REFINITIV STREETEVENTS

EDITED TRANSCRIPT

LIGHT.AS - Q3 2020 Signify NV Earnings Call

EVENT DATE/TIME: OCTOBER 23, 2020 / 7:00AM GMT

CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

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

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

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

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

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

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

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

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

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

PRESENTATION

Operator

Ladies and gentlemen, welcome to the Signify third quarter results 2020. (Operator Instructions) I would now like to give the floor to Rogier 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 third quarter results 2020. With me are Eric Rondolat, CEO of Signify; and René Van Schooten, CFO; Javier van Engelen, who has been appointed as our new CFO and who will take over from René Van Schooten after the Extraordinary General Meeting this week or next week is also joining us today.

In a moment, Eric will take you through the third quarter business and operational performance. René will then tell you more about the financial performance in the third quarter, and Eric will end today's presentation with 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, and both documents are now available for download from our Investor Relations website. The full transcript of this conference call will be made available as soon as possible on our Investor Relations website.

And 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. So let's go to Slide 4 with the main elements of our performance in the third quarter. So the installed base of connected light points increased from 64 million in Q2 2020 to 71 million in the third quarter of this year.

Total sales increased by 12.1% at EUR 1.7 billion or minus 8.3% on a comparable basis. Our connected businesses and consumer business performed better than our professional business.

LED-based sales represented 82% of total sales compared with 81% last year on a pro forma basis, including Cooper Lighting and Klite.

We continue to make good progress on reducing our cost base by EUR 22 million, a reduction of 4.9%. Our adjusted EBITA margin increased by 50 basis points to 11.5%, including a negative currency impact of 30 basis points, which was mainly driven by a strong gross margin improvement supported by rigorous pricing management.

Our net income increased from EUR 74 million last year to EUR 90 million this quarter, mainly as a result of improved operational profitability. Our free cash flow of EUR 214 million reflects solid profitability improvements, strong working capital management and the consolidation of Klite and Cooper Lighting. But last but not least, steady progress has been made on the integration of Cooper Lighting and also Klite.

I propose now that we move to Slide #5, where you can see a snapshot of the financial performance of our growing profit engines, digital solutions and digital products. Comparable sales growth of the growing profit engine declined by 7.9% due to measures taken against the spread of COVID-19. And despite the decline in top line, the growing profit engine have improved the adjusted EBITA margin by 130 basis points to 12.3%.

Digital products improved its profitability by 370 basis points, while the adjusted EBITA margin of digital solutions remained stable year-on-year when including the pro forma Cooper Lighting financials in Q3 2019.

Let me now provide you with more details for each of the divisions, starting on Slide 6 with digital solutions. Nominal sales increased by 31.2% as a result of the consolidation of Cooper Lighting. Comparable sales declined by 11.2% and reflects a continued difficult market environment, albeit an improved trend compared with Q2 2020.

The most severely impacted markets were Latin America, Canada, India, Southeast Asia, Italy and France. LED-based sales accounting for 92% of total sales and connected sales are representing 27% of total sales, excluding Cooper Lighting. The adjusted EBITA margin of 11% remained stable year-on-year when including the pro forma Cooper Lighting financials in Q3 2019.

On the next slide, Slide #7, you can see some of the business highlights of this quarter for digital solutions. The first highlight I would like to mention illustrates our commitment to climate action, as we switch to LED, 1,300 luminaires in the Port of Antwerp, reducing energy usage by 30%, while receiving a higher light output than before.

This higher light output in turn speaks to our commitment to safety and security as drivers in the Port of Antwerp will have a better view on the roads. Additionally, the luminaires are connected to Interact City, driving further operational efficiencies and enabling the measurement of motion, traffic and also noise.

The partnership with the football club of RB Leipzig is very interesting as it includes the implementation of interact sports for the pitch, the mixed zone, the hospitality areas and Interact Landmark for the facade. We also equipped the clubs Home of eSports (sic) [Home of eSport] with our Philips Hue smart lighting to enhance the experience of visitors. This project also illustrates our focus on health and well-being as we will be installing our UV-C disinfection upper air in the commercial buildings, the stadium and the dressing rooms of the teams.

And lastly, we're planning to install Trulifi by Signify in the press room to ensure journalists and photographies can upload their articles and photos fast and secure, further underlining our commitment to safety and security.

And we also made progress on strategic partnership. First of all, to support food availability by joining forces with ScaleAQ, we can accelerate the switch to sustainable fish farming across the world. Another partnership supports safety and security as together with EDZCOM, we can accelerate the adoption of LiFi by manufacturing companies in Europe.

