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LIGHT.AS - Q3 2024 Signify NV Earnings Call

EVENT DATE/TIME: OCTOBER 25, 2024 / 7:00AM GMT

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PRESENTATION

Operator

Hello, and welcome to the Signify third quarter results 2024.

(Operator Instructions)

Today, I am pleased to present Eric Rondolat, CEO; Zeljko Kosanovic, CFO; and Thelke Gerdes, Head of Investor Relations. Please go ahead with your meeting.

Thelke Gerdes - *Signify NV - Head of Investor Relations*

Good morning, everyone, and welcome to Signify's earnings call for the third quarter 2024. With me today are Eric Rondolat, CEO of Signify; and Zeljko Kosanovic, the CFO. During this call, Eric will first take you through the third quarter highlights, after which Zeljko will present the company's third quarter financial performance. Eric will then come back to discuss the outlook for the remainder of the year. And after that, we'll be happy to take your questions.

Our press release and presentation were published at 7:00 this morning. Both documents are available for download from our Investor Relations website. The transcript of this conference call will be made available as soon as possible. And with that, I hand over to Eric.

Eric Rondolat - *Signify NV - Chief Executive Officer, Chairman of the Board of Management*

Thank you, Thelke. Good morning, everyone, and thank you for joining us today. Let's start with some highlights from the third quarter of 2024 on Slide 4. So we grew our installed base of connected lighting points to 139 million, and our LED-based sales reached 90% of total sales compared to 85% one year ago. As anticipated, our top line improved sequentially in the quarter with a comparable sales decline of 5.2%.

Our teams effectively managed the rapid decline of our conventional business and the ongoing headwinds in the Chinese market. Without these two challenges, our decline would have been limited to 1.3%. Given the decreasing contribution of our conventional business to EBITA, our bottom line showed good resilience. Our cost reduction program began to yield the expected benefits, resulting in an adjusted EBITA margin of 10.5% for the whole quarter.

We considerably lowered our adjusted items, thanks to consistently reducing restructuring costs, along with a sizable one-off tax benefits. This resulted in robust net income growth of 30%. Additionally, our ongoing focus on cash conversion led to strong free cash flow generation for the quarter. I will now move to the performance of our four businesses.

Let's start with the professional business on Slide 5. Nominal sales were EUR995 million with comparable sales showing a decline of 4.1%. We saw the expected recovery of our agricultural business and continued growth for connected lighting. Our business in China as well as in Europe remained weak. Southern and Eastern Europe, along with the distribution channel, retail and hospitality sectors were soft, while we saw a strong performance from the Nordics.

An expansion of our gross margin was driven by the positive sales mix, bill-of-material savings and concept savings, which more than compensated for price pressure in some parts of the business. Our professional business achieved an adjusted EBITA margin improvement of 20 basis points to 10.8%, primarily due to gross margin improvement and cost reductions as the benefits of our cost reduction program began to materialize. Our performance in the third quarter illustrates the operating leverage this business is capable of, even as top line pressure persists in some markets.

Let's move to the consumer business on Slide 6. Comparable sales decreased by 1.8% to EUR304 million. Excluding China, our consumer business delivered a comparable sales growth of 2.6%, reflecting the recovery across all other regions. Our Klite business, which is mostly an export business, showed a strong performance during the quarter.

The adjusted EBITA margin decreased by 120 basis points to 7.6%, mostly due to China and higher transportation costs. Continuing with the OEM business on Slide 7. Our OEM business delivered a strong performance in Q3, particularly in Europe. The growth in Q3 came despite the impact of the customers in-sourcing in the US. This illustrates further the rebound of this business in 2024.

Comparable sales increased by 0.2%. The adjusted EBITA margin increased by 300 basis points to 15.2%, including a one-time effect of around 200 basis points. EBITA also benefited from the expansion of our gross margin through bill-of-material savings and productivity gains. Finally, the business achieved overall reductions in line with our cost reduction program. And finally, the conventional business on Slide 8.

