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EDITED TRANSCRIPT

LIGHT.AS - Q3 2022 Signify NV Earnings Call

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PRESENTATION

Operator

Hello, and welcome to the Signify Third Quarter Results 2022. (Operator Instructions)

Today I am pleased to present Eric Rondolat, CEO; Javier van Engelen, CFO; and 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 third quarter 2022. With me today are Eric Rondolat, CEO of Signify; and Javier van Engelen, CFO. During this call, Eric will first take you through the business and operational performance, after which Javier will review the company's financial performance in the third. Eric will then discuss the outlook. After that, we will 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. And with that, I will 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 third quarter on Slide 4. We delivered 4.3% comparable sales growth in an environment that is getting increasingly volatile. The sustained performance of our professional business continued to compensate lower consumer demand and the slowdown in China. We managed to improve profitability compared to the second quarter, although pressures from currency movements and higher energy costs affected our P&L.

The adjusted EBITDA came in at 10.4% as an adverse FX impact was partly offset by operating leverage and strengthened cost discipline. Net income increased to EUR 120 million and as expected, our free cash flow generation strengthened driven by improved profitability and the stabilization of our working capital.

On the next slide, Slide 5, we see Signifyâ€™s overall Q3 performance. So we increase the number of connected light points from EUR 103 million into Q2 EUR 109 million at the end of Q3. LED-based sales represented 83% of our total revenues. Nominal sales increased by 16.3% with comparable sales by 4.3%. Adjusted EBITA increased to EUR 199 million in Q3 2022 compared to EUR 182 million last year.

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The adjusted EBITA margin decreased by 70 basis points to 10.4% mainly due to a strong and negative currency effect of 220 basis points. This was a result, both from the weakening of the Euro versus the US dollar and the Chinese Yuan and a temporary headwind from FX hedging. Javier will talk more to this later but excluding as the temporary adjust hedging effect, the adjusted EBITA margin was stable versus Q3 2021. Again, this quarter price increases more than offset higher input costs. Net income increased from EUR 94 to EUR 112 million. And finally free cash flow increased by EUR 50 million to EUR 135 million.

Now, let's move to a digital solution on Slide 6. Top line performance remained strong with comparable sales growth of 12% and an adjusted EBITA margin of 11.2%. Double digit CSG growth was driven by continued strong action and strong traction in the professional segment across most markets, particularly the US and Europe. As in previous quarters, the CSG growth was driven by a healthy combination of volume, price and positive sales mix. The adjusted EBITA margin improvement of 70 basis points was driven by price increases and operating leverage with more than compensated the effect of higher input costs and an adverse effects impact.

On the next slide, Slide 7. I would like to discuss a couple of business highlights of our digital solution and division. We have been appointed to design the supply and the lighting for all 69 Everlast Gyms across the UK. Designing the gyms with LED lighting dramatically cuts at the energy consumption by about 80% versus the traditional technologies that were deployed earlier. The interact connected lighting system provides the centralized lighting control for all the gyms ensuring a consistent look and feel as well as providing increased visibility, flexibility and control of the lights. The gyms also features 3D printed luminaires, which are designed and develop to suit the exact needs of each individual location. These are made from 100% recyclable polycarbonate material.

And other key highlights is an LED horticulture project that we did in South Korea. We have installed Philips GreenPower LED top lighting compact at the 2.8 hectare Parm Farm tomato greenhouse. This solution accelerates plant growth, produces higher yields, enables higher crop quality production and saves up to 50% in energy use compared to conventional light sources. But I also have to mention the fabulous facade lighting of the Santa Maria Novella church in Florence as this is the city of my mom.

Now let's move on to digital products on Slide 8. In the third quarter Digital Products Division reported a comparable sales decline of 2.5%. And the converse sales growth performance was driven by strong demand from LED Electronics while we continue to experience softness in the consumer channel and China. The adjusted EBITA declined by 250 basis points to 10.5% driven by your strong adverse effects impact and lower fixed cost absorption.

Moving on to Slide 9 for the business highlights of Digital Products. We launch a Ultra Efficient A-class downlight and outdoor luminaires with wall and pedestals in Europe. These save more than 50% of energy compared with standard LED alternatives. We also launch SpaceSense a new way of automating our Wiz lights using Wi-Fi sensing technology. SpaceSense can detect a motion using Wi-Fi signals to automate the lights accordingly. As such there is no need for additional and dedicated sensors and batteries.