Let's move on now to Digital Products on Slide #8. Nominal sales increased by 1.9% to EUR 575 million. Comparable sales declined by 2%, and sales in the consumer channel showed strong performance. Connected-based sales represented 21% and sellout rates in connected home remain robust. Demand in the OEM and professional channels continued to be impacted by the COVID-19 situation. The most severely impacted markets were Canada, India, Southeast Asia and Indonesia.

The adjusted EBITA margin improved by 370 basis points, driven by positive mix impact from the connected home business, solid price management, continued COGS savings and the ongoing successful integration of Klite.

There are a couple of business highlights that we would like to bring to your attention, and that's on the next slide, this is Slide #9. Illustrating our focus on health and well-being, we now launched the UV-C disinfection consumer desk lamp to help disinfect virus and bacteria from homes in different countries in Asia and the Middle East. The lamp are equipped with voice guidance and a built-in sensor that shuts off the device when detecting movement to provide for an extra layer of protection. While the initial launch has taken place in the countries you see on the slide, we're also looking at the introduction in other geographies.

We have also made further progress in smart lighting for consumers by introducing the new Philips Hue Play gradient lightstrip to provide TV viewers with an even more immersive viewing experience than before. The lightstrip is specifically designed for this purpose and can be mounted behind any TV with included brackets for easy installation and an optimal design 45-degree light projection.

It is also the first lightstrip that is pixelated, meaning that consumers can produce an almost unlimited combination of colors on one lightstrip that can seamlessly blend together and provide more nuance than ever before.

We have also launched 100 new WiZ products in 4 continents that combine Bluetooth and Wi-Fi technology, further expanding our share in the smart lighting market. These products include a smart plug, a sensor, a remote and a wide range of bulbs and spots in different color ranges.

Let's now turn to Slide #10 to discuss the performance of conventional products. Comparable sales decreased by 11%. The business declined less than in previous quarters as we benefited from strong demand for consumer lamps, UV-C lamps and horticulture lighting. We believe that the decline in sales is lower than the market decline, resulting in continued market share gains. At the same time, conventional products continue to generate high solid free cash flow.

On the next slide, Slide 11, I would like to give you an update on the good progress we made on our sustainability targets. In the first 9 months of 2020, sustainable revenues represented 83.6% of the total revenues, exceeding our 2020 target of 80%. We sold 2.7 billion LED lamps and luminaires in the period from 2015 till the first 9 months of 2020, well ahead of our commitment to deliver more than 2 billion LED lamps and luminaires by the end of this year.

We are very pleased that we have achieved carbon neutrality already in September, ahead of our objective. We have also decreased our waste to landfill by 92% compared with last year, and we are ahead of our targets related to a safe and healthy workplace and a sustainable supply chain. So while we are progressing towards our commitment for 2020, we are already embark on a new 5-year journey in which we focus on doubling our positive impact on the environment and also on society.

So that's what I wanted to exchange with you. I will now hand over to René, who will tell us more about the financial performance for the third quarter of 2020.

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

Thank you, Eric. Let's go to Slide 13, where you see the adjusted EBITA bridge. The adjusted gross margin as a percentage of sales increased by 200 basis points in Q3 2020, including a currency effect of minus 10 basis points. This improvement is mainly a result of continued strong pricing management and ongoing bill of material savings.

Pricing was well managed across the divisions. Price erosion in LED lamps and electronics continues to slow down, while we have been able to selectively increase prices on parts of our portfolio.

Our indirect cost base decreased by EUR 22 million compared to Q3 2019, when excluding the impacts of ForEx and changes in scope as a result of the acquisitions of Cooper Lighting and Klite.

If we look at Signify's adjusted EBITA margin performance, excluding the acquisitions of Cooper in Q3 2020, we will still have an improvement in the adjusted EBITA margin year-over-year. Overall ForEx impact on the adjusted EBITA margin was minus EUR 10 million. Scope and other includes the effects of Cooper Lighting and Klite acquisitions.

Let's now go to Slide 14. You can see the quarterly development of our indirect cost base. We continue to make solid progress on reducing our indirect costs. At a very early stage of the COVID-19 outbreak, a broad range of mitigation actions were identified to preserve profitability. Furthermore, we benefited from the carryover effect on the many initiatives that we have implemented last year and in the first half of this year. As said, this has resulted in indirect cost savings of EUR 22 million in Q3, excluding the effect of currencies and changes in scope.

We have a positive currency impact of EUR 12 million. Hence, our adjusted indirect costs were EUR 408 million, excluding the scope additions. By adding EUR 112 million coming from scope effects related to the Cooper Lighting and Klite acquisitions, we ended with a total adjusted indirect cost of EUR 520 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 our depth of cost base as soon as we see things changing.

