REFINITIV STREETEVENTS

EDITED TRANSCRIPT

LIGHT.AS - Q1 2022 Signify NV Earnings Call

EVENT DATE/TIME: APRIL 29, 2022 / 7:00AM GMT

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 and 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*

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

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

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

PRESENTATION

Operator

Hello, and welcome to the Signify First Quarter Results 2022. (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 Signify's Earnings Call for the First Quarter 2022. With me today are Eric Rondolat, the CEO of Signify and Javier Van Engelen, the CFO. During the call, Eric will first take you through the business and operational performance, after which Javier will review the company's financial performance for the first quarter.

Eric will then discuss the outlook and closing remarks. After that, we'll be happy to take your questions. Our press release and presentation were published at 7 o'clock this morning, both documents are available for download on 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 hand over to you, 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. Let's start with some of the highlights for the first quarter immediately on Slide 4. So Signify delivered top line growth driven by a strong momentum within the Digital Solution division. As you know, operating conditions in the quarter became more challenging. Our main priority was to protect and support our Ukrainian employees and their families in the best possible way and we very happy to see a very strong engagement from our colleagues and the Signify foundation supporting the people and communities affected by the war.

Investments into Russia was stopped and all new business was closed since February 25th. Our Q1 top line was also impacted by the renewed lockdowns in China. Inflationary pressure has led us to further practice cost increases that -- sorry Ukrainian inflationary pressure has led to further cost increases compensated by price action. The adjusted EBITDA margin remained strong at 10.5% and at the same time, the supply chain disruptions led to an increase of inventory levels, which temporarily impact negatively our cash flow. We expect this to revert as the year progresses.

Let's move now to Slide 5, where we see Signify overall Q1 performance. So as you can see, we increased the installed base of connected light points from 96 million in Q4 to 100 million at the end of Q1. LED-based sales represented 84% of the global revenue. Nominal sales increased by 11.8%, with comparable sales up by 6.4%. Adjusted EBITA increased to EUR 172 million in Q1 2021 to EUR 187 million in Q1 of 2022. The EBITA margin remained strong at 10.5%, a 30 basis points decline versus Q1 2021, which was a high base of comparison.

We managed to achieve a double digit adjusted EBITA margin for the second consecutive time. Net income increased by 45% to EUR 87 million. It is driven by higher income from operations and lower net financial expenses and includes impairments related to operations in Russia and Ukraine. And finally, free cash flow was negative EUR 189 million, but Javier will explain in more details later.

Now let's move to our divisions starting with Digital Solution on Slide 6. The division delivered a strong Q1 performance with comparable sales growth of 16.9% and adjusted EBITA margin of 9.7%. The double-digit comparable sales growth was driven by continued strong action in the United States and a good traction in most of the other geographies. Adjusted EBITA margin improved by 70 basis points to 9.7%, benefiting from operating leverage, price increases and sales mix more than offsetting higher cost of raw material components and logistics.

This is the strongest EBITA margin the division has achieved in the first quarter so far. Next I would like to discuss some of the digital solutions highlights, let's go to Slide 7. First, I would like to zoom in on the second highlight. So we equipped Belgian schools with LiFi, which provides both students and staff with fast and reliable access to online through light. This installation succeeds successful installations in schools in Italy, Germany, the US and also the Netherlands.

The fourth highlight shows the potential of solar lighting. We installed our Philips Sunstay solar luminaires in (inaudible) situated in the Portuguese Algarve Province. Solar panels capture the sunshine during the day and at night motion sensors detect the presence of people and adjust the light intensity as needed for greater safety and comfort for the residents.

Let's move now to the next division on Slide 8. In the first quarter, the Digital Products division reported a comparable sales growth of 0.2% on the strong base of comparison. Connected home sales remain at good levels. The adjusted EBITA margin was 12.8%, once again on the strong comparison base.

This reflects a gross margin that was impacted by the higher cost of goods sold base and continued investment in marketing to support future growth.

Slide 9 shows some of Digital Products introduction and software improvements done in the quarter. So we launched the Philips Ultra Definition light bulb in North America. It is the next level of our EyeComfort product range, comfortable for the eyes and enhancing the light quality due to its high color rendering index, comparable to natural light. The third highlight shows how we expanded the WiZ offering in the Indian markets through locally relevant product introductions, including various downlights and ceiling spots, a desk lamp and also light strips.