Comparable sales showed a decline of 29.4%, still affected by the fluorescent bans in Europe that came into effect last year. In addition, some US States, including California, have announced sales ban to be implemented starting January 1. The adjusted EBITA margin declined by 160 basis points to 19.3% as the negative volume effect was partly compensated by cost savings.

On the next slide, which is Slide 9, I would like to discuss a couple of business highlights. Starting with the Atlantis resort in Dubai. The lighting system that we have implemented enables seamless control of lighting and other third-party applications. It enhances guest experience with circadian lighting that supports guests' well-being during their stay.

We also expanded our partnership with Great Lakes Greenhouses, installing our GreenPower LED solution integrated with our GrowWise Control System. The integration maximizes crop production and energy efficiency by up to 40%, enhancing crop quality while simplifying greenhouse management. In the consumer business, we launched the highly anticipated second-generation Philips Hue 8K Sync Box. The upgraded device allows users to sync and stream the highest quality content with no latency at ultra-fast refresh rates and with very high resolution, offering an enhanced experience for gamers.

Following its launch, we have seen some excellent reviews and feedback from the media and consumers who are praising the performance and enhanced features. Finally, in the OEM business, we entered a partnership with Finnish design company, Secto Design, integrating our Philips core LED lamp into Secto Design iconic wooden luminaires. This allows consumers to adjust the color temperature of the lighting fixture via a switch integrated into the body of the lamp.

Next, I would like to discuss our sustainability performance on Slide 10. In the third quarter of the year, we continued to advance on our Brighter Lives, Better World 2025 sustainability program commitments. We are on schedule, first, to achieve our 2025 target to reduce greenhouse gas emissions. Circular revenues increased to 36.7%. The main contribution coming from Professional serviceable luminaires in the Americas. Brighter Lives revenues remained at 31% with a strong contribution from consumer products, mainly EyeComfort, that support health and well-being.

And finally, the percentage of women in leadership positions remained at 29%. We continue our efforts to increase the overall representation of women in our business through focused hiring practices for diversity across all levels. Let me now hand over to Zeljko, who will take you through our Q3 financial performance and also the highlights for the first half of the year.

Zeljko Kosanovic - *Signify NV - Chief Financial Officer*

Thank you, Eric, and good morning to everyone on the call. It's my pleasure to present our third quarter 2024 results this morning. Let me dive straight into the financial highlights on Slide 12, where we are showing the adjusted EBITA margin bridge for total Signify. The adjusted EBITA margin decreased by 20 basis points from 10.7% in Q3 2023 to 10.5% in Q3 this year, as a strong 90 basis point gross margin improvement was offset by the negative impact from volume decline.

Looking at the bridge in more detail, the negative volume effect was 130 basis points. Notably, this effect has been gradually diminishing throughout the year as parts of our business have returned to growth. The combined effect of price and mix was a negative 200 basis points, and negative pricing in parts of our business was partially compensated by positive sales mix.

Across our businesses, price trends remained largely unchanged in the third quarter compared to Q2. We continue to face pricing pressure in China, India and parts of Europe, while experiencing a more stable pricing environment in North America and within our conventional business. Cost of goods sold improvements accelerated to 230 basis points as we continue to benefit from bill-of-material savings, productivity gains and other cost reductions. The currency and other effects had a small positive contribution of 10 basis points each.

Adjusted indirect cost savings had a positive effect of 50 basis points, reflecting increased benefits from the implementation of our cost reduction program. With the effect of cost reduction program gaining momentum in the third quarter, we have observed sequential improvements. Adjusted indirect costs, which were 33.5% of sales in the second quarter, an increase of 170 basis points year-on-year, have decreased to 31.3% in the third quarter, reflecting a year-over-year increase of only 110 basis points. We do anticipate reaching our run rate targets in the fourth quarter as cost savings continue to ramp up.