Let's now look at working capital in the third quarter of 2020 on the next slide, Slide 15. When we include sales of Cooper Lighting and Klite on a 12-month pro forma basis, working capital decreased by 300 basis points to 6.4% of sales in Q3 2020. The improvement was mainly driven by agile inventory management and active monitoring of receivables and payables. Inventories as a percentage of sales reduced 210 basis points to 14.4% when including the sales of Cooper Lighting and Klite on a 12-month pro forma basis.

Let's now take a closer look at our debt position, net debt position, on the following slide, Slide 16. Following the debt repayment of EUR 350 million to reduce our overall gross debt position, our cash position decreased by EUR 264 million to EUR 762 million at the end of Q3 2020. The net debt decreased EUR 170 million. Next to the profit we generated in the quarter and the change in working capital I just mentioned, you can see the other items in the bridge that impacted cash and thus, our net debt position.

Net CapEx was EUR 26 million in the quarter. Next to that, we paid EUR 27 million for tax and interest. Other includes cash used for derivatives, acquisitions, new lease liabilities and foreign exchange effect on cash, cash equivalent and debt. In addition, we repurchased shares for a total consideration of EUR 32 million to cover obligations arising from long-term incentive performance share plans and other employee share plans. All in all, our net debt position amounted to EUR 1.589 billion at the end of Q3. This has resulted in a reduction of our net leverage ratio from 2.4 at the end of June to 2.2 at the end of September.

Before I hand over to Eric, I would like to inform you about our foreign exchange outlook. Based on the prevailing spot rates at the end of September 2020, the currency impact on the adjusted EBITA margin for Q4 2020 is expected to be minus 10 basis points and around minus 30 basis points for the full year.

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

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

Thank you, René. Let me now go to the final slide of the presentation, which is Slide 21, to discuss the outlook. So given the uncertainty brought by the rising number of COVID-19 cases, Signify does not provide financial guidance for the full year 2020. We remain confident in the underlying resilience of our business and operating model and that our liquidity needs are well covered by the financial framework we have in place. And during the virtual Capital Markets Day 2020, which is scheduled to take place on December 9, Signify will provide more detail on its expectations for the medium term.

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

QUESTIONS AND ANSWERS

Operator

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

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

It's Martin from Citi. So a question really around how you're seeing the business process normalize? I mean, obviously, we've seen pent-up demand, perhaps some restocking effects, things like that. If you could talk just a little bit about the phasing in the quarter as to how you've seen the business progress because some of these items that might begin to slow now.

And also related to that from your own cost perspective, obviously, we know there were lots of cost actions taken and the things that were stocked beforehand like marketing or things like that need to restart now, just to get some sort of sense as to how things normalize from here in terms of your progress?

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

Yes, Martin. The thing is, we are not in a situation of normalization yet. We thought at the beginning of the year that we would have a difficult Q2 and then that the situation will stabilize. You've seen as much as we see it ourselves the rate of increase of the infection cases has now been taking place, which is bringing uncertainty in the near term. So I will not talk about normalization on the market yet. We still see on the professional side of the trade, but also to give an extent on the consumer side, but to a lesser extent, but the level of the inventories are not at the levels at which they were before the crisis.

And given the uncertainties that we have ahead, we still see our customers not willing to replenish the inventories at the historical levels. There is still, across end user segments, a lot of variety and still a market that is not fully redeployed. When we talk about the public segment, which is probably the one which is still having a fair bit of traction because of investment in infrastructure, supporting by different types of stimuli.

But when you look at the retail professional customers, except probably food retail, the other part of that market is really down, and it has not improved. We see a slight improvement in recovery at this point in time on the hospitality business, but it's not come back to its historical levels.

Offices is down. On the industry side, I think there's a lower traction for manufacturing plants equipment. But on the other hand, we see a lot of traction on warehouses. So we are still in a period of relative high level of uncertainty, and I don't think we are close to a normalized situation.

From a cost perspective, so you would remember that we had savings of around EUR 56 million in Q1, EUR 86 million in Q2. But in Q2, we had also the measures that we did put in place in terms of solidarity, which were around EUR 30 million on the nonmanufacturing costs, the indirect cost, that would bring them back compared to Q1 around EUR 56 million.

We have commented that it is EUR 20 million for Q3. But we also have to take into account that the differential between what happened in Q3 last year and Q3 this year. Last year, we had to release some provision; and this year, we accrued, linked to the fact that we had a bit of a worse performance last year than we expected and probably a bit of a better one this year than expected, which would bring the delta in terms of cost much closer to EUR 15 million in 2020. So from a cost perspective, what has been done all over the year is quite consistent and, of course, helping the performance.

But your question is very important because moving forward, we are operating in a -- people are working from home. We're not traveling a lot. So we're looking at what should be our landing point in terms of cost if the activity goes back up, meaning that we resume our normal way of doing business with the top line that may still be impacted at least in the shorter term.

