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LIGHT.AS - Q2 2020 Signify NV Earnings Call

EVENT DATE/TIME: JULY 24, 2020 / 7:00AM GMT

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PRESENTATION

Operator

Ladies and gentlemen, welcome to the Signify Second Quarter and First Half Year Results 2020. (Operator Instructions)

I would now like to give the floor to Rogier Dierckx, Head of Investor Relations. Mr. Dierckx, please go ahead, sir.

Rogier Dierckx - *Signify N.V. - Head of IR*

Good morning, everyone, and welcome to the Signify Earnings Call for the Second Quarter Results 2020. With me are Eric Rondolat, CEO of Signify; and Rene Van Schooten, CFO. Javier van Engelen, who has been appointed as our new CFO and who will take over from Rene Van Schooten as of the closure of Q3 in October, is also joining us today.

As a reminder, at the beginning of this year, we have announced our intent to adapt our business structure to enable a stronger customer focus and enhance specialization to further increase execution speed. As part of this change, we have moved to 3 divisions: Digital Solutions, Digital Products and Conventional Products. We have adapted our segment reporting accordingly as of this quarter. For the historical comparable figures for Digital Products division, we would like to refer to the IR notification that has been shared with you on June 11, 2020.

In a moment, Eric will take you through the second quarter business and operational performance. Rene will tell you more about the financial performance in the second quarter, and Eric will end today's presentation with the highlights of the first half of 2020 and the outlook. After that, we will be happy to answer your questions.

Our press release and the related slide deck were published at 7:00 a.m. CET this morning. Both documents are now available for download from our Investor Relations website. A full transcript of this conference call will be made available as soon as possible on our Investor Relations website.

With that, I will now hand over to Eric.

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

Thank you, Rogier. Good morning, everyone, and thank you for joining us today. I propose that we go immediately to Slide 4 with the main elements of our performance in the second quarter.

The installed base of connected light points increased from 61 million in Q1 to 64 million in the second quarter of 2020. Our total sales decreased by 0.6% to EUR 1.5 billion or by minus 22.5% on a comparable basis. LED-based sales represented 80% of total sales compared with 79% last year on a pro forma basis, including Cooper Lighting and Klite.

We continue to make good progress on reducing our cost base. Excluding the impact of currency movements and changes in scope, our adjusted indirect costs decreased by EUR 86 million, a reduction of 19.1%. Our adjusted EBITA margin remained stable at 9%, including a negative currency impact of 60 basis points. Our net income increased from EUR 50 million last year to EUR 81 million for this quarter mainly as a result of lower restructuring costs and a onetime noncash tax benefit from changes in the organizational structure.

We are also pleased with our free cash flow of EUR 158 million, which reflects maintained profitability and strong working capital management, the consolidation of Cooper Lighting, and it also includes a EUR 40 million temporary positive impact from real estate proceeds and government-extended payment terms for taxes.

Let's now move to Slide 5 where you can see a snapshot of the financial performance of our growing profit engines, namely the Digital Solutions and Digital Products divisions. Comparable sales of the growing profit engines declined by 21.9% due to the spread of COVID-19 and the subsequent measures taken by governments but also by our customers. Despite the decline in top line, the growing profit engines have improved the adjusted EBITA margin by 100 basis points to 9.5%, with both divisions improving their profitability driven by an increase in gross margin and indirect cost savings.

Let me now provide you with more details for each of the divisions starting on Slide 6 with Digital Solutions. Nominal sales increased by 23.6% as a result of the consolidation of Cooper Lighting. Comparable sales declined by 22.4% and reflects a significant decline in demand across all regions as a result of the COVID-19 impact. The most severely impacted markets were Canada, India, Southeast Asia, France and the U.K. LED-based sales accounted for 91% of total sales, and connected-based sales represented 18% of total sales, excluding Cooper Lighting at this point in time. The adjusted EBITA margin increased by 80 basis points to 9.6%, which was driven by an increase in gross margin but also indirect cost savings.

On the next slide, Slide 7, you can see some of the business highlights of this quarter for Digital Solutions. I'd like to zoom in on our partnership with the New York Power Authority supporting smart street lighting in the State of New York. So this project was effectively launched in 2018 by Governor Andrew Cuomo, and it aims at replacing at least half of the more than 1 million street lights in the State of New York with energy-efficient and sustainable alternatives.