Moving now to Slide 10 and Conventional Products. Comparable sales declined by 15.1%, the adjusted EBITA margin declined to 16% mainly due to the sudden rise in both energy and transportation cost. This division is more exposed to energy and transportation cost inflation. We were able to compensate part of this impact with price increases.

Next I would like to discuss our sustainability performance on Slide 11. So we are on track for 3 out of our 4 metrics. The cumulative carbon reduction across our value chain is on track, helped by the accelerated shift to energy efficient and connected LED lighting and our ongoing effort to decarbonize the supply chain.

Circular revenues increased to 30% and it's -- which is well on track for our annual target. This performance was helped by an expansion of the serviceable portfolio of outdoor luminaires. Our Brighter Lives revenues were 27% on track to achieve our target. This was mainly driven by the consumer well-being portfolio, as well as UVC's infection and emergency lighting.

We increased the percentage of women in leadership position to 26%, but we are slightly off track for the quarter. We expect to see further progress during the year and this quarter we conducted the first all-employee sessions of the powering inclusion series. We celebrated International Women's Day with our BreakTheBias campaign and we participated in the UN Global Compact Target Gender Equality event.

But with this, let me hand over to Javier, who will take you through the highlights of our financial performance in Q1.

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

Thank you, Eric, and good morning to everyone on the call. Let me start with some of the key financial highlights on Slide 13, where we are displaying the adjusted EBITA bridge for total Signify. After a record profit margin in Q1 2021, we managed to keep Q1 adjusted EBITA margin above 10% for the second year in a row and this in a complicated external environment. In fact, compared to the high base in Q1 last year, we limited adjusted EBITA erosion to 30 basis points from 10.8% to 10.5%, mainly as pricing momentum accelerated.

If you look at the bridge in more detail, you see the following dynamics. The volume growth contributed with positive EUR 14 million, driven by the acceleration of the Professional Business. Mix still had a positive EUR 4 million effect and this on a favorable base in Q1 2021 where we saw a steep increase in connect home sales. The positive impact of our price increases further accelerated versus previous quarters and together with the positive mix effect it more than offset both structural and transitory cost increases.

The net effect was a positive EUR 25 million compared to a positive plus EUR 23 million and a minus EUR 15 million in Q4 and Q3 2021 respectively. Indirect cost increased by EUR 7 million as we continue to invest in both our front and commercial capability and in marketing to support our growth momentum. Yet as a percent of sales, indirect cost decreased from 31% to 29.5% of sales.

Finally, FX had an adverse impact of EUR 13 million, mainly coming from depreciation of the Chinese renminbi. On Slide 14, I'd like to zoom in on our working capital performance during the quarter. On an absolute basis versus Q1 2021, working capital increased by EUR 323 million to EUR 559 million or from 3.5% to 7.9% of sales. While Q1 is traditionally a higher working capital trimester due to payments from the high preceding Q4 sales, the Q1 '22 working capital was especially affected by the significant inventory buildup in the second half of 2021 due to the longer supply lead times.

Following the structural improvements we have made over the past 2 years, both in accounts receivable and on accounts payable, we are sure that we are confident that we'll get back to previous low single-digit levels as soon as supply lead times reduce.

Finally on Slide 15, you can see our net debt and leverage evolution. At the end of March, our net debt position increased by EUR 222 million to EUR 1.4 billion, mainly as the important positive contribution from EBITA was more than offset by the temporary increase in working capitals, as mentioned in the previous slide.

We also completed the repurchase of EUR 32 million worth of shares for long-term incentives. As a result of the higher net debt, our net leverage ratio increased from 1.4 times to 1.6 times. For the balance of the year, we remain on track to deliver on our commitment to reduce our leverage ratio back to 1x EBITA by the end of 2022.

I would like now to hand over back to Eric for an update on the EU Green Deal, the outlook and some closing remarks. Thank you.

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

Thank you, Javier. So we are pleased to report that we are starting to see traction in the EU Green Deal related projects, as you can see on Slide 17. I would like to highlight a few of the projects we have won so far. So in Germany, we are installing energy efficient LED road and street luminaires in Hamburg and improving energy efficiency in Bad Salzuflen through our Interact City system.

In Poland, we are modernizing the public lighting of Kutno with Interact City lighting system. And in Spain where we're selling more than 4,000 LED lights in 5 municipal parks in Alcazar de San Juan. We're also replacing 9,000 street like points in 7 municipalities in the region of Ciudad Real. The project pipeline is growing and increasing energy prices create an even stronger incentive to implement our solution.