And we're working on it at this point in time, Martin. We're looking at what can be done in a more structural way in order to adapt the cost structure of the company to whatever we have in front of us. So we remain very adaptable to the situation.

Operator

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

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

My first one actually is around the renovation market. I was hoping you could give us maybe some indication in terms of within the portfolio, your share of nonresidential business versus resi? And if we think about the nonresi exposures specifically, how much of that exposure is subjected or is driven by what I would call substantial renovation project?

And if you would have that indication for Europe considering the announcement on EU Green deal, that would be quite helpful? That's question number one.

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

So much stronger traction in the residential market, but I think you know it, you've seen the numbers in the U.S. that were very positive. But when we come to the nonres, we estimate that about 40% of our turnover is depending on that market, Lucie.

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

So that 40% of your nonresidential exposure is exposed to renovation?

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

40% of our business, which is exposed to the construction nonres.

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

Okay. But my question was more, how much of your nonresidential exposure do you think is exposed to renovation? So 40% is nonresi at the group level. But then within that, how much is renovation, I mean potential renovation?

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

Yes. Understand. Look, these are not numbers that I have at the top of my mind, but you need to see -- there's another important understanding here. Renovation for us is quite large. Basically, when the ceiling is being changed, for us, it's like a new project. So I would say that if you have normally 1/3 is new and 2/3 is renovation. For us, it takes a different proportion because when the ceiling is taken out, it's like if it was a new project for the lighting business. Look, we don't have the statistic that you mentioned here that we're not communicating specifically on that. What we say that the exposure of the overall company to construction nonres is about 40%.

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

Okay. And my second question was around the UV-C lighting sales. I was hoping you could help us understand how much that business was growing. And also, it seems that it is both on the conventional side and on the digital product side. So whether you could maybe separate the 2?

And I would just wanted to have an update on your capacity increase. You had said you were going to increase capacity by 8x by the end of 2020. So I was just curious whether that increase was already achieved or whether this is still to be completed? And if you are planning further increase in capacity in this area? And if so, for which cost?

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

So let's take it by part, Lucie. I think that's the right way to do it. Let's talk about conventional products. This is where we are increasing capacity. Because we're increasing the capacity of light source, and the light source is a conventional light source. We are on track to multiply by 8 our capacity at the beginning of 2021. At this point in time, for these products, for the conventional part of the business, we are on allocation, meaning that we cannot serve all the orders that we have at this point in time, despite the capacity increase.

So there's a clear intake of business in UV-C in the conventional part which is also showing not only UV-C because we're also performing well on horticulture and on the consumer business, but this is why we show, in the conventional part of the business, a lesser decline than the previous quarters at minus 11%.

Now let's move to the other businesses. In digital products, we are going to -- well, we've launched already on the market in Asia and Middle East to start with, to be expanded to other geographies, a disinfection desk lamp for the home, which is equipped with voice guidance and sensors in order to make sure that it shuts off if there is any presence in the room. And this is a product that is going to be, we believe, very successful, of course, completely complying with the safety requirements.

But we also see traction, and it's the beginning. So although we see already an impact on conventional products, it's still yet to be seen on digital solution. When we see the business starting to grow, we've talked about 12 families of products that we will bring into the market that is effective. And we're monitoring the deployment of these technologies worldwide because there is a need worldwide at this point in time.

And we start to have interesting wins. We've talked about in Q3 the football club of RB Leipzig where basically we're equipping with upper air disinfection and the commercial path of the building in the stadium, but also the local room. So we start to see a conversion also of the technology into sales in the professional part of the business.

We need to understand that from a go to market we're learning, and it is also -- I think it's an advantage in the longer run. It is a complicated pitch to be done by salespeople. When they need to understand the technology, they need to understand the application. So it requires to have very well-trained sales forces, which is what we are doing at this point in time, making sure that we have capable people capable to understand the technology, the application of the customer and to serve them with what they need. So we see the traction very clearly in conventional products, and it's growing in digital solutions.

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

Sorry, and regarding whether you are looking to increase further capacity after the 8x that you have already planned?

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

We have the possibility to do it on a very short-term basis, if needed. It's not planned at this point in time, but I have reserved that possibility to do it very quickly if ever we need it in 2021.

Operator

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

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

My first question is on gross margins. You mentioned the mix being beneficial clearly from the connected home segment. Just talking more in general about gross margins, what are you seeing? I can remember from the previous call, as you say, because of COVID-19, there has been maybe a little bit less competitive pressure and therefore price erosion on the top line. And also the dynamics that you're seeing with the cost of goods sold, am I correct from the press release that, that is beneficial for you as well? Could you explain the dynamics and how you see that going forward?

