REFINITIV STREETEVENTS

EDITED TRANSCRIPT

LIGHT.AS - Q2 2021 Signify NV Earnings Call

EVENT DATE/TIME: JULY 23, 2021 / 7:00AM 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

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 Securities, 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*

PRESENTATION

Operator

Hello, and welcome to the Signify Second Quarter and Half Year Results 2021. (Operator Instructions)

Today, I'm pleased to present Eric Rondolat, CEO; Javier van Engelen, CFO; Thelke Gerdes, Head of IR. Please go ahead with your meeting.

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

Good morning, everyone, and welcome to the Signify earnings call for the second quarter 2021. With me are Eric Rondolat, CEO of Signify; and Javier van Engelen, CFO.

As usual, Eric will touch on the key operational and financial takeaways for the second quarter 2021. Javier will then focus on a review of the company's performance in the second quarter and highlights of the first half. To close, Eric will end today's presentation with the outlook and the closing remarks. After that, we'll be happy to take your questions.

Our press release and presentation were published at 7:00 this morning. 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.

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 second quarter of 2021. We increased the installed base of connected light points from 83 million in Q1 to 86 million at the end of Q2. This further illustrates the growth of our connected lighting activities. I would like to highlight that the 86 million that I've just talked about still exclude the 2 million connected light points of Telensa, the U.K.-based street lighting company we recently acquired. This acquisition completed on July 1.

©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

LED-based sales represented 82% of sales, up from 80% in the same quarter of last year. In the second quarter, we saw an acceleration of the pace of recovery, led by our consumer connected lighting offers and our growth platforms. We achieved EUR 1.6 billion in sales, representing a nominal growth of 9.6% and a comparable sales growth of 14.1%. As expected, sales growth was hampered by ongoing supply constraints, in particular, component shortages and logistics (technical difficulty) increase from the EUR 50 million we disclosed at the end of Q1 to EUR 85 million at the end of Q2. These supply shortages have more than strongly affected our Digital Solutions and Digital Products divisions.

Adjusted indirect costs decreased by 130 basis points to 30.6% of sales. Adjusted EBITA margin increased by 190 basis points to 10.9%, driven by gross margin expansion and operating leverage. Our net income slightly increased to EUR 82 million. And finally, free cash flow was EUR 104 million, including an increased investment in future growth.

On the next slide, we will discuss the performance per division. Let's start with Digital Solutions on Slide 5. Our comparable sales increased by 12.6%, which reflects a sequential improvement on the back of a low comparison base. Sales growth was affected by extended lockdowns in some of our markets like India, ASEAN, Canada and also supply constraints. Adjusted EBITA margin improved by 110 basis points versus last year, up to 10.7%. This was supported by operating leverage and procurement savings.

On Slide 6, you will find (technical difficulty) Digital Solutions division. The first illustrates our commitment to food availability, and our target of doubling our Brighter Lives revenue to 32% in 2025. In the Nordics, where fruits and vegetables are still largely imported, there are now 2 more companies that are using our Philips Greenpower LEDs and GrowWise control system.

Control over the light spectrum and lighting levels helps to steer the quality of the crops and boost the yield of both companies. It also helps them to predict growth levels, so they can optimize production to match demand during the season. The first customer is Ljusgårda in Sweden, which is expanding its growing area from 2,500 square meter to become one of the Europe's largest vertical farms. At full capacity, the vertical farm can produce 60 tonnes of lettuce every month, the equivalent of around 1 million bags of salad.

The second customer is (inaudible) which operates Norway's largest greenhouse. They will now be able to grow tomatoes and peppers all the year round. The customer also has the ability to dim the light levels when there is sufficient daylight to ensure even light levels throughout the day and lower energy consumption. Together, these companies contribute to reducing the food miles for consumers in Sweden and also in Norway.

As part of our commitment to heath and safety and doubling our Brighter Lives revenue, we also continue to provide our customers around the world with protection through UV-C disinfection lighting. In The Netherlands, we had 2 theaters to welcome back guests, performers and employees with peace of mind by installing almost 100 upper air disinfection luminaires in total. We also installed 2 upper air luminaires at the (inaudible) School in Brandenburg, Germany. These disinfect the air above the head of the students and teachers, so classes can continue without interruption.

Other customers include a store of retailer to (inaudible) market in Lombardy, the first retailer in Italy to provide it shoppers with this kind of service. We also installed UV-C at multiple smaller restaurants in Hong Kong, a coffee chain in Korea and a large number of metro carriages in Singapore.

Now let's move to Digital Products on Slide 7, and we see that it continues to show a strong sales performance as well as a further year-on-year improvement of the adjusted EBITA margin. Comparable sales grew by 20.4%, mainly driven by continued strong consumer demand and for our connected home category. Also in Digital Products, the growth was hampered by components and container shortages. The adjusted EBITA margin was 12%, an increase of 270 basis points over last year. This improvement was driven by solid year-on-year gross margin expansion, higher contribution of connected home lighting, careful balancing of pricing versus cost and also operating leverage.