And this brings us to the outlook on Slide 18. So we are maintaining our guidance for 2022. This assumes that the Chinese market and global supply chain dynamics do not deteriorate further. We are confident that we will manage the external volatility with the same agility as we demonstrated over the past years.

And with that, I would like to open the call for questions with both Javier and myself, I'm going to be happy to answer.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of George Featherstone from Bank of America.

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

I'd like to start with one on the supply chain. Wondered if you could give us an update on the number of components that you have in escalation compared to the end of Q4 2021. And also help us understand how you're impacted by the lockdowns in China, particularly how much we are sourcing requirements from the region?

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

Yes. George, so if you remember, we went from 230 to 167, then we went to 90 and we are at 40 escalation level 4 at the end of Q1. So as you can see, it has been improving all along. We are still far from the situations that we experienced before the crisis, but that's clearly moving in the right direction.

We have been implementing a lot of action in 2021 and in hindsight I mean they're really impacting now positively our performance. We have multiplied our dual sourcing on key components which we didn't have in the future and it is also reflected in the number of escalation. But I would say from a marginal standpoint, we talked about escalations, but we talked also about the vessel reliability. We talked also about our suppliers lead time. What we see is that, we were at the bottom and now we are in an improvement trend. So we see all the indicators becoming now more positive than what they were before.

I think that's a very good -- that's a very good sign after so many so many quarters. But I think as far as we concern the measure that we have taken has helped us -- have helped us in especially in Q1 to be much less affected by competence issues. China is a worry, effectively, we don't see so much of an impact yet in Q1.

Although, paralysis of some of the key regions and some of the key harbors namely Shanghai and to a given extent Ningbo would certainly have an impact on the supply chain, whether it is components that we are standing to other manufacturing regions or finished goods that are coming from China.

So this is why we put this as a condition for us moving forward, but the situation is extremely fluid. Nobody knew at the end of the previous quarter that this will happen, would happen. We just need to -- we just need to adapt. So at this point in time, I will say that China doesn't have a major impact on the supply chain, but as the supply chain is globally improving, if really China goes into a massive lockdown, we could have a further deterioration. But we'll see what we have ahead of us when things happen.

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

And just like to touch on a couple of other things data points that you usually provide that we have in this occasion. So first would be, could you give us an update on the order book. I think in Q1 you said plus 67% year-on-year growth. So I just wanted to know where is now. And then also the share of connected sales for digital solutions and digital products if possible?

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

So in terms of order book, what we see, we see that the order book in absolute value is quite stable, but it's a more healthy, meaning that in that order book we have much less overdue orders. And that's very important for us because you know that one of our obsession was to be able to deliver customers now. If I look at where we are at the beginning of Q2 compared to the same period last year, we have an order book, which is 55% greater than the previous quarter than the quarter of the previous year.

In terms of shelf connected, look we didn't look at it that way, but our systems and services business in the Professional business have been growing quite healthily also on a strong base last year. And when it comes with the consumer part of the business, it has been also growing, but a bit less than we had expected. We've seen that in on the consumer side, there was -- there was a slight contraction, we're still growing but less than we had expected also on the very strong base in Q1 last year. So the connected business are moving in the right direction.

Operator

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

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

I will have 2 as well. But I'll start with the first one and then ask afterwards. So the first one is on net pricing and pricing in general. I guess you've been now a few years actually of pricing improving. Can we talk about how you see that going forward especially in the context of your guidance for a margin increase in the next 3 quarters when going forward which is much higher than what we've seen this quarter. On also if I may ask there, we've had headlines this week regarding China-US tariffs potentially being removed. Can you tie that in the answer as well? And I'll ask my second after you address these.

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

Yes. Daniela, let me tackle the first point on pricing and first as you indicated, first looking backwards. If you -- if you look back at a couple of quarters, we've seen this positive trend on pricing, which in the first instance was a lower erosion that we saw from let's say the LED business over time that has taken -- that has been replaced by really price inflation to offset costs.

If you look at the trend we've seen in the last couple of quarters and if you've seen from the reconciliation we have in the -- in the presentation, you've seen an acceleration of pricing, right? So the pricing element that in the bridge that we have EUR 63 million. When you look back last quarter is only EUR 30 million and its pricing which happens across the 3 divisions of the percentage -- in percentage terms, Conventional Products, which is mostly affected by the inflation on both energy price and transport. There we see percentage wise the highest increase, but we see pricing across the 3 divisions and it's indeed accelerating as we implement more price increases.

