and you can also see it in the bridge we have, yes, we've been able to compensate price increases on inflation of materials by our price increases in the market. The impact on Q1 is relatively small on both because it takes a bit of time for the cost increases to move through inventory. And our price increase in the market are also getting implemented as we speak, which means that in Q1, it was compensating , so we're able to maintain gross margin for that basis. And in the full year, we expect that we will have the capacity still not to have a negative gross margin impact on inflation of raw materials and our price increases.

Having said that, and you see that from the bridge we have on Page 12, we still have an underlying improvement year-on-year on gross margin. And that's because of the cost savings that we have generated in 2020 which are now carrying through in 2021. That's where we still get the benefit of. So you see basically that we have a significant improvement in gross margin in Q1 counting on those cost savings that we've implemented in 2020. While at the same time, we have minimized the impact of inflation of raw materials through the price increases we've taken.

You've also asked about the amount of pricing we take. We're not specific on how much exactly we take by division, but it's in the low teens, in the low single digits, and we expect that at this point in time, that's holding in the market. And again as (technical difficulty) to able to manage gross margin on a continuous basis properly on that side.

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

Andreas, on your second question, let's sell zoom on Digital Products. So you have, on one side, the consumer business, which is performing strongly and the professional part of the portfolio, which is not only the drivers, but also LED lamps that are going to the professional markets that are performing at a much lower level in terms of growth. Now we've been very happy to see that not only the connected part of the business, also the nonconnected part of the business has performed extremely well in Q1 and also in the past quarters. Not only in terms of top line, but also in terms of contribution to the profitability. But it's true that we're enjoying strong double-digit performance in the connected part of the business.

So this is the story that you heard for many years when we embark on the connected lighting journey. We invested a lot upstream, we've created an ecosystem that is extremely robust with Hue. We've added (technical difficulty) by users. And we see that both platforms are really performing extremely well, from a top line perspective, and they're creating also a strong operational leverage on the bottom part of the P&L, and they are a strong contributor to the performance of Digital Products.

So this is a continuous trend from what we experienced in the past quarters. No restocking has not really happened because in this business there is also shortages of components. So basically, we could potentially have sold more if we had the capacity to produce on these businesses. So restocking has not happened yet.

Operator

Our next question comes from the line of Daniela Costa at 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 have 2 things. I wanted to first ask you about the working capital at 3.5% of sales, really a very low number compared to a lot of industrial companies, and it's been decreasing for a while. Can you talk us through, particularly at this point in time, the sustainability of that as we go into continuing shortages of components? And then just maybe a reminder of how -- like what exactly operationally did you change to achieve that? And why is that sustainable? That's the first question. Then the second one, I'll ask after maybe.

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

Daniela, Javier here. It's a good question and something that, of course, we've been looking at very carefully as we get back to growing business on making sure our working capital is structurally taken down. Let me again refer back to what we said in Q4 -- at the end of Q4, we had made, and I think I referred to that. There was a same question on sustainability of the lower levels. We ended up last year with a working capital at 4.8%, which has come down from the beginning of the year last year of above 7%, close to 8%. We already didn't talked about sustainability of that because we had specifically worked very strongly on receivables, especially in terms of also bad debt. And we will also have a strong track record on payables. The variability we often see is on the inventory level. But I've mentioned already then that we thought that, that level where we ended up last year would be sustainable going forward.

So as we look at the working capital in Q1, we're now at 3.5%, which indeed is a further structural improvement. I would say that in terms of payables and receivables, we are at a level, which I think is really sustainable going forward. And I think there's perhaps still a little bit of improvement that we can make, but that we are good levels.

On inventory, as I said before, it's going to be a little bit give or take this year. And depending on the capacity, yes, not to rebuild stocks. I think the 3.5% is a level where depending -- if shortages continue to happen, I think that, again, the level that we reach end of last year, and we're kind of now trending toward, is sustainable going forward. If volume really picks up, there should be further efficiencies in rotation of our stocks perhaps compensated partially by a bit of a stock build up and recovery from where we are today. But fundamentally, we do believe that we are at this 4%, 3% levels that I think structurally, we can maintain. And if all goes well and volume picks up, there might be further efficiency in the future going forward.

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

Very clear. And then my second question relates to your commentary that you're already seeing some concrete orders from stimulus. And you mentioned 2 large ones on street lighting. And I wanted to ask you how much of that is baked in on your 3% to 6%. Is it significant within that or not?