The next slide, Slide 8, shows a few business highlights from the Digital Products division, all illustrating our commitment to customer-driven innovation. First, all Philips Hue and WiZ products will be compatible with a new standard called Matter, which enables smart home devices to interact with each other.

The next highlight illustrates how disinfection remains relevant. In Q2, we introduced the Philips UV-C mini disinfection box in Europe, providing consumers with an additional layer of protection against viruses and bacteria. This mini box can disinfect smartphone, keys, money, watches in

©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

just 8 minutes. It is so small that it is perfect to store or take on the go, for instance, when you travel. It is also equipped with the USB-C port, so it can easily be charged through, for instance, a power bank.

Lastly, I'd like to highlight how we are helping our customers to switch from conventional to LED lighting. So we launched TrueForce LED highbays luminaire to serve as a quick and easy LED replacement for HID lighting. This provides installers with a fast, easy and hassle-free installation. It also offers energy saving of 65%. Germany-based Ipsen installed this TrueForce LED highbay luminaire at its production facility in Kleve with a lot of success and great benefits.

Moving on to Slide 9 to talk about Conventional Products, which grew 4.7% on a comparable basis, while increasing adjusted EBITA margin by 110 basis points to 18.6%. The Conventional Products division has proven its resilience during the quarter, delivering positive growth for the first time in years. While benefiting from a broad-based market recovery, we saw traction across most segments, most notably in horticulture. The adjusted EBITA margin increased to 18.6%, driven by continued pricing discipline and operational efficiencies.

Moving to Slide 10. I would like to talk about UV-C, its applications and the innovations which we have brought to market. It's now roughly 1 year ago that we launched our first UV-C products other than lamps, which have been part of our portfolio for more than 35 years. As it becomes more accepted that COVID-19 infections occur mostly through the air, we have seen unprecedented demand for UV-C air disinfection. We launched products in 9 different groups with over 20 product families.

Our products see their application in all segments, ranging from retail to hospitality, from offices to industry and from medical care to homes. We realized over 850 projects with many more in the pipeline. Overall, COVID-19 pandemic has led to a growing awareness of airborne viruses and bacteria and the need for disinfection. And there is a large business opportunity for UV-C in the aftermath of COVID-19. We will continue to launch new applications while educating both customers and regulators on the benefits of this technology.

Next, I would like to discuss the second quarter performance of our Brighter Lives, Better World 2025 program. In the second quarter, we continued on the journey to achieving our ambition of doubling our positive impact on the environment and society in 2020. (technical difficulty) a cumulative carbon reduction across our value chain of 33 million tonnes, which makes us ahead of track for the 2025 target of 340 million tonnes. This reduction was driven by an accelerated shift to energy efficient and connected LED lighting in the first half of 2021, decreasing our carbon emission in the use phase.

Our circular revenues increased to (technical difficulty) versus our 2019 baseline of 16%, while we set ourselves a target of 32% in 2025. This increase was mainly driven by our strong portfolio of serviceable luminaires and further expansion of our 3D printing footprint.

Brighter Lives revenue was 25%, which is progressing nicely towards our 2025 targets of 32%. We had customer wins, which included quality of light, eye comfort products, horticulture lighting and UV-C disinfection lighting, which I've already talked about, and they all contributed and contributing to our Brighter Lives revenue.

We're also on track to reach our 2025 target for the percentage of women in leadership position of 34%. As by the end of the second quarter, it already increased to 25%. This quarter, we also received further recognition for our leadership in sustainability. Sustainalytics ranked us first in our industry and in the top 5% of the ESG Risk Ratings Universe.

Let me hereby hand the presentation over to Javier, who will discuss the second quarter financial performance and the highlights for the first half of 2021.

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

Thank you, Eric, and hello, good morning to everyone.

Moving to Slide 13, where we visualize the adjusted EBITA bridge for Signify. Versus quarter 2 2020, adjusted EBITA margin improved by 190 basis points to 10.9%. This improvement was driven by higher sales, which provided us operating leverage, improved sales mix, which is mainly attributable

©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

to strong demand for our connected lighting offers. In addition to sales mix, our gross margin also benefited from a careful balancing of price versus cost. Indirect cost as a percent of sales improved by 130 basis points, driven by operating leverage. At constant FX, indirect costs increased by EUR 42 million versus '22 Q2 base that included EUR 30 million of employee contributions and government subsidies. Finally, ForEx had an adverse impact of about EUR 8 million.

On Slide 14, we take a closer look at our year-on-year working capital performance. Working capital improved from 6.1% of pro forma 12-month sales in Q2 2020 to 4% of sales in Q2 2021, evidencing the structural improvements made during the last 12 months. The year-on-year improvement is mainly driven by the combination of higher payables and lower receivables, offset by higher inventories as we ramp up for a stronger second half of the year.