From an offsetting of cost of goods and the cost of goods increases, if you remember in Q3 last year it was still a slight negative about minus EUR 15 million. We turned to a positive EUR 23 million in Q4 last year and is now plus EUR 25 million.

So at the macro level, what do you see that from a pricing point of view, we're doing what it takes to compensate what we have been so far anticipating in terms of cost increases. If you look at -- it depends a bit by division. If you look at conventional obviously, the sudden increase in one quarter of an energy price is something that we did then recovered in the subsequent quarter because that was not anticipated.

So that pricing dynamic is working and forward I think you can expect the same dynamic. We've taken price increases to compensate for cost inflation. And I would expect as we go throughout the year, you'll see that positive impact.

Now again, it's a fluid situation out there on how short-term impact happens. We are trying to project at least 6 months out and then incorporates in pricing. It's true that with inflation happening with consumer confidence going down, it might become a little bit more difficult on pricing and we have to also make sure we have the right cost savings in place. But fundamentally so far, I think you could expect that we will target to compensate through pricing, cost savings, the inflation impact we have. So that on a -- on the run rate basis sequentially quarter-by-quarter we maintain our gross margin at the levels where we are.

And then I would say on China and US tariffs, I'm not sure, Eric, if you have any more information?

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

No, you know, I think, Daniela, with time this had substantially reduced from what it was at the beginning. So there may be a few tens of millions here and there, but we're going to look into it into more details, I haven't really checked that specifically.

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

And then just on inventory, can I just clarify in terms of like the increase, would you say it's all down to goods in transit or is also a part of like you over produced and could that have had an impact on margin, what's the mix there?

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

Well, when we talk about inventory, you have 3 elements. You have Industrial inventory, you have good in transit and you have finished goods. So when you see the global increase of inventory, I would say it's an increase on the 3 different categories. Now what we need to picture is the following. Imagine that you have a supply chain where you have flexibility, which is 3 months and then that flexibility becomes 8 months.

This means that basically when you forecast, you need to forecast on day one for what's going to happen in 8 months from now. It also means that if you realize during these 8 months that you're going to consume less, it's very difficult to change because it's already in the pipe and the supply chain has lost the flexibility that it used to have.

So when you put things in perspective, we had in our plans to sell more than what we sold in Q3 2021, also in Q4 2021 and Q1 2022. Why? Well, we know what has happened. We had a major supply chain issue in worldwide, which affected us in H2 2021. And the Q1 2022 didn't really happen exactly as we expected it from a macro perspective.

So at the end of the day, we had planned to sell more.

And that generates an inventory that is coming and you see the situation of the inventory today and it has an impact on the 3 different category, which is Industrial inventory, good in transit, but also finished goods. So the lack of flexibility that we have now has grown that inventory and I would say one part is, I would say normal now linked to the fact that when your supply chain lead time increases, you need to increase your inventory to cover your demand and the next part is what I would say an era in forecasting because we showed that we would be selling more than what we have.

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

Got it. So there is a little bit of overproduction, which potentially positively impacts the margin?

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

Well, what we believe is that some of the inventory that was produced and that is coming was -- will be sold during the year or so. I mean we have a reserve on cash that we need now to convert and this is what we're going to do in the rest of the year.

Operator

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

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

I'll go one at a time. And firstly just to look at the breakdown of your pricing. I think we share about [strip] 9% of sales this quarter and including -- included in that I suppose there is also the logistics surcharge. And can you break it down for us please? And also if I look at your annual report from last year and your cost of material has actually only increased 3.3%, but the shipping costs increased more than 30%. So a lot of headwind you had last year was shipping. And then you mentioned the COGS otherwise very, very well last year.

So if we look at this year, given the logistic surcharge that you implemented in November, would you be confident that this can offset majority, if not all of the potential future logistic headwinds with this -- this new surcharge?

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

You want to (inaudible) yes, just, Joseph, looking at more on when it comes to -- to get obsession that we have made and you asked a question, which is more looking forward. I prefer to talk about what has happened because talking about what's going to happen next is complicated. We didn't see coming the increase of the price of energy that we have right now. At the same time, the cost of logistics have been fluctuating, but systematically increasing during the year.

And I would like to be able to -- to be accurate on what's going to happen next, but I can't. Of course, we have our plans. Our plan is to adapt as we've done previously. We have the surcharge that we have goods on transportation and that has been effective and you see it in the numbers. We expect also that sometimes during the year if things stabilize that we're going to be able to regain a bit of cost power on the cost of goods sold because they've been increasing a lot during the past period.