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

Yes, Marc. So first, the gross margin focus has been a very important focus for us since the beginning of the crisis. I think I've said that a few times. But at the end of January and beginning of February, we gathered all the teams and explain what would be the trajectory or the expected trajectory for our gross margin. We have, in order to do so, accelerated the synergies with the acquisition that we had made. So Cooper on one hand, but also Klite on the other hand, by insourcing more some of the production that we had at suppliers in China, which is basically also improving our gross margin performance.

We've seen in Q3 a positive mix impact, as you've mentioned it, from the connected offers, not only on the consumer side, but also on the professional side. And we have continued to apply a very rigorous pricing discipline. And price is about method. Price is about being consistent on the market, making sure that we can segment our offers, meaning that if you have a given offer, you could have a different way to sell that need with different offers that are segmented from lower price to higher price, and that goes also into the protection or even the improvement of the gross margin.

So what you see in terms of operating margin improvement is gross margin led on rigorous pricing management, but also linked to a good performance in cost of goods sold. We've always performed quite well in cost of goods sold over the past years because we had to decline the cost of the products quite substantially. We continue to do that.

And I would say that the acquisition of Klite and even more the acquisition of Cooper has been very important for us to be able to achieve further reduction in cost of goods sold because we are taking an even bigger volume, and it gives us a big advantage when we need to negotiate with suppliers.

So it's been a combination of taking decisions very quickly and then executing very rigorously on the price side, executing very rigorously on the COGS side and mix impact that has helped also in Q3 because of the connected offices.

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

Okay. That's clear. And second question is on the digital product side and so the connected home. Typically, the fourth quarter was -- is the key quarter there being very large compared to the rest of the year. Given that you already had a very strong third quarter, do you think this is something that will accelerate going into the fourth quarter? Or is it also something that maybe it's put forward a bit, would be very interested in your view there?

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

No, it's not really put forward, Marc. I think the fourth quarter is always a very important quarter for all the consumer business, and we think it's still going to be the case this year.

Operator

Our next question comes from the line of Daniela Costa of 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*

The first one I wanted to just ask a follow-up on pricing on your commentary of the erosions in LED decreasing, which contrasts, I guess, with sort of some of your peers who are using more or set to use more tactical pricing. Can you comment sort of like on the market that do you see this price erosion has more of your own efforts to stay disciplined? Or do you see sort of a risk going forward from the commentary of your peers? How would you plan for that if they get a bit more aggressive?

And then I have a follow-up on cash, but I can ask later.

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

Yes. Look, when it comes to pricing, and you may remember, since the IPO, we've always said that pricing is a discipline, and we don't use it tactically to gain share. There may be a very specific situation where we can be aggressive, but I would say it's going to be much more on projects where the competitive landscape can change.

But when it comes to product, we're rigorous, we're not tactical. We would reply to aggressivity on the pricing with the strategy. So let me give you an example. When there were some price erosion on the market, we decided to bring in the markets where it was necessarily a B brand, meaning that for a given segment of the offer, you would have the B brand at a lower price than you would have A1, A2, A3, three different products answering the same need, but with different types of functionality and different prices.

And I think that's the way that we implement, and we didn't signify in order to face aggressivity or aggressiveness in pricing from competition. What is very clear to us is that our brand has also a price elasticity, which is not infinite. So whenever the prices are too low, we don't address that market with our main brands. We use the B brand.

So this is the way we answer, not by moving price up and down tactically. And I think that the strategy which has been rigorous, stable, consistent and also very important in front of our customers who expect themselves to have us coming with a strategic pricing approach. But that's the way we do it, Daniela.

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

And then on cash normally, like Q4 cash seasonality is quite favorable. You had a very strong Q3 anyway. Shall we expect a reversal in Q4? Or still the normal Q4 seasonality being much better than other quarters?

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

Thank you very much, Daniela, for that question. I think over the first half year and also in the second half year, we have done a lot to improve the phasing of our working capital movements, making sure that the cash comes in more evenly. We have a history of strong cash flow, as you quoted, in the second half of the year, particularly in Q4, and we remain very confident that also our cash flow will be solid in the fourth quarter. I add, of course, that our working capital is at a very healthy level. And we also are confident that we can sustain that.

Operator

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

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

Coming back to free cash flow, I think in your original guidance, the expectations were for free cash flow as a percentage of sales to be at least 6% for the full year, and year-to-date, I think you're running at just over 10% of sales. Given the performance you've had so far, is there any reason not to reinstate the guidance for the full year?

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

Yes. We -- look, the truth is, given the uncertainty that we saw in the market at that point in time, we didn't really think about repositioning the guidance. You see where the performance is today. We're confident in our capacity to continue to generate free cash flow in Q4. So let's take it where it is. Is it going to be better than 6%? Yes. We maintain that guidance for the full year, and we're not expanding it at this point in time.

