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LIGHT.AS - Q1 2023 Signify NV Earnings Call

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PRESENTATION

Operator

Hello, and welcome to the Signify First Quarter Results 2023. Today's call is being recorded. (Operator Instructions)

Today, I'm 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 first quarter 2023. With me today are Eric Rondolat, CEO of Signify; and Javier van Engelen, our CFO.

During this call, Eric will start to take you through the first quarter highlights, after which Javier will present the company's financial performance. Eric will then come back to discuss the outlook for the remainder of the year. And after that, we'll be happy to take your questions. Our press release and presentation were published at 7:00 this morning. Both documents are available for download from our Investor Relations website. The transcript of this conference call will be made available as soon as possible.

And with that, I will now hand over to Eric.

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

Thank you, Thelke. Good morning, everyone, and thank you for joining us today. So let's start with some of the highlights for the first quarter of 2023 on Slide 4.

largely in line with our expectations. We continue to see persistent weakness in parts of our business in the Consumer segment and in the Indoor Professional business. We also saw a continued slowdown in our OEM sales.

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At the same time, we made progress with our 2023 priorities, resulting in an improvement in our gross margin. As far as financials are concerned, comparable sales declined by 9.1%. The EBITA margin of 8.9% was impacted by lower fixed cost absorption as a result of the top line decline. Net income came in at EUR 28 million, and free cash flow was EUR 51 million.

On the next slide, Slide 5, which signifies overall Q1 performance. So as you can see, we have increased the installed base of connected light points from EUR 114 million in the previous quarter to EUR 117 million at the end of Q1. LED-based sales were 82% of total sales and nominal sales in Q1 were EUR 1.7 billion, translating into a nominal decline of 6.1% and a comparable sales decline of 9.1%.

Similar to Q4, the Q1 performance was mainly impacted by the continued softness in the consumer segment, a slowdown in the OEM channel. Lower sales in professional indoor lighting as well as a strong comparison base in some areas.

The adjusted EBITA margin decreased by 160 basis points to 8.9% versus 10.5% in Q1 last year. We structurally improved our gross margin, benefiting from our continued price discipline as well as measures to reduce COGS. On the other hand, the lack of top line resulted in an under absorption of fixed costs, while we also had a temporary impact from the unwinding of our previous FX hedging policy.

Net income came at EUR 28 million compared to EUR 87 million in Q1 last year. The year-on-year decrease is due to the lower income from operations and higher financial expenses, the latter due to the combined effect of higher interest costs and negative noncash fair value adjustments of our virtual power purchase agreements.

Finally, our free cash flow was EUR 51 million in the quarter, as said, a considerable improvement from the negative EUR 189 million in Q1 2022, mainly due to a lower cash outflow from working capital.

Now let's move on to our division, and we are going to start with Digital Solutions on Slide 6. Nominal sales in Q4 were EUR 951 million with comparable sales showing a decline of 8.7% against a high comparison base of 16.9% in Q1 2022. While the outdoor segment and especially the public segment continued to grow, we saw a more challenging indoor professional business, particularly in Europe and the U.S. and softness in the agricultural lighting.

The adjusted EBITA margin was 8.7%, a decrease of 100 basis points from last year, mainly due to an absorption of fixed costs and an adverse year-on-year currency impact. This was partly offset by gross margin improvements from price increases and COGS discipline.

On the next slide, Slide 7, I would like to discuss a couple of business highlights of our Digital Solutions division. So we have completed a large-scale smart city project in Huanggang City in China. For this project, we supplied nearly 200 BrightSites smart poles over 2,000 Philips LED street lights and the Interact connected lighting system. It is the biggest smart pole project in China. The BrightSites as Smart poles integrate security cameras, environmental sensors, WiFi and other devices to collect city data and enable remote management and data analysis, all within a secure network. The combination will reduce energy consumption by about 60% and operational costs by about 50%.

Next, I would like to highlight the launch of our new Philips StoreFlow retail lighting, interact retail, hybrid lighting controls and a range of luminaires made of waste materials. Indeed, Philips StoreFlow is made of at least 68% bio-based plastic, reducing the CO_2 footprint of the plastics by about 18%.

Let's now move on to Digital Products on Slide 8. In the first quarter, the Digital Products division saw a comparable sales decline of 10.1%. This was mainly driven by continued weakness in the consumer connected segment and in our OEM business. The adjusted EBITDA margin was 8.3%, compared to 12.8% in Q1 2022. The margin was impacted by lower fixed cost absorption and due to the volume reduction. This was partly compensated by pricing and mix.