Reinforcing our leadership in connected street lighting, Guidehouse Insights, which was formerly known as Navigant Research, again recognized us as the leading company in smart street lighting. While at the same time, DEKRA has awarded us with its security certification, confirming that our connected lighting systems are based on a certified secure development process. We're the first lighting company that has been awarded with such recognition.

I also like to highlight a new innovation that we launched, inspired by nature and called NatureConnect.

Okay. I propose that we move to Slide 8 where we're going to talk about Digital Products. Comparable sales declined by 21.1%. LED-based sales accounted for 98% of total sales, while connected-based sales represented 14%. Overall demand was significantly impacted by the COVID-19 pandemic. The most severely impacted markets were North America, India, France, Spain, U.K. and also Southeast Asia.

Online sales in the consumer channel showed a solid performance, and sell-out rates for connected home lighting remained strong. The adjusted EBITA margin improved by 110 basis points driven by positive mix impact, reduced price erosion and improved cost structure in connected home lighting.

There are a couple of business highlights that I would like to bring to your attention on Slide 9. So first of all, we introduced our Philips Hue portfolio in Russia and providing Russian consumers with the full breadth and depth of the Philips Hue portfolio, including bulbs, fixtures and dimmer switches, lightstrips and sensors. At the same time, we expanded our Philips Hue product portfolio. This includes the new Philips Hue White bulb with output doubled to 1600 lumen. We added the Bluetooth-capable Philips Hue White ambiance indoor range and new products such as a new family of indoor ceiling fixtures and adapted the Philips Hue lightstrip.

And in the emerging markets, we launched the Meson Interlaced Optics, whose double-layered optic design with micro lens produces even light distribution and reduces glare, and as such, reinforces our EyeComfort proposition.

I propose that we now move to Slide 10 to discuss the performance for Conventional Products. Comparable sales declined by 25.2%. The division showed a solid performance partly as a result of strong demand for UV-C and horticulture lighting. We believe that the decline in sales is lower than the overall market decline resulting in continued market share gains. The adjusted EBITA margin remained robust at 17.5%.

Let's now turn to Slide 11 to talk about our investment in UV-C lighting. So let me start with saying that Signify is leveraging more than 35 years of expertise in UV-C lighting to address the growing global need for the disinfection of air, surfaces as well as objects. Our UV-C lighting is well-proven and trusted as an efficient disinfectant. This was recently validated in a laboratory test by the Boston University showing that the Signify UV-C light sources inactivate the virus that causes COVID-19 in a matter of seconds. To complement our portfolio, we have recently acquired the asset of Germicidal Lamps & Applications, also called GLA, a Netherlands-based company with upper room air disinfection luminaires. We have also expanded our portfolio with 12 new families of UV-C-based products for air, surfaces and objects for professional markets and are increasing our UV-C light and source production capacity by a factor 8 this year.

On the right, you can see a picture of GLA's disinfection product with lamellas directing the light upwards.

On Slide 12, you can see an update on the integrations of both Cooper Lighting and Klite. So let me start with Cooper Lighting. We continue to anticipate cost synergies of more than USD 60 million per year to be achieved over 3 years. But we managed to accelerate the cost synergies that were planned for the first year. The bill of material savings remain ahead of plan, sourcing optimization is also ahead of plan, and the savings from supply chain are on track. We achieved significant cost avoidance from shared service centers and also identified additional revenue synergies doubling the original objective.

Also, the integration of Klite is well on track. The supply chain of Klite is fully operational again, while sourcing synergies are on track. People and system integration are complete, and insourcing plan is also ahead of what we had originally planned.

Regarding the sales to third, we see continued loyalty of existing customers of Klite, and we are capturing also new customers.

This is what I wanted to cover regarding the business and operational performance. I will now hand over to Rene, who will tell us more about the financial performance for the second quarter of 2020.

René Van Schooten - *Signify N.V. - CFO & Member of the Board of Management*

Thank you, Eric.

Let's go to Slide 14, where you see the adjusted EBITA bridge. The adjusted gross margin as a percentage of sales increased by 90 basis points in the second quarter of 2020, including a currency effect of minus 50 basis points. The impact of price on the gross margin was significantly lower than in preceding quarters as a consequence of easing of price erosion. This was manifest in both Digital Solutions and Digital Products. Price erosion in LED lamps and electronics continue to slow down, while we have been able to selectively increase prices on part of our portfolio.

Our indirect cost base decreased by EUR 86 million compared with the second quarter in 2019 when excluding the impact of ForEx and changes in scope as a result of the acquisitions of Cooper Lighting and Klite. The overall ForEx impact on the adjusted EBITA margin was minus EUR 8 million. Scope and other includes the effects of Cooper Lighting and Klite acquisitions.