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

Okay. And maybe one follow-up for me on the UV-C side of things. It seems as though, obviously, in conventional, you've had quite a pickup relative to your historic organic sales decline. How should we think about the normal run rate of this business going forward, given the contribution from UV-C?

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

Yes. Let's -- look, nothing is normal at this point in time. This is the other issue that we're facing because we have markets that are going down, markets that are going up, the consumer business moving a bit faster this quarter than the rest. So the situation is still extremely fluid. What -- my conviction is that we should have a positive impact of conventional UV-C on the overall performance of our conventional business.

But not only UV-C, I think horticulture also should have a positive contribution to that business moving forward. Now when are things going to normalize and at which level? I think it's very, very early to say it. But the only thing I can tell you is that I see a positive contribution of those businesses to the overall conventional business.

Operator

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

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

It seems that the connected lighting business is doing pretty well for you and probably aiding margins as well. So how do you see this business growing forward? And also, how are you planning to monetize this connected data, which you probably are getting from these connected lighting sources? That is the first question. I will ask my second question afterwards, if it's fine.

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

Yes, sure. On the connected lighting, you have 2 parts, Rajesh. One is what we do in the consumer space. And that has been a longer-term investment on Philips Hue. We've invested a lot over the past 6 to 7 years to create a platform which is very complete from the app to all the different connected products that are compatible with our ecosystem.

We're not talking only about bulbs. We're talking about luminaires. We're talking about light streets. We're talking about entertainment. And all is around use cases with control devices, smart plugs, smart sensors and so on. So we offer a complete ecosystem, and that was the strategy from the very beginning.

It's not about product. It's about the system that is connecting everything together. We have bought -- and we have made the acquisition of WiZ, a bit more than a year ago, and I'm extremely satisfied with the performance of that business, which has been growing slightly more than the aggressive growth that we had in the business plan. And that part of the consumer smart home lighting is complementary to Hue.

We talk about Wi-Fi and Bluetooth, where on the side of Hue, we talk about Zigbee and Bluetooth. So at the end of the day, we're covering that market fairly well. And we are getting data, and I'm going to come back to -- I'm going to come back to that.

Now we've seen also very good traction on the professional side of the business, where we have verticalized when we reorganized Signify, as we commented a few quarters ago, with more customer centricity, more specialization. So now we have teams that can do the quotation, the sales, the delivery, the installation, the commissioning of those professional systems within the same thing.

And we see very positive results in terms of funnel growth and also in terms of sales expansion. And this is totally in line with our strategy. We believe that after the transition to LED, the market will be transitioning to connected.

You rightly said that we're generating data when we connect. I have to tell you that at this point in time, we have a service business, data-enabled service business. It is at this point in time small. We see that not many customers are going for it at this point in time. It's going to be very much depending on some segments. We see that the industry segment, this is where the customers are the most likely to go for it.

So we're working on it. We think the market is not totally ready for this, but it will be in the future. I think we'll give some more indication about all this during the Capital Market Day that we intend to -- not that we intend, that we will conduct in December 9.

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

Okay. My next question would be on the U.S. market. If you could share your insights into what is happening in the U.S. market with respect to price and volume.

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

On the U.S. market, we had a very positive traction on the consumer business. You see also that at the level of the U.S. market, we see a very positive traction on digital and e-commerce, which we have also benefited from the residential investments in U.S. are still quite strong. So here, we see a very positive development on both sides.

When it comes to the professional part of the business, it really depends on the segments, as I've commented earlier. We don't see a great pressure on price. We see a degradation of some end markets. You still have, as we commented earlier, some companies on the market may be practicing lower prices. For us, we are stable in our positioning when it comes to price with very segmented offers. But it's really what we face on the U.S. market, like in many, very different tractions depending on the end markets.

Operator

Our next question comes from the line of Akash Gupta of JPMorgan.

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

My first question is related to ESG. I mean Signify is the leader in the sector when it comes to ESG. Even you started putting efforts way ahead of everyone else. The question I have is that, is there any risk to dividend this year on social grounds, given you have to ask your employees to take 20% salary cut in early part of the year?

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

Let me try to understand the question a bit better. Is there a risk coming on social grounds? Look...

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

Policy this year because you have to ask your employees to sacrifice 20% of their pay cut early in the year?

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

Yes. So let me reposition the -- what we did this year. So we went to our employee base because we realized very early on and that was in February, March that Q2 would be a very impacted quarter from a top line perspective. We said to our people worldwide, given the situation that the economies are in and given the situation that the society is in, we want to refrain from laying people off.