Moving on to Slide 9, after the business highlights of digital products. We launched the Philips Hue Sync TV app for Samsung TVs. This app synchronizes Philips Hue Smart lights with Samsung branded TVs. It allows users to experience immersive and seamless light syncing in their homes when watching TV or playing games without having the need for a sync box. It is compatible with all TV content and video formats, including native apps.

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Moreover, from February 24, the restriction on Hazardous substances directive ban the placing of compact fluorescent nonintegrated lamps on the European market.

In addition, linear fluorescent lamps, T5 and T8 will be phased out as per August 24. In order to help our customers with a switch to LED, we extended the range of energy-efficient alternatives test alternatives provide energy savings between 45% and 70%.

Moving on to Slide 10 and Conventional Products. Comparable sales declined by 8.5% as further pricing partially compensated the continued volume declines. The adjusted EBITA margin recovered in 22.5%, an improvement of 650 basis points versus Q1 last year. In part, we have seen that the headwinds we saw in 2022 have turned into tailwinds and namely energy and transportation costs and FX.

In addition, we have taken measures to restore the margin. We implemented strong price discipline to offset cost pressures. We have taken further action to control costs, such as additional factory restructuring.

Finally, the division benefited from some onetime effects in the quarter, the largest being the reversal of a legal provision.

As a result, Conventional Products underlying profitability is back on its history to [old track].

Next, I would like to discuss our sustainability performance on Slide 11. The cumulative carbon reduction across our value chain is on track and to double the pace to the Paris agreement. This is mainly driven by energy efficient and connected LED lighting, which drive emission reduction in the use phase.

Circular revenues were 29%, stable versus the previous quarter, yet on track to reach the 2025 target. Circular revenues continue to be driven by serviceable and circular luminaires. Bright lives revenues constitute 27% on track to reach our 2025 target of 32%. The main contribution continues to be the consumer well-being and safety and security portfolios.

Women leadership position was 29%, an increase versus the previous quarter and on track to reach also the 2025 target. The improvement was mainly driven by the new external hires and the internal promotion of women.

I would now like to hand over to Javier, who will discuss our financial performance in more details.

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 EBITDA bridge for total Signify. As you noticed, we've decided to simplify our EBITDA bridge from absolute values to percentages, which we believe will better illustrate the actual effect of the different components on our EBITDA margin.

As you can see, the adjusted EBITDA margin decreased by 160 basis points from a strong base of 10.5% in Q1 2022 to 8.9% this year. This was driven by a large volume effect, leading to a 300 basis points under absorption of fixed costs. We were able to largely offset this volume effects through price increases, which contributed 220 basis points, cost of goods sold savings of 30 basis points and a slightly positive mix effect of 10 basis points.

In addition, the adjusted indirect cost savings had a positive effect of 30 basis points.

Currency still shows as a negative being the combination of a temporary cost of unwinding our previous FX hedging policy and the significant weakening of some emerging market currencies, mainly the Egyptian pound. However, please note that this negative effect is being recovered through pricing taken in order to maintain gross margin amidst strong currency devaluation. Finally, other effects were a negative 50 basis points and included, amongst others, the impact from acquisitions and some other one-off impacts.

On Slide 14, I'd like to zoom in on our working capital performance during the quarter. While sequentially, working capital continues to stabilize compared to Q1 2022, our working capital increased by EUR 58 million to EUR 617 million or from 7.9% to 8.3% of sales. Inventories did decrease

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by EUR 198 million year-on-year show the continued progress we have made over the past quarters to reduce inventory through improved demand planning and stricter inventory discipline. Receivables were EUR 96 million lower than Q1 2022 due to our continued efforts to keep our receivables levels healthy, obviously on a lower sales year-on-year.

Payables reduced by EUR 363 million returned to more normalized levels. We do remain confident we will return to our working capital to previous mid- to low single-digit levels, our supply chain lead times and delivery reliability continue improving.

On Slide 15, you can see our net debt and leverage evolution. At the end of Q1 2023, our net debt position was EUR 1.3 billion, a reduction of EUR 25 million versus the end of 2022. The lower net debt is mostly driven by our free cash flow generation of EUR 51 million in Q1, which benefited, as said, from a lower outflow from working capital.