On Slide 13, I would like to discuss our working capital performance during the quarter. Compared to the end of September 2023, our working capital reduced by EUR152 million or by 140 basis points from 9.1% to 7.7% of sales. Inventories decreased by EUR158 million, mainly from improving supply chain lead times. Receivables reduced by EUR114 million due to both our efforts to minimize overdues and due to the lower year-on-year sales level. Payables were EUR124 million lower, being a logical consequence of driving down our inventory, while structural payment terms remains largely unchanged. Other items further reduced working capital by EUR6 million.

And with that, I would like to hand back to Eric to wrap up on the outlook and the closing remarks.

Eric Rondolat - *Signify NV - Chief Executive Officer, Chairman of the Board of Management*

Yes. Thanks, Zeljko. Let's conclude with the outlook on Slide 15. So we confirm our guidance for an adjusted EBITA margin at the lower end of the 10% to 10.5% range and free cash flow generation of 6% to 7% of sales for the whole of 2024. And with that, I hand it back to the operator for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Akash Gupta, JPMorgan.

Akash Gupta - *JPMorgan Chase & Co - Analyst*

My first one is on channel inventory and maybe if you can talk about what sort of promotional activity you are expecting in fourth quarter? And on the same topic, can you help us walk through how shall we think about revenue growth expectations in Q4, where China may see some benefit from the recent stimulus measures and professional things are bottoming out there? Maybe if you can help us walk through how shall we think about the near term? And any comment on channel inventory and promotional activity?

Eric Rondolat - *Signify NV - Chief Executive Officer, Chairman of the Board of Management*

Good morning, Akash. Look, the inventory has been fluctuating during the year at a level that we believe is not the optimum level. So we still believe that the working capital can be improved by inventory decrease. For Q4, there are not specific promotional activities in 2024 that would be radically different than during the previous years. Of course you have, especially on the consumer side of the business, some specific events in Q4 with big promotional activities for our retailers and online retailers, and we do that as we do every year, nothing really specific.

Now what we do for the inventory, we look at the quality of our inventory, and we have specific actions on inventory, which is slow moving. But I would say that's in the normal course of business. When it comes to the inventory in the channel, the inventory in the channel is at the right level. Probably, we have a specific case in Europe where the business has been very slow where we have seen our distribution channel further reducing in absolute value their inventory, but putting it more in line with the percentage of sales that they expect coming forward.

On revenue growth expectation, what we have said since we started the year, that we would see an improvement in our top line quarter after quarter. And that's what we did since Q2, showed a better performance than -- Q1 and Q3 shows a better performance than Q2, and we expect to see the same in Q4.

On the China stimulus, that has been effectively communicated by the government, we see a potential indirect impact because at this point in time, it's not really on lighting. It's more on different sorts of domestic appliance, but we believe there should be an indirect positive impact on our consumer sales. It still needs to be seen, but that's talking to experts, what we expect in terms of impact.

As far as the Professional business is concerned, there are different types of stimulus in the different countries, not only Europe and the States, especially on outdoor infrastructure that we try to capture locally.

Akash Gupta - *JPMorgan Chase & Co - Analyst*

And my follow-up question is on phasing of savings. So when I look at your margin bridge, indirect cost was 0.5% tailwind. But I guess in earlier quarter, it was 0.8%. So on one side, your savings should rise as we go from one quarter to the other. But when we look at the indirect cost tailwind, it is lower than it was before.

So maybe you can tell us about where shall we expect these savings to fall in your bridge? And you can also comment about phasing of these restructuring savings.

Zeljko Kosanovic - *Signify NV - Chief Financial Officer*

Just to update on the implementation of our cost reduction plan. So it is proceeding and happening as we plan. We are confirming -- so to your question on the phasing of the savings, so we confirm, as we had indicated earlier, that 2/3 of the savings towards the EUR200 million gross savings run rate. So 2/3 will be captured in 2024 with an acceleration that we saw in Q3 and that is expected to pursue in Q4, and that will lead to full savings being implemented to 100% in 2025. So we are on track with that dynamic of capture of the savings, which will be reflected in the evolution of our profitability in the fourth quarter.