In the third quarter, we have also teamed up Philips Hue with CORSAIR to create the ultimate gaming setup. CORSAIR iCUE can be used to set scenes on Philips Hue light, synchronizing with CORSAIR RGB gaming peripherals to create the perfect gaming atmosphere.

Let's move on now to Slide 10 and Conventional Products. Comparable sales declined by 9.5% as continued volume declines were partly compensated by pricing. The adjusted EBITA margin declined by 460 basis points to 14.2% and this is explained by three factors. First, price increases and indirect cost savings fully offset inflationary cost increases. Second, lower volumes negatively affected fixed cost absorption. And finally, the division was disproportionately affected by the temporary headwind from FX hedging. Without this impact, the adjusted EBITA margin would have been above 16%.

Next, I would like to discuss our sustainability performance on Slide 11. We continue to deliver on our Brighter Lives, Better World 2025 Sustainability Program Commitments. The cumulative carbon reduction over our value chain is on track and is mainly driven by energy efficient and connected lighting in the use phase. Circular revenues were at 30% mainly driven by serviceable and circular luminaires.

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Vitalize revenues increased by 28% mainly due to our safety and security and consumer wellbeing portfolio. The percentage of women in leadership positions was 27% stable with the second quarter. We continue to create action plans to address this gap and accelerate our progress towards the end goal. This quarter we also have published our first ever Diversity, Equity and Inclusion reports.

Let me now hand over to Javier for the Q3 Financial Highlights.

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

Thank you, Eric. And good morning to everyone on the call. Let me dive straight into the key financial highlights on Slide 13, where we are displaying the adjusted EBITA bridge for total Signify. Let me walk you through it in more detail. Adjusted EBITA increase from EUR 180 million to EUR 199 million or a plus 9% year-on-year. The increasingly positive impact of pricing increases worth EUR 91 million in Q3. More than offset the EUR 45 million negative impact of higher input costs.

A minor negative volume effect was offset by a small positive on mix. Minus EUR 23 million impact versus Q3 2021 was caused by a negative currency effects. This is a combined effect from the weakening of the Euro versus both the US dollar and the Chinese RMB and a temporary headwind for hedging. The temporary headwind for hedging is worth about 70 basis points and is caused by a high anticipated hedging position on the strengthened US dollar. In total, our adjusted EBITA margin declined by 70 basis points to 10.4%, however, excluding the temporary headwind from FX hedging, the margin was stable year-on-year.

On Slide 14, let me talk you through our Q3 working capital performance. While sequentially working capital is stabilizing compared to Q3 2021 our working capital is increased by EUR 504 million to EUR 820 million or from 4.7% to 10.7% of sales. Inventories were EUR 395 million higher year-on-year impacted by acquisitions, cross price increases, FX and continued longer supplier lead times. Sequentially, we see inventories have peaked and are starting to come down as lead times are beginning to ease. Receivables were EUR 196 million higher than Q3 2021 mainly due to the higher sales and FX. In fact receivable days remained virtually unchanged versus a year ago. We do remain confident that we will return to previous mid to low single digit levels of working capital and supply chain lead times continue reducing.

On Slide 15, you can see our net debt and leverage evolution. At the end of September, our net debt position was EUR 1.685 billion, a reduction of EUR 64 million versus the end of June. The lower net debt is mostly driven by our free cash flow generation of EUR 135 million in Q3, which benefited from a strong EBITA and a stabilization of working capital. Other had an impact of EUR 71 million and includes new lease liabilities, derivatives and the FX impact on cash, cash equivalents and debt. As a result of the lower net debt, our net debt-to-EBITDA multiple reduced from 1.7% to 1.5.

And with that, let me hand over to Eric for the outlook.

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

Thank you, Javier. Let's conclude with the outlook on Slide 17. So faced with an increasingly volatile environment, Signify now expects to achieve a comparable sales growth between 2% and 3% for the full year 2022. This is mainly driven by the uncertain near-term outlook, especially for the consumer segment and the Chinese market.

Regarding the adjusted EBITA margin and the free cash flow, we are targeting the lower end of the previously communicated guidance ranges. Signify has already shifted gears to adapt to a structurally weaker external environment in the coming quarters when inflationary headwinds and volatility are likely to persist. And we focus on measures to control cost and cash in line with our track record of delivering margin expansion and strong free cash flow generation in difficult environments. While some areas will be more affected by reduced demand, connected energy-efficient lighting solutions, which are even more relevant and cost-efficient as energy prices surges will continue to benefit from a strong traction.