On the next slide, you can see our net debt evolution. At the end of the same period last year, following the first months of Cooper integration, our net debt-to-EBITDA ratio stood at 2.4x. By the end of the first quarter of 2021, we managed to lower our net debt position to EUR 1.1 billion with a net leverage of 1.4x. At the end of June, our net position stood at EUR 1.4 billion, translating into a net leverage of 1.7x. The increased debt and net leverage was mainly due to the 2 dividend payments last quarter with a total value of EUR 292 million and the purchase of treasury shares to cover obligations arising from (technical difficulty) employee share plans. This was partially offset by the quarter 2 free cash flow generation of EUR 104 million. On top of the purchase of treasury shares, other include derivatives, acquisitions, new lease liabilities, dividends to minority shareholders and FX impact on cash, cash equivalents and debt. Overall, we remain well on track to deliver on our commitment to reduce our leverage ratio back to 1x by the end of 2022.

Finally, please allow me to share a few highlights related to our total (technical difficulty) H1 performance. Over the first half of 2021, we achieved a comparable sales growth of 8.4%. While this growth was on the back of a first half 2020 that was strongly affected by COVID, it's worth noting a couple of points. Our top line growth was driven by continued strong traction in our consumer segment, our Connected Systems and growth platforms as well as a resilient performance on Conventional Products that declined by only 1.2%. Digital Solutions is also showing an increasing pace of recovery, particularly in the second quarter. Overall, the plus 8.4% growth was achieved in the midst both of a continued and new government interventions and of a challenging supply environment with shortages of both components and transportation containers.

The adjusted EBITA margin improved by 230 basis points in the first half of 2021 compared to 2020 from 8.5% in 2020 to 10.8% in 2021. At the end of the first half, the margin was 10% ahead -- 10 basis points ahead of the adjusted EBITA margin of 10.7% we achieved for the full year 2020. Even as we invest in continued top line recovery, free cash flow of EUR 272 million over the first half was slightly higher than last year, with positive contributors being higher profitability and a structural improvement in working capital.

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

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

Thank you, Javier. Let's turn to the last slide, Slide 18, for the outlook for 2021.

(technical difficulty) so an easing of lockdowns, overall, although the situation remains volatile in some parts of the world, in particular, with the emergence of new virus variants, which may lead to renewed lockdowns in fall or winter. In addition to this, we expect supplies chain constraints to continue to persist in the second half of 2021. We are confident that the measures that we have taken will help us to counter those challenges and deliver our guidance for the year. We therefore confirm the CSG of 3% to 6% for the full year 2020. In addition, we continue to expect our adjusted EBITA margin to be in the range of 11.5% to 12.5% for the year. And taking into account also the high EBITA margin base of last year, we expect a stable margin development in Q3. We also continue to expect free cash flow to exceed 8% of sales.

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

©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

QUESTIONS AND ANSWERS

Operator

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

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

Martin from Citi. The question was really around pricing and how you're seeing inflation items. And I appreciate there's a lot of moving parts inside this. When we look at your earnings bridge, it looks like pricing is more negative than it was in the first quarter, but I realized it was a base of comparison effect. But also, you've managed to offset that in your cost of goods sold productivity. Just to understand a bit more about the underlying price dynamics, what you've seen with raw materials, how you've offset that? Just if you can give us a bit more color on how you're seeing that pricing dynamic?

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

Thank you, Martin. I'll take first stab at this, and then Eric can complete at the end, if need be. Look, pricing, as you know, is a complex dynamic. And as we said before, pricing is how we look also at margin management. And I think that's the way to look at some of the bridges that you've seen. So let's take a step back. When we also talked about pricing in the past, what we've said is we see increasing trend in raw material costs. We see inflationary trends. First question is we see 2 kind of trends. We see an underlying inflation trend that is now trending up, but we see also short terms of spots by (technical difficulty) and those happen at prices which are significantly higher, and we can come back to that in a second.

What we have been doing is we have indeed increased price increases to the market. We have left a bit of agility also to the markets to -- on the timing of the increases of the pricing also as we saw the cost of goods, the pace of which they were coming through our P&L. When you go to the bridge that you've seen in the presentation deck, your observation is, I think, the key one where you see that the pricing is offset by cost of goods. So we have a balance between both. And that's what we always managed. We're going to manage our gross margin by ensuring that pricing is offsetting the cost increases. And that's if you look at our sequential improvement or our sequential gross margin versus quarter 1, you see that we're holding that stable. If you compare versus a year ago, you still see the increase in gross margin, which is driven by continued cost savings that we see, and we have generated in the first half, which again has given us a bit more flexibility on the agility of price increases to manage that margin. So that's how we manage pricing in the market in general.

If you look at (technical difficulty) trends, there -- I would say there's no change versus what we've talked last time. We see indeed a continued low level of, I would say, structural pricing erosion. It's still there, but it's at the lower levels than what historically is. We see the inflation coming, what we call structural inflation from raw materials that we will think will persist and for which we will take pricing as that comes through the P&L. And then there's what we call for now, let's call it, more the speculative increases on components where there's clearly an element of spot by markets where people are making some money on the detriment of others. And there -- let's be clear, there are some material, some components that we buy at 10x, at 20x the price but even 40x and sometimes more. And these are smaller components that we want to buy to secure our customer service that we at least can service our clients. For those ones, we don't necessarily price because we think that's a short-term effect that we have.