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

No. It's marginal at this point in time. We see really the uptake of this, Daniela, happening in the second half of the year for the European Green Deal. I think it's going to really have an impact at the back end of the year. And it's not a yearly plan. It's going to extend between 2021 to 2027, and then we believe that depending on how fast things can be voted in the U.S. that we will have an impact on the U.S. side. The U.S. side is interesting because we've been able to measure a little bit more concretely what it means for the lighting market. We believe at this point in time, until further notice, that it can be an additional business around EUR 3 billion to EUR 4 billion for the lighting industry, from the EUR 2.3 trillion that we're talking about at this point in time. And that will extend between -- yes, the beginning of 2022 and 2031. So I would say it's marginally in the numbers at this point in time, but we see the buildup.

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

Sorry, was it EUR 3 billion to EUR 4 billion U.S. only or global?

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

No. EUR 3 billion to EUR 4 billion for the U.S. part.

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*

Actually, I have just a couple of follow-ups on the questions that were already asked. The first one was around the Digital Solutions. And I was curious to know if you could help us understand what you're seeing actually in your backlog at the moment in this area, how much it has increased versus what you're expecting for the second half in terms of growth to pick up?

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

So Lucie, there are 2 ways to look at the backlog. First, there's a part of backlog, which has been a pushed from Q1 to Q2 because we could not deliver. Because of shortages of components, because of the fact that in the U.S., the supply chain was basically paralyzed for 1.5 weeks because of climate condition, and also because of something else, which is the shortage of containers. It seems trivial, but it's a reality. In the ports of China and also the ports of the U.S., we have difficulties to find at this point in time, containers to route our products.

So when you look at all these different elements, they have an impact on the quarter of about [50 million.] So the [50 million] that we could have invoiced more if we had the capacity. If you translate that in terms of growth -- points of growth, it's about 3 percentage points. So this is what has moved from Q1 to Q2.

Now when we look at our European funnels, and our funnel in the U.S. or in China, they have been building up along the quarter. This is why we are optimistic in the rebound of that business to a given extent in Q2. But certainly, in the second half of the year, where we believe that the easing of lockdowns and the return to a more normal type of activities and economical traction should help this business on top of the various incentives that we have just talked about. So that's why we are hopeful for Q2, but also very much for the second half of the year.

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

I guess that brings me to my second question, which is also a follow-up. But how should we think about the growth in Digital Products from here? Because, arguably, the comp last year in the first half was not overly demanding, and we are possibly approaching what I would call maybe the peak work-from-home type of demand. And you were just also suggesting yourself, we are going to see a reopening of the economy and people having more mobility. So how should we think about that part of the business then as we go towards the rest of the year?

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

So we're looking into this quite extensively, Lucie, because that's a very important point. And basically, the question that we asked to ourselves is the following one. Is that positive traction on the consumer side linked to the fact that people are staying more at home, and will this go away when we go back to a more normal way of operating across the planet.

Now we've looked into details about what people are buying at home during the pandemic, and this is the position that we are taking. So what we believe is that refurbishing, renovating homes and doing it ourselves is something that will continue after the crisis. I think that people have understood and consumers homeowners have realized that equipping their home, making it a joyful, plays in place to be -- is something important that we have learned during the crisis, and that will be kept moving forward. So there are different studies that we have read that are hinting at this.

The second element is, yes, people will spend more money maybe on travels, going on holidays, which they haven't done as much as they used to because of the pandemic. And we believe that what will suffer more in the purchasing is not the home improvement area in general, but more some of the big spending that people have done during the crisis, a lot of appliances were bought, TVs, appliances that are quite costly. And I think this is where we believe that there will be less spending.

Now the other element that (technical difficulty) especially on our connected businesses. What is important for us to see is the home penetration. Because we know that when we penetrate new homes, then there is a natural extension that happens all the time. So let's say that people would start with 3 connected objects. And we see that over time, it goes from 3 to 5, from 5 to 8. And we know that, that dynamic is a real one, and we've experienced and witnessed it in many different ways and forms.