On Page 15 or Slide 15, you can see the quarterly development of our indirect cost base. We have made good progress again on further reducing our indirect costs. At a very early stage of the COVID-19 outbreak, a broad range of mitigating actions were identified to preserve profitability. Furthermore, we benefited from the carryover effect for many initiatives that we implemented last year and in the first quarter. As said, this has resulted in indirect cost savings of EUR 86 million in the second quarter, excluding the effect of currencies and changes in scope, of which EUR 30 million were related to nonstructural cost savings because of solidarity measures and government support. We had a positive currency impact of EUR 3 million. Hence, our adjusted indirect costs were EUR 360 million, excluding scope additions. By adding EUR 108 million coming from scope effects related to the Cooper Lighting and Klite acquisitions, we ended with total adjusted indirect cost of EUR 468 million. We continue to work on initiatives that will further decrease the indirect cost base. We will stay on top of what's happening around us and adapt our cost base as soon as we see things happening.

Let's now take a look at working capital in the second quarter of 2020 on the next slide, Slide 16. When we include Cooper -- when we include sales of Cooper Lighting and Klite on a 12-month pro forma basis, working capital decreased by 170 basis points to 6.3% of sales in the second quarter of 2020. The improvement was mainly driven by agile inventory management and active monitoring of receivables and payables.

Let's now take a closer look at our net debt position on the following slide, Slide 17. Since the end of Q1, Signify's cash position has increased by EUR 102 million to EUR 1.26 billion at the end of the second quarter. Net debt decreased by EUR 104 million.

Next, to the profit we generated in the quarter and the changes in working capital I just mentioned, you can see other items in the bridge that impacted cash and therefore our net -- our debt position. Net CapEx was EUR 5 million in the quarter and included EUR 20 million of proceeds from the sale of real estate. The net change in provisions amounted to EUR 23 million. Next to that, we paid EUR 30 million for tax and interest. All in all, our net debt position amounted to EUR 1.706 billion at the end of the quarter. This represents a net leverage ratio of 2.45x, coming down from 2.7x at the end of Q1.

Before I hand over to Eric, I would like to inform you about our FX outlook. Based on the prevailing spot rates at the end of June 2020, the currency impact on the adjusted EBITA margin for Q3 2020 is expected to be neutral, around minus 10 basis points for the full year 2020.

Let me now hand back to Eric for the final part of the presentation.

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

Thank you, Rene. Let me now briefly zoom in on the overall performance of H1 on Slide 19. So despite the impact of COVID-19 on the top line performance, we have been able to improve our adjusted EBITA margin by 10 basis points to 8.5%, which includes a negative impact from currencies of 30 basis points compared to the first half of 2019. We are very satisfied with the continued savings on bill of materials and indirect costs. As you can see, our currency comparable indirect costs decreased by EUR 141 million, which is a reduction of 15.5%. We had a significant underlying improvement in our free cash flow in the first half of 2020, also when taking into account the EUR 40 million positive impact related to delayed tax payments and real estate proceeds.

On the next slide, Slide 20, I would like to give you an update on the progress we made on our sustainability targets. For the first half of 2020, sustainable revenues represented 83% of the total revenues of the company, exceeding our 2020 targets of 80%. We sold already 2.6 billion LED lamps and luminaires in the period from 2015 to the first half of 2020, well ahead of our commitments to deliver more than 2 billion LED lamps and luminaires by the end of 2020. We have also decreased our waste to landfill by 89% compared with last year, and we are ahead of our targets related to a safe and healthy workplace and a sustainable supply chain. We are very pleased that we have reduced our carbon footprint by 26% compared with last year and are well on track to achieve carbon neutrality this year. Furthermore, we have announced that we will start phasing out plastics with the aim to be plastic-free on all consumer-related packaging in 2021.

Last but not least, let me share our excitement and my personal excitement that our new sustainability targets as part of our next 5-year program will be announced in the second half of 2020 with even more ambitious commitments.

So let me now go to the final slide of my presentation, Slide 21, to discuss the outlook. So considering the persistent uncertainty about the future course of the pandemic and also the length and depth of the impact on the global economy, we still do not provide financial guidance at this point in time. However, we are confident in the underlying resilience of our businesses and operating model, and that our liquidity needs are well covered by the financial framework we have in place. In line with our policy to prioritize future deleveraging, we, therefore, confirm our intention to utilize up to EUR 350 million to reduce gross debt in 2020.