Other had an impact of EUR 26 million and included the acquisition of intelligent lighting controls in U.S., new lease liabilities, derivatives and the FX impact on cash, cash equivalents and debt. Our net debt-to-EBITDA multiple increased slightly but remains at a comfortable level of 1.4x.

I would like now to hand over back to Eric for wrapping up with the outlook and some closing remarks.

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

Thanks, Javier. Let's conclude with the outlook on Slide 17. Given the structural improvements in our gross margin and free cash flow generation as well as our intensified measures to reduce fixed costs, we confirm our guidance for the full year. While we expect the remainder of H1 2023 to remain challenging. We continue to see the potential for an improved second half. For the full year, we continue to expect an adjusted EBITDA margin in the range of 10.5% to 11.5% and a free cash flow between 6% to 8% of sales.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

And our first question comes from Daniela Costa of 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 wanted to ask mainly on 2 things. The first one -- you obviously, you keep the guidance despite this still being a tough quarter. We have had sort of multiple tailwinds and headwinds that we have heard for the market. Obviously, we have the IRA's in the back end of the year. We have lower shipping costs, but we also have like credit tightening and a lot of news flow on (inaudible) . I was just wondering if you could guide us through how the cadence for the year and how your assumptions of like a stronger second half build up on the back of those items?

And my second question is just regarding maybe a subset on that. Can you talk through like where the results now, especially in digital products, do you think it's the result of mainly distributor destocking for your retailers and wholesalers? Is that done? And sort of like how underlying trends versus maybe that element of destocking play out in the results?

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

Yes. On the guidance and on the performance for the quarter, Look, we are at the end of the quarter very close to our own internal forecast. So when we look at how the quarter played there can be small differences here and there, but we are fairly close to what we expected. When we see the dynamic for the full year, we expect a Q2 that is going to be somewhat close to Q1 in terms of performance. We have also to remind that and Q2 last year were both high in terms of comparison from a bottom line perspective and Q1 was high from a top line perspective in terms of comparison base.

Now what we see and you have seen the numbers last year, H2 has been much weaker in bottom line because of the gross margin deterioration that we start to see from Q2 last year and being very strong in Q3 and Q4. And we had also, in Q4, a very we're going to have very low comparison base in terms of top line.

So at the end of the day, the very important element in Q1 for us, which was expected in the recovery first on the conventional business that has degraded substantially its performance. So we are back to historical levels. I would say if you [met] from some of the nonrecurring impact around the 20% that we used to achieve in general in terms of bottom line. So we are there. And the gross margin for the whole group has recovered. We're above 39%. It's an improve on the S, it's an improved also -- so strong improvement on an improvement on [CDP], not a lot of improvement on [DDP] for different reasons that we have briefly commented. So that's the way we see the dynamic.

In Q2 pretty much in line with Q1 and then an improvement in H2. Now if there is a massive degradation in the end markets, maybe the situation could look different, but we don't see that at this point in time. We are working on the gross margin, and we are working on our cost, our cost structure in order to achieve the guidance. And in the forecast that we have done in the past 2 weeks, we reviewed all our markets and all our businesses, and we are confirming that we will be in the guidance that we have indicated.

On DDP , DDP is mainly touched, I would say, by 2 negative impacts. So the first one is the consumer market, which is continuing to be slow. And I would say that it first started in some regions, expanded to others, but now we see a weak consumer market nearly everywhere. We are also impacted by China. So China for the whole group is also a negative contributor in Q1 and China, given the population is also a big contribution to the consumer market. So China is also a detracting point in the consumer exposure. The other element that you have in DDP , which is probably a bit newer is the OEM business. And the own business going has gone down for many different reasons.

So the first one is the end market on the professional side, especially indoor, which is weaker. The fact that our customers are destocking. So many of the OEMs when the shortage came in 2021 and partially in the beginning of 2022, they did they brought up the inventory, the build up inventory, and now they are destocking.

A third element in the OEM is that some of our big customers are insourcing more than what they did in the past. So at the end of the day, this is another negative element to the performance. So clearly, destocking is one of the contributor for the OEM business, but that's not the only one.

On the side of the consumer business, yes, we haven't seen restocking as we could have expected it. So the inventory of our retailers, whether they are online or off-line retailers is low, and they are more on the destocking mode and on the restocking move.

Operator

And we're now moving on to our next questioner, which is George Featherstone from Bank of America.