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

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will take our first question from George Featherstone.

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

It's George Featherstone from Bank of America. I'd just like to start, please, on the guidance and maybe some color you can give on October. So the year-to-date organic growth is quite a bit above your guidance for the year now. Aside from the tough comparatives you have in the fourth quarter, is there any comment you can make on October's trading that can help contextualize this and in terms of how you expect the remainder of the year to develop, particularly in your consumer exposure.

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

Yes. George, when we look at the year-to-date, we had 5.3% in terms of comparable sales growth. Now, when we look at Q4, we need to take into account the following. So we're comparing ourselves with a relatively strong base because we grew by between 4% to 5% in Q4 last year. But when we did our forecast and we got at a very, very high level of detail, we realized that there were 3 things that we may not have in Q4 this year that we had in Q4 last year.

The first element is that in Q4 2021, we also invoice some of the backlog or the order book that we had accumulated in Q3 where we had difficulties to deliver because of the component shortages. Second, we had a very strong horticulture business in Q4 last year. And our horticulture business is temporarily affected by the price of energy. Growers these days are having the P&L pretty much pressured by the higher price of gas and electricity.

And third element, you may remember that in Q4 last year, we had a very strong quarter on the consumer side, which we believe we're not going to get this quarter given the softness that we have experienced already at the end of Q2 and in Q3, which we've commented earlier, and we believe that, that trend will continue in Q4. So if you look at those fundamental 3 elements, when you compare Q4 last year to Q4 this year, this is why we have reviewed our guidance between 2% to 3% of growth for the full year, which also translates to a negative performance in Q4 2022.

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

Okay. Are you able to give us any color then on October and perhaps how the consumer has performed relative to those measures you're talking about? Just on top of that relative to how it performed last year, can you give us an indication of how much is down?

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

October is complicated because we need to wait until the very end of the month because this is where we do the full consolidation of the numbers and many things happening at the end of the month, but we would not specifically comment on October. The only thing that I can tell you on the -- specifically on the consumer business is that there were a lot of destocking in Q3. And so there were a lot of destocking from our retail customers. Some of them reached at the end of Q3, a level of 3 weeks in terms of inventory, which is historically extremely low because normally they operate around the double of that. So we believe that there is a need to rebuild in Q4, the inventory of our consumer retailers, and we believe that that's going to happen. But that's all I can tell you right now.

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

Okay. And if I could just squeeze one more quick one in. On the switch of the strategy to be more defensive maybe in this environment, can you talk us through what areas you're targeting on the cost base? And is there anything structurally you need to change? And also does this compromise your ability to capture the demand in the professional segment?

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

Yes, we are commenting that on a regular basis. We were waiting to know whether the markets would be quickly building back up or not. We believe that what is happening today is going to last a bit more than what we had originally forecast. And maybe some of the changes in the parameters we have to deal with may be more structural than transitory. So we are going to adapt to that. So if you look at the company from a top line perspective, we know that there are some points of weakness in terms of growth traction.

I'm going to talk about Russia. I'm going to talk about China, which is quite an important market for us and the consumer business. On the other hand, we believe that with connected lighting on the professional side and all the green switch moves that are happening around the world, not only in Europe and the U.S., but we see now an extension also to the growth market, there is potential. And we see that potential being very concrete.

On the other hand, when you look at the dynamic to generate operating margin, while operating margin may come less from high growth and dilution of costs. But it will come from a bit of a rebuilding of the gross margin because we also think that our cost in the bill of material. I'm going to be going down. We're going to be able to negotiate. We enter in a market where there is less traction. So we believe that our suppliers also see that. So that helps us to renegotiate prices, which we are doing extensively at this point in time. So that will help us to rebuild the gross margin.

While at the same time, we believe we need also to act on our nonmanufacturing cost, which means that we're going to have an expansion of the operating margin coming from an expansion of the gross margin, but also the reduction of our indirect costs. Where are we going to do this? Well, are we looking at it? The principle that we have established before remains, which is that we want to have a small, efficient and cost-effective holdings. So we want to eventually further reduce the central part of the organization to the benefit of the operating part of Signify.