Operator

Martin Wilkie, Citi.

Martin Wilkie - *Citigroup Inc - Analyst*

It's Martin from Citi. The first question I had was just coming back to pricing. Obviously, you've mentioned negative pricing in certain categories. But to link that back to your inventory comments, when you think forward to 2025, is there an expectation that as those channel inventories normalize, that, that negative pricing eases somewhat? Or how do you think about the pricing trajectory as you go into next year? Is this a level we should continue to expect or something that's more of a blip in the second half?

Eric Rondolat - *Signify NV - Chief Executive Officer, Chairman of the Board of Management*

What we've seen on the pricing -- and for us, we look more at the gross margin, and that's what Zeljko explained. But if we look at the pricing, the pricing is also linked to the cost and the cost of the bill-of-material. What we have seen lately and starting H2 is some pressure on the price of components, so the cost to us. Basically, we've seen price of metal, price of plastic, price of transportation going up. So that has translated to less price erosion than what we would have originally estimated.

So the consequence is you see that the gross margin is very resilient and clearly above 40%. Now moving forward, we think we can still extract cost from the bill-of-material on some commodities, which is giving us a good confidence on the gross margin moving forward. If you look at the pricing, of course, quarter last year to quarter this year, the price is still negative. There's an impact of the negative price. But if we look quarter-to-quarter, which is Q3 to Q2 or Q2 to Q3, there's much less impact of price.

And that's a good thing to see, not only for Q3, but for the upcoming quarters.

Martin Wilkie - *Citigroup Inc - Analyst*

Great. And if I could have a follow-up, just going back to China. And obviously, we've seen many companies having challenges in China over the last few quarters. When you look at your industry, do you think you're in line with the overall market? Or have there been market share shifts?

Or how should we think about that softness in China for you versus the overall market?

Eric Rondolat - *Signify NV - Chief Executive Officer, Chairman of the Board of Management*

Yes, Martin, we communicated very early on in the year on China and probably China has been for us in 2024 the -- a bit of a surprise to see that the market was suffering from so many headwinds. I've communicated on -- why on the professional side, but also on the consumer side. So I went to China myself and I talked to companies that are operating locally. So what happened in our industry is when there's an issue from an economic standpoint -- I mean, lighting can be stopped very quickly. That's linked to how projects normally are unfolding.

So that's why we saw probably, especially on the professional side of the market that we were hit before other industries that are connected to ours. But when you look at what is happening today, I think everybody is saying the same thing. From an industry standpoint, I mean, we're not gaining, we're not losing market share. Now we have in China also a small market share compared to the rest of the world because it's a market which is very fragmented. Now there's maybe one peculiarity in our industry, Martin, is that there are a lot of actors in the lighting industry that are operating out of China.

And as they are also limited in their exports, they turn themselves more to the internal market. So what we saw in China, on top of a difficult volume trend, we saw also a quite, quite competitive environment with price erosion. So maybe that's an element which is a bit more specific to the lighting industry, given the number of players that are enacting in that field in China.

Operator

Marc Hesselink, ING.

Marc Hesselink - *ING Group - Analyst*

I think in the first half of the year, you pointed out that Americas was relatively strong compared to the other regions. Is that still the case in the third quarter and your expectations for the fourth quarter?

Eric Rondolat - *Signify NV - Chief Executive Officer, Chairman of the Board of Management*

Yes, Marc, we have seen Americas being at the level of performance which is higher than Europe and, of course, China. We still expect that to be the case in Q4. I would say that probably market that does better than the Americas today is India for us.