Again, what we target to do is to balance with pricing, the cost increases we see (technical difficulty) as we see it in Q3 and Q4. And we believe that we'll probably also there, again, from a price implementation point of view, continue our strategy to compensate that through pricing in the market, but we do believe there's going to be continued pressure there from a costing point of view. I think these are the key components we see in the market.

Operator

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

©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

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

Wanted to ask 3 questions, if that's possible. First, just starting on Conventional. Obviously, there's a comp, I guess, impact and you get to positive growth, but you were pretty upbeat on your commentary about disinfection and specialty lighting. So how do you view Conventional going forward? Can it actually continue to grow? Or are you still think it will eventually decline and the negatives will offset the new positive opportunities you spoke about?

And then the second question is regarding whether you can give us an update on Cooper synergies? How much they contributed for the results in Digital Solutions? Are they fully captured? What's still left there?

And then final question just on if you could help quantify on the Digital Products deceleration basically or the lower than consensus had growth. How much you think was the hit from delayed revenues because of the supply chain? I think you quantified it in 1Q. If you could help us think about the number and when does that come back in terms of your planning?

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

On Conventional, it's a 4.7% growth on a very low base of comparison because we declined by 25% for the same quarter last year. So I think we also need to take into account the base of comparison. And nevertheless, when you see the dynamic in that business, it was pretty much helped by horticulture that was driving at a much higher level than the average of that business. Horticulture is one of the focused growth platform that we have, and we've been very successful in the past quarters with that business in line with our strategy.

Now moving forward, it's still a business that has (technical difficulty) its foundational historical activities declining. We need to let the dust (technical difficulty) is going to lead us. But probably with UV-C and also horticulture, they're going to be able to impact positively what we've seen as a historical decline for that business.

Now when it comes to UV-C, where we are growing more today, and this is why I want (technical difficulty) that we have developed. So we're growing more at this point in time in the applications for the consumer business, but also for the professional business that we have developed lately. And we saw a very positive level of traction. I've highlighted also small projects in many different places of the world for many different applications. So the growth of UV-C will be most seen probably in Digital Products and the Digital Solutions than in Conventional in the future.

Update on Cooper. Cruising very well, in line with what we had developed previously, synergies that we have already generated and we continue on our road map are also happening, but Cooper was impacted, as I would say, Digital Solutions, in general, by both the shortage in containers, but also the shortage in different types of components.

When it comes to Digital Products, well, it's 20-plus (technical difficulty) I think we compensate nearly fully the decline of last year. You need to understand that in -- and I know that you know that very well. In Digital Products, you don't only have the consumer business, which is trending extremely well, and that has continued. It's not only about the connected offer, which had a smashing performance in the quarter, but it's also about other businesses. We are selling to professional customers on the LED lamp side, and we are also selling to OEMs. And these are professional customers. And I would say that these businesses follow more the trend that we see on the professional market rather than the trend we see on the consumer side of things.

What is very important for me is that, that business continues to deliver the value according to our strategy guidelines with a steep increase of 270 basis points of the operating margin for the quarter. Now when you talk about the operating margin, and there were a lot of expectations, but we have to take also into account that Q2 was positively affected last year by what we call the VULA, voluntary contribution of our employees, and it's probably around the 300 basis points. So basically, we have -- if we want to compare like-for-like, we had close to 300 basis points of additional improvement versus Q2 last year. So I would say, while we're close to 600 basis points of improvement from a profitability standpoint, for a quarter, that has never been historically very high for Digital Products. So at the end of the day, the top line, Daniela, is probably also to be taken into

©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.

account with the variety of businesses we have within that division. And from a profitability standpoint, I think the top line is translated to the bottom line with an increased like-for-like close to 600 basis points.

Operator

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

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

My first one would be on Professional. I wondered if you could give us some more color on the regional performance, particularly in key markets like the U.S. and Europe and China and just how that has changed quarter-on-quarter?

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

So George, when you look at -- okay, I'm going to talk about the Professional business and Digital Solutions because Professional business also includes some other activities that I've just mentioned in Digital Products. What we see, if we take a bit of distance, from a macro perspective, we saw a continued recovery in China. So we've seen a regular improvement on the Chinese market, and that's the case not only on the consumer side, it's also the case on the Professional side of the business.

We have seen in (technical difficulty) recovery of -- in Q2 versus Q1. I would isolate Canada because Canada had very severe lockdowns that impacted substantially the performance of the Professional part of the business. (technical difficulty) is very sensitive to the lockdowns in general. We've seen a slight degradation in Europe at the back end of the quarter with more tension linked to the COVID-19 crisis and lockdowns in that region.

And when it comes to -- you mentioned it, but it's quite important, the other markets, where we're also very involved. In the rest of the world, we had a degradation of the performance and the recovery linked to the fact that India, Indonesia and the ASEAN countries went into very severe lockdowns. Now what is very exciting in the Professional part of the business and Digital Solution is that our connected lighting part of the business is growing very healthy and strong double digit. And what we see also is that the growth platform, so the activities that we had listed as having a potential to grow higher than the average are actually growing much higher than the average. So I would not be always satisfied with what I see because we're quite demanding. But at this point in time, I see that some of the activities that we have started to develop a few years ago are now really, really paying off in terms of growth traction and contributing to the growth of the Professional business.