At the same time, there may be a few other adaptations that we need to think about moving forward that can bring 2 things, probably a bit of cost advantage, but also speed advantage. So we're looking at all these aspects at this point in time, but that's how we're changing from a strategy of growth and dilution of fee cost to an adaptation to the existing environment.

Operator

We will take our next question from Daniela Costa.

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

If I may ask on 2 things. I guess, into pricing into Q4 and 2023, as you think, I guess, about your price list for next year, obviously, it's been sequentially going up. There's still some elements of inflation on raw materials, sorry, on labor and on energy, but raw materials is falling down and volumes might be falling down. So how shall we think about it going forward as the comps are also getting tougher?

And then the second thing, back to the -- your own working capital and your point about sort of having peaked and, I guess, destocking yourself. What -- how quickly can you come back to the mid-single-digit levels that you used to have? Is that -- how volatile should we expect working capital to be going forward? That would be helpful to get your color on that.

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

Yes. Daniela, I'll take the first question, and Javier will take the second one. Look, on pricing, when you look at what has happened during the whole crisis, pricing at the beginning was not fully compensated, compensating the increase that we have in COGS and in bill of material. But when you see what's happening in the 2 past quarters, we are doing that. So basically, we have priced according to the cost increase. And if you look purely at where in all the geographies where we operate, we have priced up to compensate on the cost of goods. That has been done.

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So when I look at us moving forward, there may be still some positive effect on price because price takes a bit of time to be put in place. In the last price increases that we've done were done in Q3. So there maybe not completely seen in the numbers yet. So there may be a little bit of positive impact there. But moving forward, I expect more that we're going to be capable to increase the gross margin with a reduction of our bill of material. That's really the objective that we have because we know that we can at this point into position the margin well at the prices where we are.

The objective is not to price ourselves out of the market because we need to generate top line. So we're measuring that as we speak and on -- nearly on a daily basis in all the locations where we operate to make sure that we're making the right decisions. And some of the other costs that are maybe not in the cost of goods sold will have to be also compensated with lower nonmanufacturing cost. That was my answer to George previously. But I will let Javier answer to the second question about (inaudible) 0:25:36.

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

Daniela, thanks for your question. Look, to answer the question on working capital and where it's going to be heading, let's quickly go back to where we came from. First of all, if you look at our working capital, our days receivable, our payables have been stable, have been well under control. So, if we talk about working capital evolution, we predominantly talk about inventory.

If you look at what happened with inventory since last year and you look at the increase, fundamentally, you can look at 4 components, which have led to the increase in the absolute number of inventory, FX movements, price increases, increasing supply chain lead times and then forecast -- reliability or forecast visibility in a very volatile environment. FX and pricing as a percent of working capital or percent of sales inventory don't really matter here. So we really talk about lead times and forecast visibility.

Now what you need to understand is between FX pricing lead times, you explained about half of the increase, visibility and market volatility is the other half of the increase we had. So how are we going to see the dynamic going forward? Lead time and forecast visibility link back together. So on the one hand, we do see a stabilization of our inventory at this point in time, we start seeing a decline of lead times. It's still not very significant, but at least we see that the lead times have been plateaued and are slightly going down, which should indeed get a better adjustment to our goods in transit, which is an important part of the inventory.

Number two, with outcomes also the ability to, again, forecast on a slightly lower time frame, which means instead of having to look 6, 9 months forward and sometimes 12 months forward, being able to forecast on a shorter period of time will also allow us to have a bit more visibility reliability on the forecast going forward. All in all, these dynamics should have a positive impact throughout next year. The one unknown is still the speed at which lead times will further come down. And so the improvement back to original levels will be probably roughly correlated to the lead time decreases, while at the same time, of course, volatility of the market is something that we will try to anticipate by being also a bit more conservative on what we think in terms of forward volumes in a recession revenue environment. But fundamentally, I think we're going to see a decline across next year. And then the final twitch to getting back to the lower levels will be when lead times get back to normal levels.

Operator

We will take our next question from Martin Wilkie/

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

It's Martin from Citi. So my first question is just going back to pricing. And it looks like you say that pricing got better into Q3. But just when we look at your commentary on the slide for Digital Solutions and Conventional, you mentioned on digital products, you haven't called out pricing. And obviously, we've now got the consumer part that is softening. Some of that is obviously comps as well as the sequential development. Can you comment on pricing specifically within consumer? Are we seeing that whether it's a reversal of discounting or would you buy demand? Is that an area where pricing has already rolled over? It was just good to get some underlying sense on that.