Marc Hesselink - *ING Group - Analyst*

And then the second question is on your adjusted EBITA margin for the fourth quarter. I think you partly addressed it with the cost savings kicking in higher. But I think you still need a quite significant uplift in the margin year-over-year, especially towards the trend that we've seen in the first nine months of the year. So maybe an you just maybe explain the moving parts on top of the cost saving that should drive it in the year-on-year improvement?

Eric Rondolat - *Signify NV - Chief Executive Officer, Chairman of the Board of Management*

You're talking about the adjusted EBITA margin?

Marc Hesselink - *ING Group - Analyst*

Yes, for the fourth quarter. I mean, to get to the low end of the range, I think you need almost a percentage point improvement in the fourth quarter.

Zeljko Kosanovic - *Signify NV - Chief Financial Officer*

Yes. So Marc, so indeed, so we expect effectively to expand in Q4 our adjusted EBITA margin year-over-year, and this will be achieved through four main elements. First, the continued gross margin discipline, driving in the same way we've been able to do for the first nine months, the dynamic of price and cost in balance to ensure the continued robustness of our gross margin. So that's one. Second, and of course, we do see, and as we observed, a certain level of stabilization on the pricing pressure sequentially quarter-over-quarter.

That's what we saw in Q3, and we expect that possibly in Q4. Then at the same time, the carryover and accelerating effects of the savings as a consequence of our restructuring program to come through. And last, the sequential improvement on our top line which, of course, helps on a better dilution of our costs. So that's -- and as we always have, a higher volume in Q4, so all in combination leads to improve our EBITA -- adjusted EBITA margin in the fourth quarter.

Q3 is just as an element to the path. Q3 adjusted EBITA progression was ahead of our plan towards the full year. So we have all the elements which are conducive to maintain the dynamic towards the achievement of the guidance that we have confirmed.

Operator

Tim Ehlers of Kepler Cheuvreux.

Tim Ehlers - *Kepler Cheuvreux SA - Analyst*

The first one would be about the margins in consumer, where you -- what was basically the only division apart from conventional where you saw a margin decline. Could you maybe elaborate a little bit on that drop and how we should view that margin going forward?

Eric Rondolat - *Signify NV - Chief Executive Officer, Chairman of the Board of Management*

Yes, Tim. Yes, situation in conventional is also comparing to a very high base last year, but that 19% is still a very comfortable position. Now when we go to consumer, there are two fundamental elements that are impacting the profitability performance in Q3. So one is the increase of transportation costs. Now, the consumer business is a much more global business.

So we produce a percentage of that business, which is probably higher than the other ones in China. We have seen also the good performance of Klite during the quarter. And so that -- we have seen an immediate increase of our cost of transportation and they're impacting quite substantially the performance in adjusted EBITA versus last year.

The second component is China. Now China is probably between, depending on the quarters, 5% to 7% of our overall business, but it has a much more important impact on our consumer business than on our professional business.

And when we saw the decline of our business in China, of our consumer business in China, it was also at a lower level of profitability than where China was normally performing, and that has also impacted our overall Consumer business. So if you look at the difference between where we were last year and where we are this year, which is about 100 basis points, it is due to these two factors: higher cost of transportation; and the negative drag on the bottom line of China.

Tim Ehlers - *Kepler Cheuvreux SA - Analyst*

Okay. Clear. But do you expect -- well, would recovery be linked to recovery in China then, because I guess the higher transportation cost will be around for a bit at least? So in order to get back to 8.5%, 9% range, a bit -- regardless of the top line development, there would need to be a recovery in China, I assume?

Eric Rondolat - *Signify NV - Chief Executive Officer, Chairman of the Board of Management*

We're doing two things. So first, we're working on our P&L in China to improve it, but we'll need also the volume in China to come back to be able to fully recover at the level of China. Now could there be compensation from the other regions? Potentially, yes. We need also to reflect the cost of transportation in our price, so a few actions are in place in order to try to compensate these drags.

Operator

Daniela Costa, Goldman Sachs.