But once again this is an extremely volatile situation that we're facing and for us we need to adapt. What we have taken into account is the cost of energy, which has have no rising very sharply in the past, in the past month in order to be able to protect the P&L and I think we've done that quite effectively. Although, some of the measures that we have taken will probably take a full effect in the coming quarters.

So at the end of the day, it's a very complicated question talking about the future. The only thing that I can tell you is we look at the past, we've adapted, we've adapted to transportation costs. We're now adapting to on to the cost of energy. We're also trying to see the opportunities we have to get a bit of cost on the bill of material. So we're doing all that as we speak.

There was another question on the breakdown from the 3.1% of pricing and I will let Javier talk to it.

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

Yes, on the breakdown again, look, I'm not 100% sure, but I'll go by, more by division, where you see the impact and what have we done so. If you break down the pricing impact across division, of course, the biggest impact we see is in conventional on converting well above the average. And as Eric already said it's because of conventional 2 things that we anticipated was the fact that energy prices were going up. And of course from a logistics point of view, also the transport for the conventional product is less efficient.

What we have not included is a sudden increase in energy cost in Q1 and I said that's further price increases that will be implemented in the market. But as I said, so conventional products has price increases or price impact which is clearly above high single digit. When you look at DDS, DDS that's more around the average where we come in BDP slightly lower, again because they are slightly less impacted from the efficiency of transportation and also from the gas prices.

So that's what we have breakdown by division and have a look at different actions. And as we go forward, as I said, conventional will have to keep an eye on that as gas prices are really determining here logistics prices and we believe that on the DDS also there we have the right plans in place for pricing what is still needed.

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

Yes. And my other question is on the other side of the equation of inflation if you like. Also we have seen very high energy prices and especially in Europe. And so what's the kind of impact on lighting demand when it comes through LED retrofit? I mean, you mentioned a bit about the Green Deal, maybe you can elaborate a bit in exactly how the customers are changing their attitude towards the LED projects et cetera, including connectivity. And also, does that also have an impact on your how to cut your lighting business as well, because I see food prices et cetera all going very high. And I think you're -- all of your lighting products can save a lot of water and fertilizer, et cetera. And there may be some tailwind from that as well, maybe you can kind of elaborate a little bit about the phase 2 potential impact?

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

Yes, Joseph. Look, it's always very complicated to see positive things in the crisis that we're seeing at this point in time. But very clearly, there will be higher demand for energy efficient solutions. And you know that with lighting, we can provide that and we can provide that at a very low cost. You change your light source, you put connectivity, it is simple to do and you get very quickly important results up to 80% of energy saving.

So clearly the hike in energy prices today is creating more demand for energy efficient solution. So we see that with the level of the Green Deal for sure. We see that at the level of our connected offers. What is very interesting is that we realized because we have calculation of ROI that with the today price of energy, the retail on investment of many of the solutions that we have been promoting to the market for many, many years has pretty much improved.

So the discussion especially when we offer connected system behind return on investment in different types of sites and application, I mean we're now in a position to offer to our customers a much better number. So we think that that will drive further the business. When we look today at our funnel in systems on the provision side, the funnel is extremely healthy and effectively given the situation we are probably more listened or people appreciate the fact that the return on investment of our solutions are much better than they used to be horticulture.

What we've seen in horticulture on the other hand is probably your move from conventional more to LNG, to be able not only to have the positive impact on yield, but also to be able to save energy, which was if you look back [12] years ago that was not a major thing for growers, they wanted quality lives, we were selling conventional, we were selling LED. But clearly today, we see that business growing very healthily, I mean it's been growing also tremendously in Q1. And clearly with the preference now for LED that had to save energy. Yes, so we see traction overall on our LED and LED connected systems.

Operator

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

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

Yes, can we speak a bit more about the Digital Solutions divisions, which obviously had a very, very strong result in the first quarter. What's behind that, is that conversion of earlier orders, is that strength -- more structural strength in there? And also if we go to look at the coming quarters that conversion of earlier backlog and the structural in the lighting trends is that -- what are your expectations there?

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

Yes. Marc, it is pretty much in line with what we had said. So you remember that we explained that 2021 was stronger recovery on digital products and that we were expecting 2022 to show a stronger recuperation on the side of Digital Solutions is what is happening.