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

I'd just like to sort of come back a little bit on the digital products division. You talked for a while now about the weak consumer and also cited that destocking effect from third quarter last year. But then clearly mentioned at the same time, you are looking to sort of change posture on cost and look at the cost base to mitigate some of the trends. Clearly, the Q1 margin deterioration is pretty significant. So I just wondered when do you

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expect the mitigating steps to start supporting the margin in that division? Or is it a case that volume needs to stabilize before margins start to recur for [DP]. That would be first one.

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

Yes. George, so you have a few things in [DDP] for DDP is still comparing in Q1 to a very solid base in terms of margin because that business was very, very strong in 2021 and the beginning of 2022. So that's one of the first element. From a cost base standpoint, so we have given team mandate to the teams to be more frugal. We haven't launched massive restructuring plans yet. We still want to see where the volumes is going to lead us because if the volume stabilizes, as you have mentioned, if we can get a bit of positive traction because we know in a nutshell, and if you try to simplify the theme, consumers now are spending money traveling, which they haven't been able to do during the pandemic. They're investing in different types of laser investment, but not so much in goods. That will come back. We don't know when, but it will come back at one stage. So we hope today that the volume will stabilize and that we have cost actions that are going to be able to compensate in order to rebuild some of the operational margin that we have lost.

We have to understand that we were comparing ourselves also to a very high base for that business. Now when I look at it structurally, everything is in place, and we need surely top line to be able to increase further bottom line. But in the meantime, we're doing some corrective actions. There is probably also in that business, if you look purely at the consumer market for us, a mix impact. So we've seen quite a strong impact on the connected offers that have been declining a bit more than the rest, and that also has a negative mix impact on our gross margin and our profit.

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

And then I'd just like to explore the FX hedging or the FX movements a little bit more detail would be good to have some more color on the movements and whether you can talk about the sort of clear reasons why you've got an FX tailwind to revenues and a headwind to profit and then that was the new hedging policy ultimately entails and the isolated impact that adds to Q1 of switching that policy.

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

George, now it's a bit of a complex topic, but let's try to make it as simple as possible. Let's break it up as what you said from a pure currency movement, if you forget any kind of hedging from a pure currency movement, the impact is about mill between the U.S. dollar, which quarter-on-quarter still strengthened versus last year. The RMB that weakened versus last quarter. Last year Q1 and the hedging we have in place against the RMB. If you take that all together, currency movements and our regular hedging is about a zero-sum game. What you're left with is what we talked last time. We have changed our hedging policy because our hedging policy was covering kind of 15 months up to 15 months forward. In an environment which is very volatile, and we've kind of shortened that. And therefore, we have broken some of the hedges that we had taken. That basically that hedging, the closing of those existing previous hedges is in Q1, still giving us a negative, which is, I would say, about 40 to 50 basis points.

Now as we unwind those hedges throughout the year because we had them on 12, 15 months, that negative will turn to a full year positive. And that's something we know because we close the hedges. We know exactly at which price we close to hedges, but it's just the unwinding that takes us throughout the year. So that negative impact that we see on FX from hedging. The previous policy negative in Q1 will decrease in Q2 and will turn positive and completely offsetting the negative of Q1 in the rest of the year. The other part of the 90 basis points that you see in the bridge is the -- is mainly driven by the very strong devaluation of Egyptian pound. So the Egyptian pound, I think, devaluated about 80% versus last year. That gives us an exposure.

Now in the bridge it shows as a negative on the FX side, it does have a positive offset within pricing because in those markets where we normally face stronger devaluations we manage our pricing on gross margin and that the gross margin in those countries has been maintained. So there's an offset in pricing.

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So long story short, that negative has 2 components. A devaluation component on emerging markets, which will be compensated by pricing and it's got this onetime effect of temporary effect of FX hedging unwinding that will turn positive in the second half of the year. I hope it helps you understand better.

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

Yes, it does. I just wonder if I can, just to come back to that comment you made about the hedging becoming positive for the full year. So what kind of contribution do you have to your year-on-year margin guidance for the full year from the hedging?

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

On a full year basis, it will just be a slight positive. It's not going to be weak. It's going to be mainly compensating the negative of the first half to a positive in the second half. So you're going to have a second half benefit of what we've lost in the first half on a full year basis. It's not that the unwinding of the hedges will not have a significant impact on a full year basis.

Operator

And next, we have Andre Kukhnin of Credit Suisse.