And customers -- just let me give you maybe more of an illustration of this. We had to talk to customers about energy efficiency 10 years ago. I think that's totally taken into account now. And people understand that with connectivity, we go to higher level even of energy efficiency. Let's take the example of a warehouse. In a warehouse, we can save up to 80% of the energy cost linked to lighting with connected lighting. And when you know that the warehouse is 24/7 lighted, that's quite important. But at the same time, and this is what customers now are looking for, we can do in a warehouse many more things with lighting. We can optimize the shop floor, and we can also improve the safety and security conditions and improve the productivity of people at work. And I think what was a very difficult message probably 7 years ago is now more and more listened to. And we have customers with which we start to equip all their sites with connected lighting. And that's a trend that we were waiting for, which is clearly happening at this point in time. So I've selected warehouses because it is also an end-user segment that has been quite dynamic during the crisis and providing us with interesting growth opportunities.

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

Okay. My second question would be around the fact that we've seen recently that the U.K. has introduced further bans on halogen and fluorescent lighting. Do you think other markets will follow suit near term? And where do you see the greatest opportunity for legislative change like this?

©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*

So the ban on halogen has been in place in Europe for a few -- for 2 or 3 years now, not in the U.S. yet. For us, that's not the major technology that we have in our portfolio of Conventional. So basically, when that stops, it's an opportunity to grow on the LED side, and that's the transfer of activity we've done over the past 8 to 10 years, so we know how to do this.

On fluorescent, so there's still -- we still need to wait a little bit. So that's a big -- that's still a big category for us, part of the overall Conventional business. So there's no clear intention at this point in time to have it to stop in the short term. I think we're talking about potentially 2023. I mean we're ready for whatever will come, and we know how to transfer one conventional activity to the rest. For Conventional and especially tubular, it's very difficult to find [LED] that would be priced in a competitive manner. This is why probably this is lasting a bit longer than the rest. But whatever may come, we're ready to adapt to new requirements from a scope perspective.

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

Okay. And my final question would be on the supply chain impact that you mentioned. I think it was EUR 85 million revenue headwind for this quarter. Can you give us some indication as to what you expect for Q3 and perhaps the second half of the year as a whole? And also, will you make up this lost revenue as we go through the year?

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

So the revenue is not lost. At this point in time, it's a revenue, which is deferred. And that's what we have seen. At the end of Q1, it was EUR 50 million. At the end of Q2, it's EUR 85 million. So if you look at it, there's an improvement because we finished with EUR 50 million at the end of Q1. And those EUR 50 million were involved during Q2, and we only added EUR 35 million during the Q2 period. So that's not a business that we've lost. It's a business that is just shifting.

At this point in time, we've done many things. So we're not only getting closer to many of our key suppliers. I'm doing that myself (technical difficulty) today volume commitments not only for the second half, but we're also giving a volume commitment by family of products. And sometimes we go down to the SKU for the full year of 2022. We have also put in place a special sale of procurement people in order for them to go also on the spot market. And because, as Javier answered previously, we find components on the spot market at a much higher price. There's a bit of speculation around the situation today. And what we're doing now so extensively, we are redesigning. So we (technical difficulty) towards a bill of material made of components that are going to be more readily available. So this is an ongoing adaptation that we have been doing, and our R&D teams are working a lot on redesigning to adapt to (technical difficulty).

To be clear, at this point in time, we're working on different level of simulations for Q3 and Q4. We think that it's not going to go away as quickly as we thought. When I told you in Q1 that I thought that we will be through in the second half, I think it takes, obviously, a bit more time because the supply chain has been taken by a crazy bullwhip effect. The problem that we have is that some people would ask for more than what they need because of the shortages. But if everybody does that, it creates an even more problem in the supply chain. So what we're doing with our suppliers at this point in time, we give them our inventory in total transparency of the products that are integrating the component for them to know that we're not overstocking and that also gives us sometimes a bit of an edge against others. So there's a lot of different things that are being done. We're also trying to see if, for some specific suppliers, we can invest for them in capacity in order to be able to block that capacity for us. So we're extremely creative.

Now George, look, we are working on Q3 and Q4. We're not giving specific comment as far as this is concerned. It's a very volatile and moving situation. But I believe that we're going to be still impacted in the second half. I see an improvement that we expect in the second half also.

Operator

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

©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

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

I have 2 questions. The first one on consumer connected lighting. I think in the last call, you elaborated that you see a lot of first-time buyers. and that you expected them to have return orders at a later stage. Is that a trend that you're seeing?

And then secondly, you did a small acquisition in street lighting. I'd imagine street lighting has really very much linked to all the green deal initiatives. Do you see that coming through? And what are your expectations there for this year, next year and the coming years?