I think you have different levels. One of them is effectively recuperation from the crisis. And we talk to that many, many, many times, as you were looking at Digital Solutions at the end of Q1, we have a recuperation from 2019, which is around 98% and that's substantially higher than what we experienced last year.

So at the end of the day, we see a recuperation from the crisis because of COVID, because of supply chain issues, a lot of customers were not so supported, lot of customers were not delivered. So one part of our growth is a recuperation. Now the other part is the growth that we experience being in strong positions in key markets and also the growth of connected lighting.

As you know, that business is now quite substantial as part of Digital Solutions, it's around 20% of what that division does and it is growing. And what is interesting for the business overall Digital Solutions declined in Q1 2021 the systems, the connected systems business of Digital Solutions group in Q1 2021. And we're still growing in Q1 2022 quite substantially on a good base. So you have a few elements, recuperation, good position, good market share in growing markets. And at the same time, our systems that are growing and growing very healthily and now representing quite a strong percentage of everything that we sell in that domain. And we are in that business as you know very differentiated because we made the investment over the past 7 years to get a full and complete systems offer from the light source, the luminair, the control devices and also the software.

The upcoming quarters will depend also on some of the macro situation that we're facing at this point in time, but if we look at the demand, the demand is strong, the demand is there. We are facing it and we are delivering and I would say in some cases, we believe also better than competition. When I look from a geographical standpoint, we were extremely strong in the US and with Cooper. We had also very strong performance in Europe because we grew all in the quarters that had already grown last year.

So this is in a healthy business, it has been the case also in the growth markets. Of course, we were impacted in China and we were impacted in Eastern Europe for the reasons that we know.

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

Okay. And then my second question is on the -- on the margin improvement. In the past, you also had a very good track record of whenever some stuff was moving against you cutting down the indirect cost. If the issues -- supply chain issues continue to impact you, is that something that you consider at this stage that you also are going to look at the indirect cost again?

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

Yes, Marc, but I would not like to have to do that because we've positioned the company in a different spin. But let me -- so let me take a bit of distance and explain. So what we see today a performance of 10.5% for Q1 is a strong performance given the fact that we compare with that to a very high base in Q1 2021 where the gross margin was extremely high, benefiting from all the carryover positive effect of the actions done in 2020 during the crisis.

So we start the year with a good level of profitability, even if it's slightly below the same period last year. So we believe we have the potential moving forward to continue to improve our performance in operating margin in line with the guidance still investing. It's extremely important for us now that we move the company in a different dynamic, which is about growing and investing for growth.

We've been substantially investing in online investments connecting to our customer through specific interfaces, continuing to digitalize our offers and our processes.

So we're spending a substantial amount of money in order to do that because we believe this is preparing the company for the future. So my willingness today is not to stop these investments and not go into a mode of indirect cost reductions. But if we have to do that depending on what is coming at us in the following quarters, we have always the possibility to do that. We know how to do it and I would not like to, but if I have to I will.

Operator

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

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

Yes, it's Martin from Citi. The first question was just coming back to conventional and then obviously as the business is gradually fading with time, but given that it looks like the price point of conventional is going to be relatively more expensive for the consumer given higher energy cost, but also because of the efficiency of LEDs. Are you assuming that transition is going to accelerate more and use previous modeled? And obviously you've talked about being the last man standing so forth in that business, managing it down, do you need to bring forward and the sort of volume ramping, capacity ramping, conventional and we should think about there in terms of and the capacity Management insight conventional, so those were first question.

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

Yes. Martin, that's a very strategic question that we are starting to look at into more detail. Now, a quarter doesn't make a trend, but if the trend of that quarter remains, probably it means that the conventional will effectively go down faster than what we had expected originally and I'm talking about the markets.

Now what we see is the market and the relative competitive position.

So we know already today that some of our competitors are struggling with the situation to such an extent that and they may not stay in the business. So there is a market share which becomes available, which we believe could translate temporarily in an increase and take off market share on our side, which is totally aligned with a strategy that we have described over the past years.

At the same time, when you look at the conventional business, the impact of the energy cost increase is substantial in the overall cost equation. And we need to know if these energy prices are going to remain and how long? But clearly the increase of cost is putting some of the technologies of conventional in I mean in a very uncompetitive position compared to LED. We talk about compact fluorescent, compact fluorescent today is under price, if not sometimes more expensive than LED.

So we see that technology fading away. It's different for incandescent, but it's also a business that has reduced substantially over the years, probably the next one from a market perspective to be is a halogen. We are not very involved in halogen, so that is not going to be a major issue at least from a top line perspective as far as we are concerned.