And that was a very strong willingness that I had at the time because if you lay off in the situation in which the pain it was at that point in time, you bring more problems to the society. And certainly, the people that are losing their job have very little chances to find a new job in the market which was very much in the bad shape.

So the commitment that we take was to say to the people, on a voluntary basis, to contribute to working 1 day less. And by working 1 day less to have an adjustment pro rata to their salary, and we did that only for Q2 because that was the quarter that we had to tackle a bit differently.

We took also a commitment, Akash, which is a very important one, that we would not lay off if that was happening. And from a societal standpoint, I think that what we've done is great because we didn't bring more problem to the society. We didn't lay off people putting them in complicated situation.

We have opened the possibility of people to do it on a voluntary basis. And I can tell you that the employee Net Promoter Score, which is a measure that we conduct on a quarterly basis after this measure, has reached its highest ever level within Signify at 29.

So at the end of the day, let's -- we need to understand very well what we did and why we did it, but there was a very big societal thinking and a lot of clear principles behind what we did at this point in time. I think we are all quite proud of what we did and how we globally reacted.

By the way, until now, we haven't done any lay off. We find other ways to adjust our -- the cost of the company, and this is also an added testimony of our strong commitment to the decision we made in Q2.

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

Maybe just a follow-up on the same topic. This means that you don't need to compensate your employees before considering dividend, am I right?

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

Sorry, I didn't hear you well. We don't need to compensate the employees and then...

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

To compensate for it because, I mean, you took this temporary measure in Q2, but your performance has improved subsequently in Q3. I mean Q4, we still need to see, but the question I have is that, is there any case that you may need to compensate your employees for the contribution they made in Q2 before you consider dividend?

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

Look, at this point in time -- I think it's a good question. Look, the year is not finished. Unfortunately, after what has happened in -- during the summer, we have an increased uncertainty entering Q4. There's more uncertainty in the near-term than before. So let's finish the year, which is an important milestone for us in order to see where the company is and what we're going to do globally.

We have different mechanisms in terms of compensation that we can use in the company in terms of -- we're going to use that we call annual incentives based on performance criteria. So this is not a simple answer. It's a global answer because, as you rightly say, everybody contributed in Q2. It's the Supervisory Board. It's the leadership team. It's also the shareholders with the dividend, and it's the employee with the voluntary contribution. So yes, we have an equation that we need to understand a bit better. But for this, we need to go until the end of the year and see really where the performance lies at the back end of December.

Operator

Our next question comes from the line of Sven Weier of UBS.

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

So the first one is a follow-up on the European Greens vision. And obviously, we now got some more details released by Brussels, but the document is still a little bit light in terms of what specifically is going to be promoted. I mean in previous documents, we could see insulation, solar and things like that, but light -- lighting has not been mentioned as an area. So do you have any further insights how lighting could be specifically promoted in this in the coming years? That's the first one.

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

Yes, Sven. There are 3 areas and that the green deal is targeting where we can contribute. So the first one is everything which is around climate change and clean energy. This is about connected energy-efficient lighting, but also solar-powered lighting. The second is about food security. This comprehensive approach in the green deal when it comes to this, and here we can contribute with horticulture and animal lighting.

And the last one we can certainly contribute to is circularity with the offers that we have put on the market and especially deployment of 3D printing devices that we have started to implement 3.5 years ago, and we are -- we're the most advanced lighting company when it comes to this. So at the end of the day, we are pretty much contributing.

What we're doing at this point in time, we're doing that centrally at the level of Europe, but also in all the different countries where we operate, we connect back to the local government in order to go from what you rightly call so far a light approach to something which is a bit more pragmatic, a bit more practical. And basically, we are bringing to Europe, but we are bringing also to the countries where we operate, and we operate in nearly all the countries in Europe, we bring to them examples of what can be done. What would be the wise investments yielding an important and a fast return and invest in lighting.

So we get a positive traction. People listen. Now we always want this to go a bit faster than the actual spin look. We were involved. I was myself involved also with the Vice President of the European Commission in order to explain how we could help and how we could contribute at the level of the green deal, but also which is very important for us helping Europe to be a carbon neutral in 2050 because we believe that there's a clear possibility that we could do so.

So we are very, very much engaged, and we believe we can contribute. But there's a process in that program. We try to speed up as much as we can locally and also centrally at the level of Europe.

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

Okay. Understood, Eric. And second question is just coming back on the nonresi bit of your exposure. And I just wonder if you could share just more granularity on what it is specifically like the office and hospitality breakdown. Because I mean if you look at the U.S. nonresi starts obviously down very, very heavily so far this year, but huge deviations in that between the segments. And I guess security was sounding a bit cautious on the outlook there. So yes, I was really wondering if you could share some more details on your specific exposure there. And -- because I think that would help us to frame our expectations on the business in the next 12 months.