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

Yes, Marc. Thanks for the questions. On the consumer connected, yes, we have a strategy, which is now proven more and more robust, which is that we are investing in 2 ecosystem, one which is (technical difficulty) with the one which is WiZ, one which is Zigbee and the other one which is Wi-Fi because really that the market will be made over the 2 different trends. That positioning has proven to be very successful because we're growing very fast in both. Hue is, of course, a very complete ecosystem that we have created with a lot of applications, indoor, outdoor, entertainment. We do so many things there. And we were talking strategically about that business not too long ago, and we were looking at the competitive landscape. And if you want to match that offer tomorrow that we have been developing and innovating in the past 7 years on, I mean, there's a lot of work to be done. And we know that we cannot be equaled on the portfolio of offers that we have and the ecosystem that we have created for that offer in the space even over a few years. So this is an offer, which is extremely well positioned. And as you said, during the crisis, a lot of consumers are going online, and they're looking at refurbishing or improving their homes, and we have benefited from that. But when we benefit from a customer, who's entering in our ecosystem, we also benefit from the fact that we know they're going to come back and buy more. You don't equip your house fully in one go. You go step by step. So entering in the system, it is, for us, a quasi certainty that we're going to have new buyers.

This is what is happening at this point in time. But what is even more interesting on that category is the added education or the accelerated education that the crisis has been doing. So we see now many consumers that would have gone to that type of products much later, already being into it and investing in the category. Once again, Marc, what is important to consider is, if we're touching theoretically close to 100% of the consumers with our nonconnected consumer offers, we are not even touching 5% of the consumer base in the connected smart home category. So there's a fantastic potential ahead.

Telensa was acquired (technical difficulty) additional capability in smart cities. And all the development that we have done there, you know that we have been very strong and probably leading with our interact city applications all over the world. I think we have close to 2,000 projects worldwide in different type of environments and cities with our cloud-based street lighting, control and monitoring software. But what Telensa is bringing is bringing another technology, which is more based on RF and ultra-narrow band that we don't have, which is very much applicable for cities and spaces with very high density of light points. So I think that with that acquisition, we are completing our catalog, and we have now a very comprehensive catalog touching every type of application. And of course, as you have mentioned it, this is also very important for us on the eve of the development of a lot of projects linked to the green deal in Europe, but also to a given extent, in the states when it comes to the renewal of infrastructures and road and street lights. We have already started to see not specifically with Telensa, but a project that we have won in the South of Europe under the banner of the green deal. And we see a renewed traction on quotation, and we think that we're going to see the first important wins probably at the back end of (technical difficulty) the beginning of next year. So this is something which is really happening.

I think there has been a tightening at the European level of the application where this is going. And we see a very positive traction there. I was intensely talking to the markets when we do our forecast for the year just last week. And we see already some traction of the Telensa newly acquired and our local organization working together. Telensa is a provider of software and nodes. So that provides the software and the nodes and the rest of the unit is providing the luminaire. So there's a fabulous synergy potential here taking into account that Telensa has been very successful and already connecting 2 million street light points all over the world.

Operator

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

©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

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

I have a few of them. I will go one at a time. I wanted to come back to the comments you were making earlier between pricing and cost reduction. I appreciate the cost reduction is very, very strong. But I think where I guess I struggled a little bit maybe to understand is why you are not keen to kind of raise the pricing a little bit more because you could actually then benefit on both sides, in the cost reduction and on the pricing, which would, on one hand, boost the top line and also it tends to be close to 100% drop through. So I'm not sure I was fully understanding the fact that we were kind of favoring the cost savings versus the pricing and not both at the same time.

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

Thank you, Lucie. I'll get back to that same question, and I'm going to go a little bit back to the answers even before. As you know, pricing is a difficult or it's a complex dynamic. We have different FX playing in the market from historical price erosion to short-term tactical things that we are doing in terms of spot buying and then the underlying trend. As we said at the beginning of the year, pricing (technical difficulty) one of the ways to look at indeed compensating what we see as cost increases. And we also said at the beginning of the year that we will be looking at the phasing of the cost increases as they come through our inventories and then take according pricing to offset that. We're still in an environment where we're also looking at a growing top line. So we want to have a careful balancing act between pricing and cost increases in order also not to jeopardize the recovery of the business.

We also see in the market that as we look at pricing implementation, it takes a bit more time also with back orders, that it takes a bit more time to get those implemented. So there's no lack of willingness to price it through, but I think we've been playing a careful balancing act between the 2. And I think that's a smart way as we clearly accelerate our recovery from the lower volume in the COVID year.

In the second half of the year, as we expect there, the cost increases to move more towards the inventory, we expect to have a more implication of that cost in the second half, and we'll have more pressure to further price up in the market. So again, to maintain and protect our gross margin. So it's just not -- I understand your question on it, yes, but if we do then we look at other, but it's not univariable. We don't look at a univariable element. We want to manage our gross margin carefully as we move forward. And therefore, we try to be agile in the pricing as we have a read on the cost increases coming through.

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

Understood. My second question was around the sustainability and specifically across the supply chain. Thank you for providing us sort of the details of how you performed versus your target. But I was just curious to understand as we kind of look a little bit more granularly in terms of ESG and sustainability, how your suppliers are kind of incentivized around sustainability at their own operations and their own facility? How much control do you have on that? How much visibility do you have on this, especially because you have a lot of third-party suppliers and also third-party manufacturing?