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

Yes, Martin. Looking in digital, have a lot of different businesses, all businesses have been priced up during the crisis that we experienced in the past quarters. Probably that we have priced up much less on the consumer connected offers. We can still -- where we can still enjoy a good level of margins and higher level of margin than the average. So at the end of the day, what is really impacting is the demand, probably because of softness in the market and also in Q3, the reduction of the inventory at our consumer retailers. Those are the 2 main things that explain the performance.

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

Great. And if I could follow-up just coming back to the point on working capital and cash flow. I mean it seems like you're either at or just past sort of peak inventory. And obviously, you're not going to talk about 2023 at this stage. But in terms of how we think about that unwinding and a rebound of free cash, will your sort of working capital outlook and how we think about free cash? Would that go back to how it was in the past? Or are you thinking because of the experience of bottlenecks and perhaps reshoring and other items, do you have to have a structurally higher level of working capital than perhaps you've run with in the past? Just to understand how you're thinking about that over the long run.

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

Look, I'll try to give a shot at that, Mark, without giving too much way forward to future that we cannot predict. But as I just explained to Daniela, if you look at how working capital has been built up over the past. Again, we've always had a very healthy balance of inventory payables and receivables. As I said, payables and receivables, they are where they have historically been very strong inventories where you see the biggest deviation. We do expect that we can go back to historical levels. There will be some puts and calls if you think about regionalization, yes or no, but it will also have some positives and negatives on your structural inventory.

But I think they can offset each other. And then it goes back to what I said before, it's a question of lead times. As you can understand, in the last year, we've been able or we've been forced to forecast sales evolutions with kind of a 9 to 12 months visibility into the future. As you remember, as we started the year, we're all far more optimistic on where basically we were looking forward to pessimistic to a very optimistic scenario that has come down throughout the year, which, of course, from a forecasting inventory build that has impacted inventory buildup throughout the year that's been paid for. And now with the visibility that we have or at least a more conservative visibility we take for the next year, we should be able to manage that inventory back down.

The visibility that we have or the less visibility lead times really depends on what happens with lead times. We see them currently going down, and we'll see how it goes further down. On the -- if you break down the inventory, one important point in inventory is, if you look at e-components, basically, there, we don't have big inventories. And over the future, I don't think that will again be a big issue that we face. So I think structurally, there's no reason why we shouldn't be able to get back to historical levels.

Operator

We will take our next question from Wim Gille.

Wim Gille - *ABN AMRO Bank N.V., Research Division - Head of Research & Equity Research Analyst*

Wim Gille from ABN AMRO. I got a question on M&A and, let's say, how it is developing in current markets. Obviously, valuations in public markets have deteriorated materially in the past couple of quarters, your balance sheet is strong so that potentially provides opportunities. So can you give us a bit of feeling on price expectations on the private side to the sell side at this point in time? What kind of discussions do you have with potential targets? How do you look at the pipeline? And is there anything we can expect in the coming, let's say, 6 quarters taking into account a favorable environment for companies with strong balance sheets.

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

Yes. We always have an ongoing list of potential M&A, and we look at opportunities to increase our market share. I would say, mostly in the luminaire business, in the professional business in geographies where we are not sufficiently strong. We eventually also look at the possibility to acquire a company that would bring technology to us, for our connected offers or a service capability. We also look eventually at companies that can help us to deliver on our digital road map. So basically, this is what we're looking at.

Look, at this point in time, we would not do M&A because of the opportunity of a lower market level. We really do it if it is fundamentally strategic for us. And we also do it if we have the bandwidth to integrate these acquisitions. And lately, we've done some acquisitions that we are integrating at this point in time. We have also a market which is extremely complicated to navigate in at this point in time. So probably that M&A in the coming weeks are not going to be our priority. Of course, if we face something that we cannot miss, we will do it. Otherwise, we have a lot on our hands to finalize the integration of some past acquisition, but also to adapt the company to the current situation.

Wim Gille - *ABN AMRO Bank N.V., Research Division - Head of Research & Equity Research Analyst*

Very helpful. Can you give us a bit more, let's say, color on what the expectations are on the private side, on the sale side regarding valuation. Have they already come down in your discussions that you have with potential targets to, let's say, realistic levels where public markets are trading at this point in time?