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

Yes. So that's -- look, we looked into it because the situation has been extremely volatile this year. And we were, in general, talking about numbers, but these numbers have varied because of the crisis as we have seen a different mix in terms of technology, a different mix in terms of geography, but also a different mix in terms of customer and segment.

Look, Sven, let me not do it here. But with the team, we're going to work on it and come back with something which is going to be a bit more comprehensive with end user segments during the Capital Market Day in order to give a bit more clarity of our exposure.

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

But would you say that the Cooper acquisition has made you a bit more defensive? Or I mean, more exposed to the segments that are more defensive or just directionally, any major change to the exposure that you had before Cooper?

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

No, I think the Cooper is bringing us a fantastic access to the markets where we can bring our technology and bring our differentiated innovations. So on the contrary, I think this acquisition make us maybe -- probably more aggressive on the market and capable to take not only market share, but a much bigger overall share when you combine the 2 front offices that we have.

One of them, Cooper, which is probably a bit more verse towards indoor applications. And if I look at the historical generalized part of the business, probably a bit more verse towards the outdoor part of the business. So in that sense, it's also pretty much complementary. So no at this point in time that didn't induce any type of defensive position. On the contrary, we feel that we have a much, much better handle on the market with that acquisition, and it's been so far very positive for us.

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

Okay. Eric. Looking forward for December then.

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

Thank you.

Operator

We are now approaching the end of the call. We will now take our last question from the line of Joseph Zhou of Redburn.

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

I have 2 questions. And the first, just to quickly follow up on UV-C, and where are you with the production expansion? And now can you be a bit more precise because your plan is to increase it by effective 8x by early next year, but where are you now?

And also on UV-C and what do you see in terms of the market dynamics for traditional UV-C technology versus the LED technology? My understanding is that in the end, you will transit towards LED. But are you seeing that happening faster now? Or is UV-C still a traditional dominant technology and then there is no change in that?

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

So look, we had an expansion of capacity at -- we had 3 different programs when it comes to the increase of capacity. So program one was the expansion of an existing capacity at some -- at one of our supplier. That has been effective. The second one was the repurpose of oven, the glass oven that we have in Poland, where we have a big industrial complex. That one is also done. And the last one, which will be finished until the -- and before the end of the year is a new oven that we're also building in Poland to tackle with that capacity increase.

So I would say that at this point in time, we've done nearly between half of the 2/3 of the capacity increase that we wanted to do. And we confirm that we're going to finalize it according to plan by the end of the year, multiplying it by factor 8 between the 1st of Jan 2020 and the 1st of Jan 2021.

When it comes to LED, it is very early days at this point in time to generate the same type of energy and particles that we need to kill viruses. The LED technology would require us to put so many LEDs that it is not, at this point in time, a suitable solution with that technology today. I think it's going to take a long time before it is becoming an alternative to conventional UV-C.

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

Yes. And my second question is on your digital products business. Within that, obviously, you have the LED and the Home divisions, which you're not disclosing that. I guess part of the strength in the quarter was driven by strong Philips Hue sales and margin. And can you give us some color on that? I guess it must be a good double-digit growth for the Home -- the old Home division in the quarter and also maybe quite acute double-digit margin for Philips Hue -- for Home as well. Can you maybe you give us a bit of color on what kind of margin level are we seeing now for the Home part of the business?

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

So when you talk about digital products, you have different businesses within the digital products division. So you have professional part and the consumer part. So the professional part is made of the OEM business and the professional lamps. And we've seen this business having the same type of performance as the rest of our professional business, which is digital solution, pretty much impacted by the crisis, depending on the geographies, but very similar type of trend.

Then on the consumer business, you have also 2 different types of business, the LED nonconnected, and that has been performing quite well worldwide. But what has been performing even better is -- so the Philips Hue offer, which was out of home, both on the lamps and luminaires and also the WiZ offer, that's an acquisition that we did more than a year ago that has been performing extremely well since we did the acquisition, and that has also been contributing substantially in Q3.

So that part of the business has grown even more. We're not disclosing the growth rate at this point in time, Joseph, but let me put it this way. In the countries where we were strong, we got -- we have gotten even stronger. So we see that the established system that we have put in place, which allows you to have a platform and an architecture to which you connect a lot of different products is something that is working because consumers are connecting more and more product to our platform.

So that's what I would say about digital products. Many different things in the same division, but all in all, on the professional side, similar to the other part of our professional business. On the consumer nonconnected, good performance; and on the consumer connected, very, very strong performance.

Operator

And I would now like to return the conference call to the speakers for any further remarks.

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 this discussion about our results. If you have any additional questions, please do not hesitate to call back Serena or myself. We're more than 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.