Andre Kukhnin - *Crédit Suisse AG, Research Division - Mechanical Engineering Capital Goods Analyst*

Thank you very much for taking my questions. Can I just follow up on demand first and on the areas that you highlighted in the OEM business and consumer. How is the cadence through the in Q1. And how does April compare to that? I presume from your comment on Q2 being similar, you've kind of found the level and trending at that, but I just wanted to double check that, please.

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

Yes, Andre, we're not specifically talking about April, but that's how we've built our cadence for the year, think Q1 and Q2 fairly similar in terms of attraction and performance and then an improvement due to a lower base of comparison in H2. That's how we've built things. And so far, what we have seen in Q1 was pretty much in line with our expectations.

Andre Kukhnin - *Crédit Suisse AG, Research Division - Mechanical Engineering Capital Goods Analyst*

Got it. And my second question is on pricing. Could you talk about the pricing trends if we net out the effects of price increases to compensate for these currency devaluations, like you mentioned, the Egyptian pound. And also specifically related to that, how has pricing evolved for the new products that you launched recently. I think you had the kind of EUR 999 new level of efficiency [valve]. We've seen some a little bit of discounting, I think, end of last year, then it came back up. So I just wanted to check how pricing is holding up across the LED portfolio and also specifically for the latest product.

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

Yes. What you're mentioning on the ultra efficiency is more tactical pricing and puncture promotion. Look, when you look at pricing, we have effectuated a lot of pricing on conventional. Because conventional is also the business that was the most impacted by the increase of cost, namely energy and transportation. So what you see in the numbers when it comes to conventional is a strong contribution of price in the numbers that we're indicating, which is minus 8% decline. So the decline in volume is much bigger than that.

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Then there's a lesser contribution of price on [DDP] and even lesser contribution of price on DDP . But if you look at the volume decline, the volume decline is higher than what we indicated here because there's a bit of pricing in the 3 divisions. But the magnitude going down from [DCP] to DDP and to DDP .

Now from a pricing perspective on the digital divisions, what we wanted to do from the very beginning, it was only to price for what we thought was the structural inflation or the structural impact of the inflation. I think that, that strategy was right because we can now rebuild on our gross margin, as you see it, while we maintain a competitiveness from a pricing perspective. So the strategy was slightly different across the portfolio, but we believe it is the right one since we're rebuilding now to gross margin.

Andre Kukhnin - *Crédit Suisse AG, Research Division - Mechanical Engineering Capital Goods Analyst*

That's very helpful. If I may, just the last one on the conventional on that fluorescent product categories phase out in Europe. Could you give us an idea on the size of that, on those sort of categories for your business?

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

Yes. On fluorescent nonintegrated, which is the first ban in February,that has a very limited impact on our top line. When it comes to fluorescent T5 and T8 in Europe, it's a bit -- it's more important because that's one of the big technology we have in that business, the big remaining one. But totally manageable. What we have done in the meantime, we have started to when we've announced restructuring on our manufacturing plans. So this is what explains also that our restructuring costs are quite high for the quarter, and they are at least for a bit more than half linked to the conventional business.

So at the end of the day, we are doing what's necessary in order to compensate so that volume decline.

Operator

And now we're moving on to a question from Akash Gupta of JPMorgan.

Akash Gupta - *JPMorgan Chase & Co, Research Division - Research Analyst*

My first one is on the market share development in the last couple of quarters. If I take pricing out, then basically in both Q4 and Q1, your volumes are likely down low double digit. And maybe can you make a comment on whether you believe you have gained or lost market share and when we talk about competition versus Chinese, have you seen any increase in Chinese competition, especially after China reopening?

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

Good morning, Akash. So basically, when you look at competition and you listen to the announcements for the listed companies, they've all indicated that if there is growth, it's mostly coming from pricing. So if you try to match from that, we looked at the situation, we believe that over the past year -- it's complicated to do quarter-by-quarter because of the comparison base, which can be very different depending on the companies. But if we look at what has happened in the past year, and we looked at that in very detail, we believe that we haven't lost -- we haven't gained, haven't lost market share in the U.S. We believe that we may have gained share in Europe when it comes to the professional business.