I would like to conclude this presentation by saying that I'm very satisfied with all the measures we've taken to protect the health and safety of our employees and the people around us while preserving profitability and cash flow. I believe that all these measures will help us to strengthen our market positions to come out of the crisis stronger.

With that, I would like to open the call for questions, which Rene and I are going to be happy to answer.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Daniela Costa from Goldman Sachs.

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

I'll select just one, and then I'll get back on the queue. But I hope you're all well. Maybe I'll start by asking regarding your project business and what are you observing in terms of like project visibility for the second half and into 2021, if you can comment on what's the tendering outlook maybe there.

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

Yes. Daniela, so it really varies across the world. As you can see, the intensity of the lockdowns really vary across geographies. What we see at this point in time, and I'm going to take a general statement that I'm going to go to more precise details. So first of all, we see worldwide that the big projects are still on, very often also supported by stimuli from local governments. Where we have seen also an impact is on the medium-sized projects that are sometimes canceled or sometimes further delayed. We have been securing for the second half of the year major projects in street lighting in Middle East, and we're very happy about that. These are projects we've been working on for a long time. And if I talk to you about those projects, because they're quite material, and they will be partially invoiced before the end of the year, and there's a substantial part of these projects that are going to be invoiced in the second part of the year.

But from a project standpoint, what we see still moving are the infrastructure projects, street lighting moving on, and we see also opportunities in connected lighting. When I look at our Professional business, the systems and services part of the business in terms of comparable sales growth has done much better than the product part of the business.

Operator

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

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

It's Martin from Citi. Just a question on Cooper. It does look like the profitability is certainly better than expected externally. You have mentioned that some of the synergies have been pulled forward. Can you just give a bit more color on what's happened there? Has the underlying market been perhaps less bad in the U.S. than it has been elsewhere? Or is this really being driven by a big acceleration of the synergies that you had already planned?

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

Yes. Martin, well, you've seen the situation as well as we do. We've been impacted in the U.S. market, which -- the U.S. market is sometimes complicated, defined as an overall market, because they are very different trends. Whether you are in the State of Georgia or you are in the State of New York or California, many different things and many different conditions apply. But at the end of the day, if we go and look at the Cooper situation, what we decided when the crisis broke was to spend more time, more energy, more resources on accelerating the synergies. And we have 2 types of synergies, the back-office synergies, the famous EUR 60 million that we've commented about. We still believe that this is the target we have to achieve over the coming 3 years. But what is happening at this point in time is that we're going to generate substantially more at the end of the first year. So we clearly have accelerated those synergies, specifically on the sourcing part of the business, but also on generating bill of material savings. And that has been a fantastic performance of our teams in Q2. So that's on the back-office synergies. On the front-office synergies, we've been able, since we work together, to identify additional front-office synergies, and we believe that we can double the number that we had originally planned. So as you can see, the integration is really taking place. From a system standpoint, from a people standpoint, it's running extremely well, but we've been able to accelerate synergies.

When I look at Cooper and I compare our performance against the business plan, we are declining, of course, much more than what we had anticipated in the business plan from a top line perspective because of the COVID-19 crisis. But at this point in time, at the end of H1, and we believe we're capable to sustain that performance until the end of the year, we are generating, from a profit perspective and from a cash perspective, the same amount in absolute value than the ones we have in the plan.

Operator

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

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

I have a question on the strong price performance you mentioned in the quarter and the spread you basically managed to achieve between sourcing pricing and sourcing costs relative to your own pricing. What part of that improvement in price is something you think will continue as maybe price pressure normalizes and LED matures a bit in terms of technology? And what is more specific to a quarter where, obviously, everybody was kind of trying to protect their profitability and maybe competition in that sense was different than in a normal quarter?

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

Yes. I think you've basically answered to the question, Andreas. It's -- on the one hand, there's less cost that you can extract from a technology which is becoming mature. And on the other hand, when the volumes are going down worldwide, we've seen much less aggressivity in pricing than during other periods. And it's also linked to the fact that if you have a top line which is going down and if you bring your margin down and bring your price down, it has a major impact on profitability and then a major impact on cash. So at the end of the day, we've seen a much more rational behavior, I would say, during that period of COVID-19 crisis.

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

And is that continuing now when you look at projects you're bidding for now? Or was that just a short-term impact during the lockdowns?