Daniela Costa - *Goldman Sachs Group Inc - Analyst*

I have two questions as well. The first one, just on -- if you could talk a little bit more about horticulture? I guess, earlier in the year, you had mentioned the orders were improving because the energy prices were lower. Now this is contributing positively to professional. We've seen some energy price increases. How do you see the forward on horticulture and how significant for the coming quarters?

Eric Rondolat - *Signify NV - Chief Executive Officer, Chairman of the Board of Management*

Well, as we said, we were expecting horticulture -- we expected horticulture to be a positive contributor on the side of Professional for Q3. It has been the case, linked to probably two different phenomena. The first one is that we had (inaudible) in Q3 last year. And that we've seen a very strong progression of our horticulture business, also linked to the fact that we have new offers coming on the market, answering to the need of the growers.

So after two years where that industry had gone substantially down, it is clearly rebounding. And we had, the illustration of that, we had clearly the view that it would happen in Q1. We know the dynamic. It's a H2-based business. At this point in time, we still have for the remaining quarter of the year for Q4, a strong backlog, and we need to produce it to invoice it during the quarter, but we see still a strong contribution of that business.

We have also the cannabis part of the business that has been down for many, many years, linked to over production, especially in the US. And we see also that business turning around, which is a very good news, albeit still on a low base. So when I look at the different components that are making our horticulture business at this point in time, we're quite optimistic because we see the market turnaround, and we're also optimistic because we see a clear backlog. So at the end of the day, it is happening pretty much in line with what we had described at that time.

Daniela Costa - *Goldman Sachs Group Inc - Analyst*

Thank you. And then my second question is just more in terms of like balance sheet priorities as you delever and obviously, sort of like observing the shares and how they've done, if your capital allocation priorities have changed in any sense throughout this year? And then what are the priorities now?

Zeljko Kosanovic - *Signify NV - Chief Financial Officer*

So maybe first, looking back at our capital allocation priorities in 2024. So we paid an increasing cash dividend of EUR [1.55] (corrected by company after the call). We will deleverage in the year around EUR440 million debt. So we had EUR1.1 billion of debt reaching maturity in 2024, of which we have replaced only EUR700 million. And the difference is quite important because given the interest rates, the current interest rates, it allows us first to reduce the total interest cost annually.

Second, it also allows to avoid an additional annual cost of around EUR18 million. So that's very substantial. So overall, I think we strongly believe that this was a very good utilization of our cash. Now if we look forward to your question, we will review our priorities, and we will communicate and provide an update on those in January. So of course, we are in good track, and we have successfully refinanced.

Then we will be looking at M&A and all the other ways to return cash to shareholders, including share buybacks, and we will be redefining and updating on the priorities of capital allocation we see in the -- in January.

Operator

Adam Parr, Redburn Atlantic.

Adam Parr - *Redburn Atlantic - Analyst*

Adam Parr from Redburn Atlantic. One for Eric, please. Given you produce quite a lot in China, with the probability of a Trump presidency currently increasing, can you please remind us how the 2017, 2018 tariffs in his last presidency impacted your profitability and what impact you might see if he puts up significant tariffs again?

Eric Rondolat - *Signify NV - Chief Executive Officer, Chairman of the Board of Management*

Yes. So the tariff situation, it's not a new one because when the tariff increased, in the past years, we adapted our production footprint. So basically, we looked at the categories of products that could be sourced closer to the US or in the US and still doing so at a price that would be competitive against the Chinese prices or the price of the goods that would be manufactured in China.

At the end of the day, when we did that exercise at that time, we did it, but it was for a limited part of the portfolio. Then we looked at the second category of products, the one that will also be better produced in Mexico, for instance, but thanks to the tariff. And we moved also some of these products. But we kept part of the production in China because there was no way given the actual level of tariffs to be produced anywhere else at the right level of cost. Now, things may change, and we are preparing ourselves.