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

So you -- if I understood well the question, you talked about the ESG profile of our suppliers at this point in time. So you know that we have audits that we do regularly on what we have called our risk suppliers, but it's about 250 key suppliers, and we audit them regularly on the basis of their ESG criteria. I would say that typically, the first time we do the audit compared to what our requirements, they would be complying around 30% to 40%. We put in best recommendations. They go up to 80% to 85%. And after the third time, they are above 95%, and that's what we want to see them doing.

At this point in time, as we are already carbon-neutral scope 1 scope 2 (technical difficulty) we have on climate change, integrate fully scope 3. If it does integrate fully scope 3, it means that it does integrate what we sell and how we improve the footprint of our customers, but also the (technical difficulty) supply chain, including our suppliers. And you've seen the results that we are ahead of our objective.

©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 objective is to do what the Paris Agreement asks us to comply with (technical difficulty) 10 years but in 5 years, so go 2x faster. So our players are at this point in time engaged in this dimension of ESG, and we are very careful, making sure that they are complying fully to these things. So we have a bit of time ahead of us. But we worked already with suppliers now for quite a while, and they're used to working with us and to our demand on that side.

Now this being said, what we experienced on the supply chain at this point in time is an unprecedented disruption, and we're trying to make the best of it on all fronts. But we are not disengaging from our ESG commitment also towards what our suppliers have to do.

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

And I guess my last question was to see a little bit of the evolution of the growth initiatives you were mentioning at the Capital Markets Day. I remember at that time, it was about 20% of sales. You've spoken now about very strong growth in UV-C and horticulture. I just was wondering kind of what's the share of those growth niches are now kind of representing for the group?

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

Yes, Lucie, we will comment about that at the end of the year as we normally do. But I can tell you one thing, I have been here for quite a while now. We had to go through the whole very complicated substitution (technical difficulty) to LED. That was a very, very big undertaking for the company. What I see happening and pretty much in line with what we've described at the Capital Markets Day, the growth profile of the company is shifting (technical difficulty) on first, the connected lighting part of the business because this is from far the biggest part, EUR 1.1 billion at the end of last year. The traction is fabulous. And I'm not only talking about the consumer and the smart home part of the business, which we know is also being helped at this point in time by the COVID crisis. But on professional applications, I see a very, very good level of traction and technologies that we have been developing over the past 5 to 7 years. That's the case on what I was commenting previously on the consumer side of the business. But I would tell you, it's the same on the professional side of the business, the full architectures with software, with control devices and adapted fixtures for different types of unusual segment, that's something that takes a lot of time to build. And we have that. It's ready. It's available. I would say, ready for sale. And we see now a very strong level of traction.

I give you an anecdote in -- when we said 2 warehouses and I go back on the example I was talking about previously to George, I think. So basically, we equip warehouses and those warehouses are rented by warehouse companies to their customers. And we had a customer experiencing when renting the space, our lighting. And when they went to another rented warehouse, they said to their supplier, "Hey, you should put the same lighting as the one we had previously (technical difficulty)." So we tell us what you've done because this is what my customer wants. So -- and that level of traction, we didn't have that previously because connected lighting doesn't only bring (technical difficulty) unprecedented levels, it brings additional collateral benefits. And we've talked a lot (technical difficulty) but this is the first time that I see really this having a very good, not only level of understanding at our customers with a very positive traction. (technical difficulty) profile in line with what we had said at the time of the capital market that is really happening. We'll give probably more indication on the sizes of those as we do normally at the end of the year. That's the way we do it. And thanks for your questions.

Operator

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

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

I have 2. But before that, can I just clarify on your outlook comments? Did you mention Q3 margin progression will be stable? Or did I misheard 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

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

No, you didn't. You heard very well like usually, Joseph. Look, at the end of the day, we looked at the performance in Q2, and we've seen that the consensus was slightly higher than the performance, not by much, but slightly higher. But I think we have to take into account that Q2 was also positively impacted by what I mentioned, the voluntary participation of our employees. So at the end of the day, if you net the Q2 performance from that (technical difficulty) if we are growing by 190 basis points in Q2 like-for-like, it's more like 490 basis points, which I think not many companies are striking at this point in time in terms of improvement of the operating profit, especially when last year, we also improved the operating profit versus 2019. So we thought that given the situation and the forecast that we had done, we could guide also maybe a bit more on how we see Q3. And we're comparing ourselves to a high base last year. And we see the performance in Q3 in operating margin in Q3 this year being stable versus last year. That's what we have in our plans at this point in time. So you heard very well, Joseph.

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

Yes. And maybe can you give us an idea on maybe Q4 as well? Do you expect also that kind of stable development year-on-year given the situation with raw mats?