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

Well, it's not only on projects, Andreas. It's also on product sales on a regular basis. We believe that we are in a period which is very complicated for many companies and probably many actors and many competitors in the lighting industry. We're working on thinner margins, so they need to apply a very rational strategy when it comes to pricing. So if we look at the upcoming months, I believe it's going to continue for a while until we really exceed that situation and we go into a more normalized market situation. I think that this is something that we have to continue to expect.

Operator

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

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

I was hoping you could give us some color on how the quarter has actually developed from April to June, and maybe how we should think currently on the current trading in July versus June. That's my first question.

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

May was better than April in revenue, and June was better than May from a comparable sales and growth perspective. So we've seen a sequential improvement during the quarter as we had originally estimated it.

Now the problem, Lucie, is, can we really count on our exit rate to understand what's going to happen in the next quarter? Well, at this point in time, for us, Q3 is a bit different than Q2. If you listen to what people say, they are expecting a sequential improvement in Q3 and then in Q4. And this is what we have based our hypothesis on at this point in time. So we should see sequential improvements, both in Q3 and also potentially in Q4. But at the end of the day, we need to understand that the situation is extremely volatile, and the level of uncertainty remains. If you look at Q3 specifically, September is a very important month in Q3 because it's clearly the biggest one of the quarter. And who knows what is really going to happen in September when you see the rate of infections going back up. Is this going to be followed by further lockdowns in economies? Well, we don't know at this point in time. So we need more than ever to be adaptable and to show a great level of agility, what we've been able to show in Q1 and Q2. But we are more optimistic at the beginning of Q3 than we were at the beginning of Q2.

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

And if I can have a follow-up on the Cooper synergies, please, following Martin's question. I guess if you are kind of well ahead on the cost synergies, do you think there is scope for you to maybe actually exceed those after the 3-year period that you have set for yourself? And you were mentioning the front-office synergies to be potentially the double of your initial objective. Are you able to quantify those as well, please?

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

Yes. We've communicated only on the back-office synergies, Lucie. So the EUR 60 million, we don't see -- after 3 years, we don't see us doing much more than the EUR 60 million. But we're going to accelerate the delivery of those synergies across the period. What we see clearly is our capacity to double the front-office synergies. We didn't give a specific number about those, but it's quite interesting. So we are also generating more than what we were expecting in the first year and year-to-date. But we have lined up many actions, up to 100 actions of potential front-office synergies. And we, at this point in time, implementing the priority ones. And it's working, and it's working extremely well. So back-office synergies, not really more than what we had originally forecasted, but we're going to accelerate and generate it faster. And for the front-office synergies, not only we can do more, but we will also do it faster.

Operator

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

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

My question is on the cost savings, quite some impact on temporary measures in the second quarter. And you also elaborated in the press release on additional cost savings for the second half of the year. Could you maybe talk about the differences between temporary measures that you're going to take in the second half and some of the structural things that will continue to come through in the second half?

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

Marc, so if you remember, we said that Q2 would be a very specific quarter because we were seeing a major impact on our top line. Well, it has been the case, 22.5% CSG decline for the quarter. So we did implement some temporary measures as the solidarity. We ask our people to voluntarily participate to working 1 day less during the quarter. So that's 20% less, which is pretty much in line with the decline of the revenue of the company. And by doing that, they were also accepting to have a reduction of the salary pro rata.

So that has happened. Many people participated. We've commented last time, 80 -- about 85% of our population worldwide voluntarily participated in the scheme at various levels.

Now we are recording in Q2 when we take into account that initiative and the government help ahead of EUR 43 million on the cost, EUR 13 million on the cost of goods sold and EUR 30 million on the non-manufacturing cost. So that's what we wanted to indicate to you guys so you could understand what had been the impact of these specific and non-recurring measures in Q2. These measures are not going to be conducted again in Q3. In Q3, we are going to continue with our extreme discipline and rigor on cost, which is what we had implemented also successfully in Q1, which is about really targeting discretionary costs, making sure that we stop projects that may not deliver the expected benefits because of the situation from an economical standpoint and also re-allocate money where it matters. We've been continuing to invest quite heavily in our digital transformation and also in new technologies and namely UV-C lighting that we've commented about previously.

So I would say that the upcoming quarters are going to be looking a bit more like Q1 versus Q2, which was impacted by those very specific and temporary measures.

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

Okay. It's clear. And then maybe as a follow-up, in your outlook, you mentioned the underlying resilience of the business model. And I think that was very clear in the first half of the year, with the margin more or less flat or even slightly up. Is that the kind of resilience that you then -- what you mean with that comment in the outlook statement?