So this is where [we believe] that a part of the spending will reduce, but we still believe that do it yourself and home renovation will continue and will benefit from it, on top of the fact that we have penetrated homes, and that will serve (technical difficulty)

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

Understood. And maybe my last question around -- was around the working capital. That was very clear, the explanation, I think, on receivable and the reduction of bad debt. But when we look at the payable, that has improved very, very strongly from 2019, and that was also coincidental with new acquisition of Klite. So I was just curious to understand maybe what happened there. Because the terms have been really almost doubled in terms of how long they have been extended, so can you maybe help us understand a little bit more what's on payables, and whether there is more to come from there as well?

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

So you may remember, Lucie, that we indicated at the time that we had a project that was called Horizon, and that project had many different objectives. But basically, it was at improving growth and performance and profitability, but also cash. And we carried probably 2.5 years ago, some dedicated actions and namely on payables, in order to improve our performance there. And so there's a strong contribution to the results you see today linked to that project.

Now, you mentioning Klite. Klite has also brought a positive contribution to payables since their payables and performance were, I would say, better in average than what we had at group level, and we used that performance to try and extend much more at group level. So it's not only Klite. It's a consequence that it happened at the same time because it happens globally for the group a bit before, and Klite was also a positive contributor.

Now when you look at the working capital as a whole, we used to be close to 11% at the time. I'm talking about 4 -- yes, 4 to 5 years ago. Now we had 3.5%. We've been reducing gradually over the years. So it is structural. What we do is clearly structural. Another approach that we have is that we look by geography. Every country has an objective in terms of working capital. And depending on where they sit, we decide to take structural actions like localizing more the production to avoid to have offers or components that stay for a very long time on the boat and so on. So there are very structural actions that are being made.

Probably also maybe to complete on the payables. Cooper, you're right, Javier is giving me little sign. Yes, I think that Cooper has also been a contributor because when we acquired Cooper, we moved Cooper very quickly to our payable terms that were more favorable. So yes, that's probably another element that's explaining the improvement on payables.

Operator

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

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

I will go one at a time. And firstly, I wanted to ask about the components shortage situation. You have alluded to kind of the impact in H1 and the less impact in H2. And how confident are you on the improvement in the second half? And when do you expect the situation to be normalized based on your arrangements with the suppliers? And what are your arrangements with the suppliers?

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

Joseph, look, a very, very tense situation on the supply chain side for us in Q1. So on the component side, it's many, many different components. We're talking about electronic components in general, in semiconductors, but also passive components. When I talk about semiconductors, it's microcontrollers and mosfets, sensors. So you see it touches a fairly big part of what we are selling to our customers.

What we have seen, we have seen a supply chain that was basically taken by surprise because many of the companies had not only not invested, but had reduced their capacities with a crisis, and then you had some industry that -- the automotive industry that came with a very high level of demand. So they had not only to put back some of the reduced capacity in place, but they had to expand capacity. And in these types of industries, if you want to expand your capacity, it basically takes between 6 to 9 months. So there is a lead time, which is linked to the physical capacity that these companies have to extend their own production output.

What we see, we see that in Q1 -- let me give you very specific numbers. We have put a dedicated team in place worldwide. And we are following about 300 suppliers on a daily basis. We have, at this point in time, 180 components that are what we call at the escalation level 4, meaning that they are followed by 1 member of the leadership team, namely the Chief Operations Officer. He follows himself, what happens on 180 components. If I was looking at that number, 1 week ago, it was 130. So we are not there out of the woods. But we have put in place a very strong team that, I have to admit, has managed the situation far beyond our original expectations. Also our share volumes and the historical connection we have with our suppliers is also weighing very positively in that situation. So probably in a crisis like that one, we are doing better than the average of the other companies.

Now what we have done, we have taken more long-term commitments on procurement. And we see gradually that the capacity is being rebuilt. We believe that Q2 will still be impacted. We should see improvements and -- strong improvements in the second half of the year, and I think we should be through in the first semester of 2022. But when you bring the supply chain down and then you need to very quickly readjust and put it back in place, it takes a bit of time, especially on those components that require very specific machines and very specific automated processes to be able to drive production.

So look, this is where we are. We're working on it. We're very well organized, and we could deliver more than what we originally expected in Q1, even if we have to leave 3 percentage points of growth on the table and push to Q2.

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

That's very great color. And my second question is on the various growing stimuli across the world, mainly the [twin] engine of the American Jobs Plan and European renovation wave. And we are at the early phase of that. But in terms of your early discussions with the customers, what kind of appetite do you see that is there for connected lighting? Are we going to see a lot of the renovation projects are purely focusing on kind of LED renovation? Or do you think people would do the connected lighting at the same time?