On the Consumer business, we believe that market share was not lost. It's a market which is going down. And we've seen other companies also suffering from the low level of traction of the market. When it comes to the OEM business that we need to look at the numbers because they're quite recent that we only look at market share 1 quarter after the event. But the fact that some customers may be doing a bit more in-sourcing may mean a loss of market share on our side, although we've been very active trying to get other customers because we knew that this would

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happen. But we don't have sufficient information for me to tell you. But no loss of market share in what we see in [DDP] in general, and I would say, [DDS] as a whole across geographies.

From a Chinese competitors perspective, I think you may have seen that Chinese competitors have suffered a lot from what has happened in China, at least for the listed companies where we can see the numbers. We have seen a lot of small Chinese companies closing because of the overall situation. We've seen in the past quarter regained energy on the side of the Chinese companies in order to bring very competitive prices to the market. But without doing crazy things because the environment is not conducive for this to happen.

So no, we haven't seen today Chinese competition because of the reopening of the market being very, very aggressive. I think they have a lot of issues on the P&L and they have to fix that.

Akash Gupta - *JPMorgan Chase & Co, Research Division - Research Analyst*

And my follow-up is on cash flow and drivers for working capital. I think have, you mentioned that you aim to bring back to the previous working capital ratios when supply chain improves. Can you provide a snapshot on where are the supply chains at the end of the quarter and how much progress we still need to make further in order to go back to those previous working capital levels?

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

Yes, guys. Thank you. Look, if you take a high level of view again on total working capital, it mainly comes down to inventories and the payables dilution year-on-year. If I take you back about 9 months, you know that our inventory was about EUR 1.7 billion. And that was built up at the end of 2021 and the start of 2022. So that inventory was also paid for largely in 2022.

If we see where the situation is today, we ended last year at EUR 1.3 billion. We're still at EUR 1.3 billion. We still believe there's some room to go further down throughout the year. But as you said, it does depend on what happens on global supply chain.

On the global supply chain, we have seen throughout last year, an improvement of reliability of retention lead times. Interesting though, is that especially in Q1, we've seen a little bit more stress on replenishment lead times. Replenishment lead times have gone slightly up. And that's why we also see that the continuous decline of inventory is kind of a bit stalled now because our goods in transit have slightly gone up again. But again, I think that's only temporary because in general, the environment starts being much better in terms of lead times and reliability. And therefore, we are clearly focusing on getting our inventory further down throughout the year to a level which is more historical. So we think it's going to further regularize throughout the year. And hopefully, by the end of the year, we'll be in still a better position than where we are today.

Operator

And we're now moving on to Marc Hesselink of ING.

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

Yes. First question is on the moving parts on growth. I think the easier comparable basis is straightforward. But you mentioned the potential for the second half of the year. What can be tailwinds in that respect?

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

I think the comparison base we're going to have on the [DDP] and the Consumer business in the second half is going to be much lower than what we have in Q1 and to a lesser extent in Q2. And I think that's the case also for the professional market because we had seen at the time the indoor part of the professional market also starting to show signs of weaknesses starting in Q3, but even more in Q4.

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So at the end of the day, when you look at the compare, even if the market doesn't grow substantially, the compare will be much more favorable in the second half than the first half. That's why we talk about the specific potential.

Now there is another market, which is the public professional market, sometimes we can say also the outdoor professional market, where we see a good level of traction linked to the different incentives that are being put on the table today by not only Europe and U.S., but also in many other markets, we see incentives for energy-efficient solutions, and we can bring many to the table with a very fast return investment even more with now the new yield train technology, which is not only budged for the consumer, but we're extending that technology to our professional office.

So at the end of the day, there's a continued traction here on the professional outdoor public business. So these are the different growth trend and potential that we see in Q2 and in H2.

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

Okay. So clear. So it's mostly comparable base and then maybe in public, maybe some more. And then another item may be linked to this China reopening. Is there anything where you expect some team work in the second half of the year for you?

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

Yes, that's a very good question. I was in -- I finally went back to China for a full week a few weeks ago. So the situation is the following one. The market is clearly reopening. So we see that the potential is there. Now the cost of the Zero COVID policy has weighed a lot on the finances of municipalities and regions and provinces. So I mean they need to bring back some cash and reinvest. The projects are there. So there is clearly an ambition to launch very important projects on many different fronts, including infrastructure. We see a lot of projects being at this point in time brought to the table. Now what we don't know exactly is when this is going to happen. Is it going to be already in Q2 not to show because they need to rebuild their finances. But we see certainly a positive traction in H2 at this point in time. We think that it's a big economy, but it's a big economy that can go very, very fast, down or up and all the signals at this point in time,is for an as fast recovery as possible in China, at least this is a clear mandate in the country. So it's going to happen.