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

Yes, Wim, I'll take this one. Look, there's nothing -- we don't comment on anything specific we're looking at, but you also see what's happening on the market. So I think what's currently happening is we see what the market is doing. There has been a correction depending what the next 3, 6, 9 months will look like. I don't think it's not going to be unpredictable that some companies will face proffered times and other ones in the crisis situation. So I think valuations will be probably volatile in the next 6 to 12 months, depending on what the agri different companies are. We'll keep an eye on that.

Again, as Eric said, we will not jump into things which are not strategic. If we've got some ideas about where could we add value also from a shareholder point of view, if we can keep a close eye on those. But in general, I think that the next 6 to 12 months will create a bit of a difference between those companies who cope well with the economic situation, those who might be suffering more. So opportunities will probably arise on the market. But again, we're not going to jump into something which is not strategic, which either we cannot absorb or where we cannot really build value over time.

Operator

We will take our next question from Joseph Zhou.

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

Eric and Javier. My first question is on Q4 really because for your updated guidance, you imply a margin that is something like (inaudible) 0:37:18, which is broadly flat or even slightly up compared to last year. So, given that the margin has been declining quite materially year-on-year for the first 3 quarters. I wonder what the margin drivers are for Q4? And obviously, it's not from top line leverage because your top line guidance implies a decline of minus 4%, 5%.

So is it more from -- looking at your (inaudible) 0:37:47 more from FX being less of a headwind or net pricing versus costs being more favorable or a combination of both, which would be -- which is the main driver basically?

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

Joseph, I'll take that one. You're absolutely right on the numbers. If you look indeed at our Q4 projection or at least our full year guidance and then a projection, then you look indeed at Q4, which roughly will be in line with last year. Let's take it from 2 angles. First of all, if you look at it sequentially, Q2, Q3, Q4, as you've seen, we've narrowed the gap on Q2. Q2, we are on the EBITDA level, 140 basis points below last year, now we're at minus 70.

And if you look at the components, and we've explained those also in Q2, if you look at the key components between Q2 and Q3, you have seen a slightly worse impact (inaudible) 0:38:39 that we have (inaudible) 0:38:41, and we also see our logistic cost coming down and that only partly from the (inaudible) 0:38:48. So, if you take FX (inaudible) 0:38:51, then you clearly see that we've had an improvement in the pricing versus cost relationship and that said, mainly driven also by logistic costs going down.

If you look sequentially, Q3 versus Q4, (inaudible) 0:39:03 control, we do expect logistic costs, and we see that currently in the market that we see container prices going down. So we see still that we're going to see some benefits on materials, on logistic costs, energy costs at this point in time, they're roughly at the same level or difficult to predict. So we would expect a continued improvement there to see on raw material costs, and therefore, there's a slight improvement expected on gross margin.

On the sequential basis, if you look again versus Q3, we do have a leverage on our top line because Q4 still remains the highest selling quarter. So from a sequential improvement, you would still expect also our total dilution of costs still to happen. If you compare versus a year ago, roughly in line with last year's profit margin in Q4. We see the same dynamic as we've seen in the course of the year. We see still pressure on gross margin, but that being compensated still by a lower percentage of NMC, which is the path we still see to be in line on profitability versus last year.

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

Javier, that's very clear. And my second question is on labor inflation. A lot of companies have talked about salary reviews and some change their review kind of when it really happens. I just wonder what is your kind of outlook for when you do the next salary review? And also, can you kind of indicate what kind of labor inflation are we looking at? Are we talking about 3%, 4%, 2%, et cetera?

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

Joseph, look, it happens in all the different countries, sometimes at different times. I think that probably today, the level is going to be probably between 2.5% to 5%. We don't know exactly what it is going to be at the end of the day. Now we're looking at our cost as a whole, so including the labor inflation, and that's what we need to make sure is adjusted and to the business that we have in front of us. So that's the way we look at it. Inflation is part of what we have to do. We do it. And the consequence of that is sometimes further or additional adjustments that we may have to do.

But yes, probably between 2.5% and 5% depending on the locations. And this is going to be -- I would say mostly, it will be in 2023. So that's the normal cadence to look at salary and wages increases. There may be some isolated cases where that could be done a bit earlier for specific reasons that would may be linked to a very high level of local inflation pretty much above what you see elsewhere. And -- but we do that on a regular basis.

Operator

(Operator Instructions) We will take our next question from Marc Hesselink.