Now the whole discussion is going back to tubular lighting and the -- and the fluorescent tubular light and this is where we need to make sure that moving forward we get a clear understanding of where the cost are versus LED that in the past it was difficult to match the price of fluorescent conventional technology with LED. Now with those cost increases the gap is narrowing, it's still to the benefit of conventional at this point in time, but if cost grow further, it will clearly accelerate that transition.

Now if we were tomorrow to change all the fluorescent tubes that we have on the planet and put LED tubes, it's not only about the light source, Martin, it's also about the infrastructure of light, it's also about the driver because not all the driver or all the ballast will accept to move from one technology to the other one.

So it's not only about replacing the light source, it's also replacing some part of the infrastructure.

Sometimes we talk about the luminaire because you know for LED, you don't need the reflectors that we have for instance with the conventional because the light destruction is different. So it's not only about replacing the light source, it's also replacing part of the infrastructure and part of the driver then ballast. So it's a bit of a bigger good job than just changing the light bulb when it comes to tubular light.

So these are all the elements that we're looking at this point in time. So clearly some technologies are going to fade away much quicker than was expected, could be potentially also the case for fluorescent if the price are maintained or go up. But at the same time changing a fluorescent tube is a bit more complicated than changing a bulb.

Sorry, it's a bit of a long answer, but there are many different aspects to it.

What I can tell you that at this point in time, we are looking at the subject very, very closely to try to understand what the future could be like. When you look at our performance, it -- I would say it's still 16% performance from an operating margin standpoint. What we were not used to have is that low level of gross margin in that business.

So we reflected pricing, I mean we did do price increases, which I believe are not fully reflected in the performance of Q1, so we're going to see how this materializes moving forward.

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

Yes, that's really helpful. I have a second question just on a sort of unrelated topic, obviously you touched on the Green Deal, lots of talk about building refurb. Obviously if a lot of building refurb there are other parts of the building that are getting done are unrelated to lighting and actually open in planning and all these things make that process be long. I mean are you seeing the lots of projects are just the lighting and if you're not dependent on sort of deep refurbs of buildings in order to get that renovation projects and to get that sort of Green Deal tight project kicking in relatively sooner?

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

Yes, a good, good very good point. Look, what we see today the Green Deal is, we see a lot of project on infrastructure and we see a lot of project on-road and street. We see a lot of project on lights in parks. That's where we see the bulk of the project. When it comes to the building, so there are renovation which are solidly lighting and they are renovation that are bigger in scope. And where you're right is that when they are bigger in scope, it takes more time because the lighting is fast, it's quick, but if you need to change HVAC, if you need to change some of the passive material, it takes much more time.

So we see the first traction being much more on infrastructure and road and street, but we have some building refurbishments, renovation which for us in license close to new when people take out the ceiling, but they take a bit longer because the installation of those are longer and the process of establishing the quotes in the project when it's a bit more than lighting takes a bit longer. So the project out there, it takes a bit over longer commercial incubation, but they are there.

Operator

As we now approach the end of the call, we will take one last question from the line of Sven Weier from UBS.

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

Yes. I'm sorry I dialed to call a little bit later, you might have commented on this already, but my first question would be around the consumer business and the slowing that you foresee in the remainder of the year because of inflation.

My question would be, have you seen the slowing already on the back of the price increases that you have done or is that at this point still very much an expectation? And then how would you see the pricing then to go further forward? I mean, we've said we can still expect the market to become much more competitive again.

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

Yes. Sven, look, we didn't go through specifically to that point, so we can comment on it of course. So yes, we've seen that the consumer business slowed down compared to the dynamic that we experienced in the previous quarters. But once again, we are comparing the consumer business to a very dynamic quarter in Q1 last year and I would say overall the full-year 2021. But we see a slowing down, it's not only, it's not only inflation -- its inflation, but it's also the consumer sentiment when you see what's happening today worldwide.

Probably, we don't see that in the US today, but in the countries of Europe, there is probably a little bit of a sentiment, which is being created when consumer confidence is not as high as it was and that translates also in the business direction.

So yes, we've seen the slowdown and we see also a slowdown on the non-connected part of the business. We see a slowdown on the connected part of the business, even if that is the latter one is still growing.