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

Yes. Well, absolutely, because we've declined by 25%. But at the same time, we've been able to maintain the operating margin. So that's one level of resilience. The other one is probably what we've been able to do with our teams. For us, protecting our human capital, as I've said also since the beginning of January, is our #1 priority. I think we did that well, making sure that we were protecting the health of our people at different levels. I'm talking about physical health. And we successfully implemented very stringent measures in all the locations that we occupy worldwide. We really had a very good follow-up of those measures by all our employees. But at the same time, it's also about mental and psychological health. So we managed during the crisis to keep the people connected together. We managed to bring a high level of motivation in a space of uncertainty. At the same time, when we measure our Employee Net Promoter Score, which is the index of employee satisfaction, at the end of Q2, it is the highest ever with a very high level of participation because 85% of the population has been participating. So these are very good signs.

And also, we did decide at the beginning of Q2 or probably during the end of Q1 that we would not be laying off because of COVID-19 in order not to bring to the society more problems and in order not to put people in the street when it's very difficult to find a new job. And I think we have been able to be extremely resilient also from a human capital standpoint. And I think it's extremely important during a crisis. You need to make sure that your teams are onboard. You need to make sure that your teams are motivated. They may be not only professional but personal complicated situation, and we need to find a way to address that. And it's never perfect. But I think that what we did during Q2 was quite good and helped us to show that level of adaptability and agility, which led up to quite a strong level of resilience in our financial performance.

Operator

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

George, your line is open. If you could please put yourself off mute?

George Featherstone - *BofA Merrill Lynch, Research Division - Research Analyst & Associate*

Apologies. Can you hear me now?

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

Yes, George.

George Featherstone - *BofA Merrill Lynch, Research Division - Research Analyst & Associate*

Sorry. Sorry for that. On the UV-C demand and product portfolio, can you provide any color on the size of the market opportunity and how we should think about the R&D and other investment required to bring the products to market?

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

So first, let me take it by part. What we've been producing in the past 35 years are the light sources, so these are the lamps that emit UV-C light. And it's a technology that we master, but it's also a technology which is quite sensitive in terms of quality because we need to produce a very, very pure and high-quality glass, and we know how to do this. So we've seen that part of the business growing multifold in the course of, I would say, with the second quarter, Q2. And we have estimated this will continue at a very high pace until the end of the year. So in order to be able to answer to that increasing demand, we have made a few commitments. So the first one is to increase our production capacity by factor 8, and this is happening in 3 steps. One step, that has already been done. There going to be a second step in September and a third step at the end of the year. And in the beginning of 2021, we are going to have an increased capacity by factor 8 versus what we originally had.

But what we're also doing, we're not only selling light sources, we're developing also range of luminaires. And that's also important for us because it generates much more turnover. And we are bringing to the market new offers in terms of luminaires. So when I say luminaires, it's in the broad sense. We have effectively fixtures for disinfecting the air and disinfecting surfaces and objects. We have also robots, and we have also UV-C chambers where people could put different types. It can be things, different types of things, it can be food, it can be tools, it can be clothes that have been tried by people and so on in order to have them disinfected. So 12 new families of products are going to be launched before the end of the year.

We also acquired a company in The Netherlands. That company is called GLA, and it is specialized with a very dedicated portfolio for upper air disinfection, meaning that the light looks upwards, as you have seen on the picture I was describing previously, and it cleans the air by convection. This is a part of the portfolio that we didn't have. So we acquired that company to acquire that portfolio, which we are now expanding worldwide.

So as you can see, we believe in that business because it is a preventive measure. So it is necessary during the crisis, but we believe that this will survive the crisis. We would want to live in spaces, whether it is in schools, retail spaces, office spaces, manufacturing plants, warehouses, hospitals, we would want to live in spaces that are free of germs and viruses, and we know that our lights are very efficient to eradicate viruses.

So this is everything that we're doing on UV-C, and we see an interesting perspective ahead, increasing our capacity, but also moving to our luminaire business, which is attracting more turnover.

George Featherstone - *BofA Merrill Lynch, Research Division - Research Analyst & Associate*

And maybe a follow-up on kind of the end market trends that you're seeing from a regional perspective. Can you give a bit more color on what you're hearing from your Digital Solutions customers in terms of activity levels in Europe and the U.S. and perhaps how far are we away from the level pre-COVID-19?