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

So what we -- we've given already the information of Q4, which is basically in the guidance, which is between -- for the full year between 11.5% to 12.5%. Now Q4, Joseph, will be linked to a few things. So we have -- and let me explain to you the way we work at Signify. So when we have, at the end of the last month of the quarter, the results, we, of course, consolidate the results worldwide. And then we have before the results announcement, what we call, our performance review where we built the forecast for the end of the year. And that has happened last week where basically we have most of our markets and divisions and functions coming to us and telling us how they see the end of the year. So we take those numbers in. We listen to them. We correct some when we believe we need to correct it upon what they tell us. And after we've made the consolidation, we take into account macro risks that we see on the market or big opportunities. And we decide how we factor them in the overall forecast. And the forecast that we established last week is telling us that we see probably a stable performance from operating margin in Q3. But the forecast that we have at this point in time also derisked from another -- the risk that we see and the volatility that is existing on the market is leading us to comply with the guidance we gave last time.

Q4 can go in many different directions. If the COVID-19 is under control and the economies are opening, we can see Q4 being very positive for us because the market demand is there if they were not lockdowns and the market demand is also there if there were not that level of component shortages, which is also touching part of our connected businesses. So they could grow even higher than what they're growing at this point in time. So I think there's still a little bit of uncertainty on Q4, which is also what we have transmitted in our outlook. But you have the message for Q3. And for Q4, it will depend on the severity of the lockdown (technical difficulty).

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

And then comes from my questions about pricing versus raw mat dynamics. And it sounds like it's a timing issue given that you have kind of a lead time when -- as when pricing hits the inventory as well as the raw mat impact. And so if I look at the next couple of quarters, so should we basically broadly expect kind of a little bit positive pricing impact, but on the other hand, kind of a negative cost savings impact? And for the remaining quarters, do you still expect for this to net effects to be net 0? Or do you see it being more negative?

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

So let me rephrase what has been said by Javier. At this point in time, we can look at the individual components of the gross margin or look at the gross margin as a whole. What we do at this point in time, Joseph, we look at the gross margin as a whole. And you've seen that our gross margin is stable, close to 40% in the past quarters, and that's what we are fighting for. What we can say is that in Q2, we don't have the full impact of the

©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

cost, and we don't have the full impact of the price. But we're managing both in such a way that we try and maintain the gross margin. This is really what we are doing at this point in time. You can understand that it's difficult to completely plan it.

Let me give you an example. I have to deliver and for me, the #1 priority is to deliver our customers. That's what I'm saying to everybody within the company, we absolutely need to do whatever we can to deliver our customers in a situation of shortages. So I have this great deal on horticulture, and we are missing components. We can buy components on the spot market, and those components are going to be 30x more expensive than what we would buy normally. So the question, are we buying? Are we not buying?

It's not a question for me. I'm buying. I absolutely need to deliver my customers. Is that going to have an impact on the gross margin? Maybe for that business, but the gross margin for that business is accretive. So at the end of the -- it's a combination of so many different things. Our eyes and the eyes of all our people in the market are on the gross margin. And the gross margin is a combination of 2 things: the impact of a cost increase and also our price increase. You need to know that the price increases have been largely communicated to the market. Now you communicate a price increase from a tariff lease price, and then you decide to gauge where you want to be positioned with the additional discounts that you are doing, but that gives us a lot of flexibility to adapt. That's the message that is given to our teams at this point in time. This is what we have in the plan that I was communicating to you about just a few minutes before, which is the forecast we do for the full year. So that's the way we manage it. And I'm just paraphrasing what Javier has been saying.

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

Yes. My final question is on something as longer term. I mean one of your competitors' targets through-cycle gross margin of 42%. And I understand your gross margin is currently around 39%, I mean, rolling terms. But can you -- do you have a -- what is kind of your ambition when it comes to the gross margin, not in this year, but kind of beyond in the medium to longer term? And also, if you don't want to put a number, maybe you can give us some color on the divisional gross margin profiles and where you see the biggest potential for improvement?

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

Well, Joseph, probably -- I mean the company that you're talking about doesn't have exactly the same activities as we do have. And you know there's quite an important impact between the activities. But let me tell you, if you ask me, (technical difficulty) around 40%, 39%, 40%, I'm fine. If that can help us to be competitive to grow, that's the main objective. The main objective of the company after having nearly finished a very complicated transition is about growth. If we get that level of margin and we grow, we can -- you know that we have an operating leverage. We've proved that in the past. That's going to help us to grow, while at the same time, improve our operating margin to do what? To reinvest in the business. At this point in time, we have also taken with Javier and the team, a very strong a strategic decision, which is to invest and quite substantially, if we mentioned it, because it's substantial in digitalized (technical difficulty) around 3 access: our offers, our processes and our customer interfaces. I can tell you on one specific example, which is the way we go to market for smart home connected. We have tremendously improved and grown the percentage of our sales that are done through our own portal, which is improving many different elements: the gross margin in one go, the connection to the consumers on the other hand, but also our cash performance. So at the end of the day, we have to work in parallel of that disruptive environment and finalizing the transition. We have also to invest in longer-term avenues that are going to be bringing growth to the company and create value. But for me, gross margin where it is given our mix is not a bad position to be in. Growth is the fundamental and key objective to Signify.

Operator

I will now hand it back to the speakers for closing remarks.

©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

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

Ladies and gentlemen, thanks (technical difficulty) 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're happy to answer all your questions. And again, thank you very much, and enjoy the rest of your day.

Operator

This concludes our conference call. Thank you all 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