Maybe we're going to show -- we're going to see early signs in Q2, but we certainly expect H2 to be better. Just to note also that for us, China has been a double-digit decline in 2022. And it is our second biggest market. So at the end of the day, it has a clear impact, so it had a negative impact. It should have a positive impact in the second half of the year.

Operator

And we're now moving on to a question from Joseph Zhou of Redburn.

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

My first question is on your end markets. And then how are you seeing the end market element versus, say, 2 to 3 months ago perhaps by region. And obviously, there are a lot of concerns about U.S. commercial construction given the current regional banks crisis? And what are you seeing in reality in your orders and conversation with customers?

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

Yes. Look, at the end of the day, we cannot say that in the past 3 months, we have seen the situation improving. So when you look at the (inaudible) construction and the residential construction, we don't see a renewed traction probably that we have seen in the U.S. a further degradation. We talked to it, and we called what the indoor lighting market in the U.S. where we have seen lower traction in Q4 last year. It's continuing to be the case in Q1, which is linked to the recessive environment where we see customers waiting to invest, not investing most of the time as we used to

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say the projects are there. There could be a need to invest, but you see what is happening also on the U.S. market, and you see companies retrenching at this point in time, quite substantially. So that environment is not conducive for that market to get a positive traction.

On the consumer side, we see the consumers being -- market being shy and that has been the case in the past 3 quarters to 3.5 quarters. So (inaudible) and also the behavior of our retailers is indicating that.

The only traction that we see in U.S. and traction that we see in Europe, the traction that we see in the other markets is on infrastructure. And it's also, I would say, on the still on the industrial part of the professional market, which is more manufacturing plants and warehouses when we still see a positive traction.

If you were looking at our performance in Europe in Q1 in professional. It's a positive performance. So we have been able to perform quite well on the base of comparison, which is not extremely high, but which is decent. So we see continued traction, which is also really pushed by the incentives that in the Green Deal in Europe is providing to us. So that's a reality. We see it happening.

But as you can imagine, no real improvement in the 3 -- in the past 3 months, an environment which is still quite volatile, some geographies maybe technically in recession, maybe not saying it very clearly. But the recession is there somewhere, and we have to deal with it.

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

That's very clear. And then just on the European florescent ban on which happened in February, but there's a bigger ban later on in August, September. Can you maybe talk a little bit about the impact on your LED business? Obviously, the fluorescence installed base is pretty large in Europe, but then at the same time, these products are also pretty durable compared to incandescent and halogen, et cetera? And do you expect some boost in your LED business? Or do you expect kind of a much slower replacement cycle for the existing fluorescent installed base?

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

So we see -- and we have already started to see and we will see the last buys, first on the conventional business, which is going to improve the top line of the conventional business. It has already happened for CFLi but it will also happen for fluorescence in the coming quarter because the ban is happening later in the year. So that's the impact on conventional. We see already a positive impact on -- LED if I was looking at [DDP], the LED light and luminaire business is having a positive traction, which is indicating that well, customers are going more and our distributors are going more for LED, anticipating the ban. We have developed, as I was saying in my introduction, specific technologies to replace specific products, LED products to replace the products that are going to be banned, and we see a good and positive traction on the LED side given this.

And here, we're talking more when we talk about fluorescent tubes, it's more on the professional side of the market than on the consumer side of the market.

Now the other positive element for us is that we have been able to also adapt the ultra efficient technology to fluorescent tube, which is going to give an additional incentive for customers to go for it, given the additional energy efficiency that this is bringing.

So a positive impact before the ban on conventional, but also a positive impact on LED as customers now are transferring faster to LED given the ban.

Operator

And our next question now comes from Wim Gille of ODDO BHF.

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Wim Gille - *ODDO BHF Corporate & Markets, Research Division - Analyst*

I actually have 2 questions. First, you mentioned during the Q&A that the impact -- the one-off impact that you mentioned on the adjusted EBITDA of the hedging was about 40 to 50 basis points in Q1. So is it fair to say that the impact or excluding this impact, your adjusted EBITDA would have been EUR 8 million higher in Q1. And can you give us a bit of feeling in absolute terms what the trajectory will be throughout the rest of the year as you would recoup those of that impact.