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

Mark from ING. First question is to get a bit of a feel for the growth for next year. You have a longer-term target of between 0 and 5%. Taking the macro backdrop, taking that what you call out the energy efficient solutions, strong demand for that and also maybe some backlog that we all over from 22% to 23%. Is that a realistic range still for next year?

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

Yes, that's a very good question, Mark. I've been exchanging recently with a lot of other companies to get also the feelings on 2023. And what I can tell you right now is what we see, we see the macro situation changing every quarter. So we're going to have to finish Q4, finish the year, see where we are and see where the environment is because a lot of that is driven by the external environment.

Look, at this point in time, of course, we are looking at our plans and we have market forecast, but those market forecasts had been changing all the yearlong and they've been brought down by analysts all over the world. So we're following that trend. Talking about 2023 at this point in time is a bit premature. And we will see. What we come up with probably when we announce the full year results, we're going to see things a bit clearer. But at this point in time, we really focus on Q4 and some of the adaptative measures that we believe we need to start in Q4 for the upcoming quarters.

But on the top line side, this is a bit what you described, including one part of the market that can still be affected on the side of the consumer, still opportunities on the professional side, but we'll see it clearer when we announce our results for the full year.

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

Okay. That's clear. But then maybe diving a little bit deeper on what you call out yourself, the energy-efficient solutions. How do you see that traction? Intuitively, it sounds logical that people would start to look at these kind of solutions. But how are you seeing that in your demand?

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

We see a good level of traction to a different level. So first of all, we are bringing to the market a lot of products with the new technologies when it comes from the LED light source. You've seen we call that the Ultra energy efficient. Basically, these light sources are saving up to 60% versus an existing LED solution. And we have done that with (inaudible) 0:45:25 on the consumer front. We've done that also for like sources on the professional part of the market. So this technology will help to do additional savings.

And with the price of energy today, if you can save 50%, the return on the investment for this solution is much faster than ever before. So we get a traction which is pure linked to this new technology not only compared to conventional but compared also to existing LED socket base.

On the other hand, where we see traction is on connected lighting systems for our professional customers. So for instance, infrastructure, which is street lighting and connected street lighting, we see a very strong traction, I would say, worldwide. We see also in retail spaces an increased demand from our customer that we provide a system, which would help them to monitor deem and switch off the lights of many different shops or supermarkets. That's a reality. And customers are today in a bit of a hurry because they want us to implement as quickly as possible in order to get the savings also as quickly as possible.

We see also that trend in the office space and in industry applications where everybody has an objective to try and reduce energy costs. So that trend is real and is happening. We have already counted for Q3, a substantial amount of projects and turnover coming from what we have called the green switches, both in Europe in the U.S. now extended to the rest of the world. And I think that this trend is even more increased by the price of energy because the return on investments are now getting much shorter. So yes, it's a reality from a technology standpoint, and it's a reality also from an energy-efficient lighting system standpoint.

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Operator

We will take our next question from Rajesh Singla.

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

This is Rajesh Singla from Societe Generale. This is regarding like if you can share some insights into the dealer channel inventory across your product portfolio, maybe across the business segments, that will be helpful.

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

Yes, Rajesh. Just a few elements. So as I've said previously, on the consumer side, we have seen in Europe and in U.S., the inventory going down. I've said some of the big customers that we have were at 3 weeks in inventory at the end of Q3. So that's very, very low compared to historical levels. So that's on the consumer channel. If we go on the professional channel, the biggest part of what we do goes through distribution. And our distributors are effectively maintaining on inventory. And we have seen that inventory also reducing during the period, not as much as what we have seen happening on the consumer side versus the historical base, but we have also seen. And I would say in Europe and in the U.S., our customers on the professional side, our distribution customers are reducing their inventory in Q3.

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

So any insight on the level of inventory on a related basis?

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

That's a bit more complicated because it's a much more diffused channels, and there's a lot of disparity across the point of sales, and I don't have an average that I can tell you because we haven't calculated that way. What we know is that the inventory has reduced also, although not as much as in the consumer channel, as I've said before.

Operator

It appears there are no further questions at this time. I'd like to turn the conference back to your host for any additional or closing remarks. Please go ahead, sir.

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

Ladies and gentlemen, thank you very much for joining our earnings call today. If you have any additional questions, please do not hesitate to contact Philip or myself. Again, thank you very much, and enjoy the rest of your day.

Operator

This concludes today's call. Thank you for your participation. You may now disconnect.

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