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

So I think the advantage of connected is, if you can save 50% to 60% moving from conventional to LED, you will increase this 50% to 60% to 70% to 80% with connectivity. So connectivity clearly brings an additional potential in terms of energy saving. And this is what our customers now understand more and more.

But connectivity brings also other elements that are conducive to sustainability at large, which is optimizing the workspace or optimizing the usage, the industrial environment. It is also helping when it comes to safety conditions. It improves the productivity of people in their work environment. And all these elements are conducive to bringing more sustainability to the workplace.

When we look at the incentive programs, I think that they are targeting many different fronts. It's not only energy efficiency, which is clearly targeting climate action. It is also clean energy. And we believe very strongly in solar. Solar has got 1 peculiarity. It's not that it's renewable. It's not only that it's [renewable] it can be used in a decentralized fashion. And we believe that the right way to tomorrow also to avoid loss is to do it in a decentralized fashion. So we have developed a lot of offers when it comes to solar lighting, and we think that those incentives are also going to bring investments in these directions.

And then you have circularity, you have food security that we have talked about a few times, which I think are also targeted clearly by the green deal in Europe. And I think also to give an extent we're going to be able to move some of the investments in Northern America and the U.S. on these other elements.

Now what we see in Europe, which is an initiative we have taken as Signify, we call that the Green Switch. So it's basically a repository of specified solutions for lighting that we bring to the attention of local governments so that the local governments, they not only have an understanding of the funds that are available for them, but they also can find some existing reference and some specification about the technology and the solutions that we bring with our lighting system that can help them to develop projects that are very loyal to the intention of the green deal in Europe. And we see positive traction there that governments come to us, they ask us for advice, and we help them to specify future projects.

Operator

Next question comes from Martin Wilkie of Citi.

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

It's Martin from Citi. Obviously, a lots been covered already, but just one question I had was on UBC. And obviously, you've shown a product in the presentation this morning. Just to get some sort of sense of how you see that developing now that lockdowns are hopefully beginning to lift and the vaccine taking effect. We have seen some small municipality in the city is talking about putting carbon into government -- so putting UVC into government buildings to prevent the spread of COVID. Is that still an attractive market for the remainder of this year? Just terms of a sense as to how you see that progressing as the vaccine penetration picks up?

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

Yes, Martin. Look, we see our business still growing in UVC, to a lesser extent than last year when it really exploded at that point in time. We see also a different pattern in the portfolio that we are selling. Last year, it was mostly light sources and we increased our capacity to be able to deliver the required products by our customers in 2020. And also now that it's continuing to grow in 2021, that production capacity is serving those customers. But what we see now in our portfolio is that we are selling also more of the finished products. Finished products on the consumer side where, if you remember, in the past quarters, we had developed a desk lamp table, UVC, that we can be used at home. And we have highlighted for this quarter, another inflection box for small objects. And we see on the consumer side, a very positive traction.

Now on the professional side, we have also developed new offers, and I was also indicating that that's what we have in our own offices, which is disinfection. And it takes a bit longer in terms of commercial incubation because customers need to be educated on UVC, which carries a risk if you're expose. But in the solutions that we bring to the market, there's absolutely no risk of exposure. But it requires some education.

Now for us, we think it's less of a sprint and more of a marathon. There are some countries at this point in time that are putting low end places. So let me give you an example. In Hong Kong, if you have a restaurant, you need to have, I think, the volume of air that you have in your restaurants to be renovated 6x in a limited amount (technical difficulty) I think it's an hour, but I'm not too sure, but anyway. There are some conditions of that nature that are low end forced. And there are different ways to do it. And what you said at this point in time in Hong Kong, of course, you can have your air to circulate through conduits and ventilation, but you can use also UVC. So we see at this point in time, very strong traction in that specific market to equip the restaurants with air disinfection.

We have other solutions that we have brought to the market that have a fantastic level of traction, which is completely closed and closure. So it takes a bit more time to disinfect, because they closed. But we see also very good traction on that side.

So our point is we need to continue to educate the market because at the end of the day, when we talk about UVC and having spaces cleaned of viruses and bacteria is something that goes beyond COVID-19. I mean there's one thing that we learned from that crisis is that infection is always possible. So if we show that the spaces where they can -- which can be crowded, where there can be a lot of people, these spaces are cleaned from virus and bacteria. This is something that I think we're going to learn from the crisis. Once again, small marathon than a sprint. And we see continued traction, even if the emphasis on our portfolio has moved from components now to finished products.