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

So overall, except probably, I would say, in the Nordic countries, we are, worldwide, lower to where we were pre-COVID. When I look at the different businesses that we have in Digital Solutions, clearly, the systems and services part, which is the connected lighting part of the business, is performing better than the more traditional product part. If I go across geographies, I would say that we see a huge impact in some countries of Asia, so namely India and Southeast Asia. You know that we had to face a very, very strong lockdown not only in India, but also in countries like Malaysia, Philippines and Thailand. So we felt strongly the impact. We also felt strongly the impact in a country like France, in a country like Canada. In a country like France, because it went up in France to locking down the construction business. And then when the construction business is locked down, this has a big impact on our business.

So countries of Europe, countries of Asia have shown strong impact. Positive, as I was saying, in Nordics, Benelux, Indonesia where we saw a good performance in Digital Solutions. But even in China, we greatly improved after a strong impact in Q1, but we are far from the pre-COVID-19 situation.

Operator

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

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

My question is related to the government support and certainly cost saving. Is it possible to break up the whole cost saving in these 2 parts?

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

We don't give that detail, but it's EUR 43 million. And the vast majority is the voluntary and solidarity move.

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

Okay. So there's no major saving, or we can say the impact from government support system is not that significant.

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

No. It's a minority part of the EUR 43 million, and it was in a limited number of countries. So I'm talking here about the U.S., Canada, France, Germany, Singapore. But it's a minor part of the EUR 43 million.

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

Okay. And my follow-up question would be like how much of the solidarity cost saving would continue in 3Q? If I heard you correctly, I think it might not be that severe in third quarter, right? Your cost savings would not be as significant from solidarity measures.

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

No. We're not pursuing that initiative in Q3. It was only something that we only wanted to do in Q2.

Operator

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

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

I have one on your Professional division or the now called Digital Solutions. Can you give us some color on the big regional performance in North America, Europe and rest of the world, please, in terms of organic growth rates, if possible, as well as exit rates? And also, in addition, if you can touch on how Cooper performed against your own North America Professional business, that would be great. That was my first question.

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

Yes. Joseph, so globally, as I've said previously, we are declining in all the regions, I would say, pretty much in line with the lockdown measures. As we've commented previously, if it's only recreational activities that are locked down, we are around minus 10%. If we include retail, it's between minus 30% to minus 40%. And if we include construction, it can go up to minus 60% to minus 70%. So then it depends on the countries, depending on the lockdowns, we have different situations.

From an exit rate, also in Digital Solutions, we have a better May than April in comparable sales growth, and we have a better June than May. But once again, I don't take the exit rate as a real indication of what's going to happen next for the reasons I've expressed previously.

Now when we look at the Americas specifically and Digital Solutions, we are -- and Americas, let's say, U.S., I'm very happy about the performance. We can also benchmark it with what's happening on the market. And I think that we are doing a great job there. There's no major difference between the Cooper Lighting part of the business and the historical part of the Signify business. They are both performing in line with the market trend, I believe also slightly better than the overall market decline. That's from a top line perspective. And from a bottom line perspective, we could, with the integration of Cooper, do a lot of very fast improvement on the bill of material, exchanging between the 2 companies, and that has been very fruitful in Q2.

So you've seen the performance of Digital Solutions with an improvement of 80 basis points of the operating margin despite a decline of slightly above 22% for the quarter. And I would say that the Americas have contributed to that as well as Europe where, despite the decline, we had quite a strong level of resilience from a P&L perspective.

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

And my follow-up question is on your New York lighting projects -- street lighting project. You mentioned the plan was to replace 0.5 million street lights with connected lighting. I think the project already started back in 2018. And can you tell us how many of those 0.5 million have you done so far? And also, if you could, the phasing of the project in the next 2, 3 years and also the revenue side, if possible.

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

So we don't indicate specifically our revenue size, Joseph, on that project. What is interesting is that it is a multiyear project, which is corresponding to the willingness of the New York Governor to bring smart lighting to the State of New York. So the State of New York is about over 1 million light sources at this point in time, and they have the objective to connect [0.5 million] (corrected by company after the call) of them. At this point in time, only a very small number has been achieved. But what is remarkable in our participation to that project, it's about the connectivity and Interact City platform. So the Interact City platform has been selected by the State of New York to be able to control and monitor all the lights that are going to be installed and that are going to be connected. So that is going to happen gradually. So gradually, luminaires will be installed. By the way, they will maybe not all be from us. But the nodes, the connectivity and the software backbone is going to be ours. Look, we're very proud to participate to such a project, which, for us, is really showing how either cities or states should really tackle the issue of climate change because, as you can imagine, we are working together to do substantial savings on their energy bill and also improving the safety and security in the street. So all that is, I guess, a very positive sign in moments where the world is not going as well as we would like it to be.