And the second is a bit of a follow-up on the fluorescent lamps and the hallogen bulbs that are going to be banned in August and September. You mentioned a positive impact on the conventional business. I assume this is related to the fact that you're clients are stocking ahead of the ban, being able to basically supply their end customers for still more further. Can you quantify that forward buying for us in terms of absolute numbers? And also, what is the size of the business, particularly on the florescent tubes.

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

The numbers are slightly lower than what the impact of the hedge unwinding in Q1 it's between EUR 4 million and EUR 5 million. And again, as I said, we're probably still going to see a slight negative in Q2, but then completely offset in the second half of the year. So swing from half 1 to half 2 (inaudible) product kind of plus -- sort of from a minus 6%, 7% to probably a plus 7%, 8% in the second half. That's kind of the order of magnitude that we are talking about to Q1, Q2 and that will happen in the second half of the year.

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

On your second question, yes, you're right. stood ahead of the ban, and that's what happens in general, when there is a ban. In terms of absolute size, especially on the fluorescence side, it's clearly more than on the nonintegrated fluorescent technology. Look, we don't give absolute numbers, but you need to know it's totally manageable within the environment that we're in. We know how to manage these bans and these reductions. It's already all is planned, not only for the last buys of our customers, but for the ramping down of the factories that we need to effectuate in order to adapt our costs. So all is done and launched as we normally do it.

Operator

And our last question for today comes from Sven Weier of UBS.

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

The first one is on the IRA, and I was just wondering, Eric, is there anything more you need to do in terms of moving maybe an assembly of production to the U.S. to qualify for the credits? That's the first one.

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

So there are many different incentives that we see in the U.S. So let me tell you the one that we see impacting us pretty much directly and probably fast is the Infrastructure and Investment Job Act, IIJA. So here, we see a funnel being built up. So it's more infrastructure investments. So that's one element.

On the IRA, it's been there for a long time. It's not as obvious, how we're going to benefit from that. We believe maybe more on the consumer side that there is a potential for us to do something there, and we are contemplating possibilities. Then there is the build in America objective. So we are sizing the opportunity at this point in time. You may know that recently, this has been put on the back burner because the conditions and to be able to comply with what was, firstly, [edicted] was very complicated for the actors on the market. So I think this is being revised at this point in time. But we have plans in some of our factories for indoor and outdoor business on how to comply. And we believe that we are better placed

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than most because we still have a substantial part of our industrial base, which is in the U.S. So we have selected the plants that would be eligible for the build in America. So we're doing everything as we speak. Frankly speaking, I see it as a positive element for us and an opportunity if we do the right things, and we're working on it.

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

Second question I had, Eric, was on the impact of the volatility in electricity prices because, obviously, last year, been moving up a lot, providing an incentive to from conventional to LED. Now it's the opposite. I mean what's the impact? Is that causing irritation especially among your energy-intensive clients on horticulture. Is that also having maybe not so good effect on the top line momentum at the moment?

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

So if you talk specifically about horticulture, it has been a big issue for us. First of all, our customers well stopped investing because the price of electricity and the price of energy in general was such that those business could not be run profitably. We have even some extreme situations, but they are quite numerous, where some of our customers had a contract that was partially variable and partially fixed. So 50% variable and 50% fixed in how they were buying energy.

So they basically stopped 50% of their production, and they continue only with the 50% where they had fixed prices.

We've seen also some other customers in the horticulture segment that stopped producing the goods, whether it was flowers or vegetables and used the fixed price that they had on the energy purchases to resell that energy to others when they prefer to make that business rather than the traditional one. What we see in the market at this point in time, the price of energy and the cost of electricity has gone down to levels that would ensure to these customers that they can run the business profitably. But the volatility that we have seen in the past quarters is leaving them to be very cautious.

So the projects are there, the projects are lined up. But I think that at this point in time, there's still cautiousness in investment, and we see agriculture at least in Q1, being again, a quite substantial detractor in our professional business. And we'll see what the future brings.

In the midterm to long term, that business will go back up, we need to find a substitute to ensure food security. So there's absolutely no issue directionally when it comes to that business being a strategic one. But in the meantime, we have seen customers hesitating a lot and not investing given the volatility of the energy prices in the past quarters.

Operator

Thank you. And that concludes today's Q&A session. So I'd now like to hand the call back for any additional comments or closing remarks.

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. And again, thank you very much, and enjoy the rest of your day.

Operator

Thank you. That concludes today's call. You may now disconnect.

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