Operator

Our next question comes from the line of Rajesh Singla of Societe Generale.

Rajesh Kumar Singla - *Societe Generale Cross Asset Research - Equity Analyst*

This is regarding indirect cost as a percentage to sales. So we still have like around 31% of sales as an indirect cost, which is comparable to -- which is substantially higher than the industry average of 25% to 29% as you have communicated in the past. So can you throw some light on the delta between where industry number comes from, like, 25% to 29%, and we are -- a number of 31%, like because the difference is like 400 basis points. And what we can do to close this gap and improve our margins further from here?

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

Yes, Rajesh. So looking at the average in Q1 is a bit to our detriment because Q1 is normally our worst quarter in terms of top line. This is where, as a percentage of cost, we have the highest percentage. Now what we looked at is companies who are more on the lamp side and companies that are more on the luminaire side. So if you take companies that are more on the lamp side, their nonmanufacturing cost of the sales will be around a 25-ish. And if it's companies that are more on the luminaire side, I mean their nonmanufacturing cost as a percentage of sales will be more around, I would say, a 29%, 30%. So this is where this 25% to 29% came from.

We knew that historically, because of the separation and the way it was done from Royal Philips, we would have a high percentage of cost, which we substantially reduced in the past despite having a declining top line. So when you look at the history of the company and how this was managed, we managed to bring it down. And in 2019, we were at 19%. And by the way, in 2019, in Q1, we're very close to where we are in Q1 now. So I think we are on the right track to go back into that interval.

Now we've communicated last quarter that we have launched a cost reduction program already last quarter. And we had, recently this week, the agreement, there is a process in Netherlands, and we have to go through our Works Council, and this was approved. So now it's going to be implemented in the rest of the year. And it is unfortunately, but necessarily so touching 600 jobs worldwide for Signify. And we are also really targeting the jobs in the central part of the organization. The philosophy that we want to have in the company (technical difficulty) a headquarter and put a maximum number of resources in the operating part of the organization.

So basically, what we're doing, we have that action plan, which is now being put in place, which going to reduce quite substantially our cost in order to put us back into that interval, which is a clear objective for us. So we had a very, very strong use of cost reduction in the past years after the IPO, we reached the 29%. And then we had the 2020 situation. But I think we're starting the year in a very promising fashion. And with what we have on the cost reduction program coming up for the rest of the year, we should be very well positioned.

Rajesh Kumar Singla - *Societe Generale Cross Asset Research - Equity Analyst*

And maybe one more question on your M&A strategy, given that the leverage ratio is now looking more comfortable and probably we would be well back on track to the historical low number by next year. So are you scouting for any M&A opportunity, given the current very favorable environment for M&A targets because of -- like bottom of the pyramid in the industry probably would be suffering because of all the issues that we are seeing in the market. So are you thinking of scouting for more M&A opportunities in the near term?

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

Well, we are looking at opportunities, but we do that in general. For us, there are 2 conditions. As I say all the time, we need to be ready. And let's also agree that we had to do the Cooper integration. I don't think it's done. And I don't think it's finished. I would like to judge the way we actually have integrated Cooper Lighting 3 years after it actually has been done. So for me, at this point in time, we're off to a great start. But we still have to be very vigilant in order to complete that integration. We have moved the IT systems, in the past week. So that was a big, big milestone, which is basically to move all the SAP instance that Cooper had under the Eaton IT landscape to ours. As you can imagine, this is a very, very touchy exercise that has been done in the past week and flawlessly so far. It's not without issues, but issues that were fixed within the hour. So the teams have done a fabulous job there.

So we're not totally out of the woods when it comes to the integration of Cooper Lighting. So first, we need to be ready. And second, we need to find strategic opportunities that we believe are in line with our strategy. So there are some cases that can be interesting in the future. So we'll see because they need to become available for acquisition, and we need to be fully ready to integrate them. But no, but we're, of course, looking at opportunities.

Operator

And as we've run out of time for questions at this point. We're going to end the Q&A session. And I'll hand back to our speakers for the closing comments.

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 discussion about our results. If you have any additional questions, please do not hesitate to contact Philip or myself. We are happy to answer your questions. Again, thank you very much, and enjoy the rest of your day.

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