Operator

Our next question comes from the line of Eric van den Hudding from VEB.

Eric van den Hudding

This is Eric van den Hudding from VEB. I think most of my questions have been answered, so I have only 2 short follow-ups. First follow-up is related to the UV-C products and especially also the introduction of lighting fixtures. Just in terms of -- it's a large range of end clients in terms of offices, schools, gyms, warehouses, public transport. Are you able to give us some clue of the potential size of this addressable market and the revenue potential of this?

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

I think you rightly say, Eric, that this is much more linked to the application. So we're really developing the applications at this point in time, understanding in a given space, given the volume, given the surface, given the application and what people do in that space. We are targeting different types of technological solutions. Look, we are sizing the market as we speak because it's evolving. It's evolving on a daily basis. Look, I hope that for the Capital Market Day that we still plan to do before the end of the year, we're going to be able to give you more insights because it is a moving target at this point in time. We start to realize that the potential ahead is interesting and going on a daily basis.

Eric van den Hudding

Okay. Then another follow-up on the comparable sales trajectory. You mentioned that you -- yes, you mentioned don't take too much from the exit rate. Are you able to give that exit rate? I know you -- the full quarter is around the low 20s in minus terms. Are you able to give an exit rate for where things stood about a month ago?

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

Let's put it this way, Eric. The best proxy I can give to you is if we don't go into -- if the economies are not going into additional and severe lockdowns in Q3, we should see a sequential improvement on our comparable sales growth for Q3. And this is what we are at this point in time taking as a hypothesis.

Eric van den Hudding

Yes. So if you look at the exit rate, is that more towards, I don't know, minus 15% or minus 10%? Where did things stood at the end of Q2?

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

Look, we're not really commenting. But if the economies continue to improve, the overall performance in Q3 should be better than the exit rate in Q2.

Operator

Our next question is a follow-up question from Daniela Costa from Goldman Sachs.

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

I wanted to ask on the free cash flow and the seasonal profile of the free cash flow that you expect this year. Normally, you would have had much stronger free cash flow in the second half, but you had a very strong first half in the first place. So shall we expect a different seasonality from normal this year or still be much stronger second half is possible?

René Van Schooten - *Signify N.V. - CFO & Member of the Board of Management*

Thank you, Daniela, for asking this question. Indeed, we have a history of strong cash flow in the second half of the year. We also remain very confident that our cash flow will be strong for the second half as well. I'd like to add, of course, that maybe the phasing over the third and the fourth quarter might be a little bit influenced. Eric already alluded to that. September is a very strong month. This high season also goes into October and November. You have seen that our working capital is at a very healthy level at the end of Q2. But of course, if we have a lot of sales in September, automatically, even when the quality of the receivables stays, the receivables will go up. On the -- at the same time, we also want to make sure that we can realize the sales in October and November. So this also has an implication for our stock levels. But overall, for the full second half of 2020, we're confident our repetition of our intention to also reduce our net debt up to EUR 350 million is reflecting that confidence.

Operator

We are now reaching the end of the call. We will now take a last question from the line of Andreas Willi from JPMorgan.

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

I just wanted to ask on the restructuring. Obviously, you didn't spend a lot in the quarter. As you said earlier, you prioritized the short-term savings for now. But what should we expect for normalized restructuring going forward? And would you expect to see, at some point, some pickup in that spending, particularly should revenues not fully return to pre-COVID levels globally in the next 4, 5 quarters?

René Van Schooten - *Signify N.V. - CFO & Member of the Board of Management*

Yes. Thank you, Andreas. Of course, we stick basically to our overall restructuring process. Of course, you have noticed that in the second quarter, we have been -- put things a little bit on their break to also look what is happening. And you might expect a catch-up in the third quarter as well. So overall, our guidance has not changed in this, in this context.

Operator

I would now like to return the conference call to the speakers.

Rogier Dierckx - *Signify N.V. - Head of IR*

Ladies and gentlemen, thank you very much for attending today's earnings call and for taking part in the discussion about our results. If you have any additional questions, please don't hesitate to contact Serena or myself. We are happy to answer your questions. And again, thank you very much, and enjoy the rest of your day.

Operator

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