So when it comes to pricing, look what we're trying to do, we're trying to price strategically but also tactically. And I don't believe that we're going to be in a world ever -- never finishing inflation. At one stage, we're going to have to be on par between prices and the capacity of the people to buy, so that's what we're looking at this point in time.

Can we gain close to knowing some specific part of the business, we think also that the market from a supply side should start to evolve. And if that happens, there are going to be a stabilization when things like maybe not going to go back to normality the way it was before, but we should have a little bit of a reset and stabilization.

Now the only element that can play and that's role in all that and that is when is a potential other lockdown of the supply chain in China that would have impact on the global supply chain because then we go back into -- not exactly the 2020 situation, but we go back into a situation at the end of 2020 and 2021 where we faced major issues in getting the products rooted across continent.

When you look at the situation of harbors today, it is not solved and there are still many, many vessels that are not off loading and they are staying on the sea, so situation is not completely solved, but it's in a momentum of improvement. And we will not want that momentum to be broken by the situation of China at this point in time.

So pricing going further, we'll see we'll adapt, I think we cannot price up forever. We need to make sure also that we are well positioned for the people to buy our products.

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

And the slowing you see on the consumer side probably as you said is largely a sentiment phenomenon, but you don't really see an issue of saturation that's because during the lockdown now people bought a lot of goods, refurbished their homes, a fair bit of a saturation issue as well that you see?

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

No. I don't -- that's specifically on the LED side because the crisis that we see today is pushing people to buy more LEDs. On the connected side, I think we have increased penetration greatly in 2021 and we get the benefits right now because more and more consumers understand the virtue of connected more and more and I appreciate the solution that we bring as being really differentiated.

So I see that as a positive thing.

You may have followed that we brought to the market the first ultra energy efficient class light bulb, so basically it's an LED bulb that is saving 60% of the energy that is consumed by existing LED bulbs. So we go to the next level. It's a very technically advanced bulb, which is protected by 5 patents on our side, so we put a lot of technological savviness in order to achieve these type of performance.

We are talking about something like 210, 220 lumen per watt, so in terms of efficacy this is huge.

So at the end of the day, that's the next trend. I think that saving energy and understanding that producing more is not what needs to be done, what needs to be done is really saving at the point of consumption. And in that sense, I think that's also driving the energy, probably inflation and sentiment are today explaining the slowdown, but the underlying demand and the capacity for us to continue to convert the installed base and the circuit base is really there.

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

The second question I have if I may was on the factory footprint and because you mentioned higher energy costs. So does it mean you are 100% exposed to spot price since you don't have any fixed longer-term contract on the energy side. And I was also wondering because you spoke about China, it sounded like that none of your factories are directly impacted by the lockdown, so they're all working so far?

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

So on the factory, let me start with China. Some of the factories are impacted, not all, they may not be impacted directly, but our suppliers are impacted. So we try to find solutions and sometimes you cannot root product because you don't have trucks going from one province to the other one.

So look, it's not all easy in China at this point in time, but our teams are finding solutions in order to minimize the impact. So it's not that there is no impact, but it's minimized today.

Now when it comes to our factory footprint and the cost of energy. So the cost of energy for us, it's a lot gas and a bit electricity.

Now on the electricity side, you may remember that part of our sustainability commitment, we did sign some virtual power purchase agreements. And we did that in the past, yes, 4 to 5 years as our contribution to sustainability.

We didn't want to buy certificates. We wanted to help people who were investing in renewable generation capabilities. So in order to do that, we have been able to guarantee that we would be buying from these people energy at a given price over a long period of time.

And when you look at the contract that we've signed and closed, it causes 100% of the consumption we have in the US. It covers about 14% of the consumption we have worldwide and 70% of the consumption we have in Europe.

So at the end of the day when we did these projects, we did these projects out of a fundamental belief that that was what we needed to do to head the world build more capacity in renewable energy and at this point in time, it has a favorable impact because the difference between the cost of energy today and the cost at which we guarantee that we would be paying energy over the years is yielding a benefit, but that's more on electricity.

And so our footprint because we also created and invested in those virtual power purchase agreements where we were consuming energy so where we had, where we had plans has been very positive, a very positive outcome.

But, yes, we're looking at this point in time, we're not going to change the footprint immediately because of that, but we are looking at our footprint also from transportation standpoint in order to make sure that we are not transporting too many goods inside continents.

Operator

Thank you. And I now hand back to our speakers for 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 Q&A. Do you have any additional questions, please do not hesitate to contact Philp or myself. Again, thank you very much and enjoy the rest of your day.

Operator

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