We are preparing ourselves in the following fashion. So first of all, we are defining other territories in low-cost countries that could serve as production base. At this point in time, we have two very important markets of Signify where it does make sense to have expanded manufacturing activities because we serve the local market and we can serve also the more global market and the US market. We are targeting India and Indonesia.

While at the same time, we are also looking at specializing some of the plants that we have in Mexico in order to be able to transfer more activities quickly if the tariffs were increasing. We're talking about tariffs for our business, our industry today that are between 20% to 25%. If that goes up to 60%, effectively, it will offer a lot of possibilities to further reduce cost by sourcing closer to the States or in other countries than China.

Look, we're looking at this, at this point in time, we have a plan. We have a plan A, we have a plan B and we have a plan C, depending where the political decisions are going to go. But we are very well positioned and probably much better than we were when the tariff increased the first time. Now from a competitivity standpoint, I think that everybody faces more or less the same situation, because when you look at China, you don't only look at finished goods, but you look also at components.

You can assemble finished goods in many different parts of the world, but getting the components is a bit more complicated because a lot of them are coming from China. So we're looking at all these aspects, components, finished goods, having different geographies and a plan to react. We believe that if tariffs are being announced, we should be able to react within six to nine months. But I guess that will be the case for the industry at large.

Operator

(Inaudible), Bank of America.

Anna Ractliffe - *Bank of America, Analyst*

I was just hoping to get a little bit more detail on the professional weakness in Europe. Were there any segments you were seeing that -- in more office or retail or anything there? And then maybe any commentary on what you're seeing so far in October, would be helpful.

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Eric Rondolat - *Signify NV - Chief Executive Officer, Chairman of the Board of Management*

Yes. An outlook in -- (inaudible) in Europe. So first of all, it is still a detractor to the performance of the overall Professional business. So it's performing at a much lower comparable sales growth than the overall business. But it has improved versus Q2 and Q1 as we had guided in our previous call.

So if you remember, we communicated on a big project that we took in 2023 in H1, supporting Ukraine LEDification. That was a one-off that impacted the base in H1. So not having that high compare in H2 is a first element that is improving the performance in Europe. Now let's look at the different channels we have in Europe. So the trade channel has been still very difficult, not only for us, I think for industries at large in Europe.

And if you look at our markets, we find quite a high level of volatility in Europe because we see a market which is very slow in Eastern Europe and also in the south part of Europe while, at the same time, we are growing double-digits in the Nordics. When we look in more details, because we made an in-depth analysis on the trade channel in Europe, so it's impacting us. We are declining, but we do better than the market.

Then, let's move to projects in the public segment, that we have called on a few times, which is also pretty much linked to the green deal, that is really incentivizing energy-efficient infrastructure. It has been quite slow in Q3, and that's more on the public side of things, linked to the delay of the money to be available.

Because what happens at the level of Europe, first, it's a country split, then it is a project evaluation and assessment to see if it's in line with the overall green deal and then the money is eventually made available. We've seen that process being a bit slow in Q3.

When it goes to more the private sector and office and industry and retail and hospitality, the situation in Europe is a bit particular. We see that the funnel is increasing, meaning that we are getting requests for quotes, but the projects are being delayed in execution. And that's a pattern that we have seen all along the year.

Sometimes it's one part of the business which is impacting more than the others, but that explains the overall slowdown in Europe. For October, we don't make specific comments on the upcoming quarter. I will stay to what I've just told describing the Q3. Now when it comes to our forecast in Q4, we're still quite cautious on Europe, and we don't expect a sudden and quick recovery in 2024.

Operator

Sven Weier, UBS.

Sven Weier - *UBS AG - Analyst*

First of all, you were alluding obviously to higher transport costs, container shipping. I guess part of that higher transport volume is probably also a bit of a pre-buy ahead of the US elections. So I was wondering if you see that maybe some of your clients are pre-buying from you and that has also contributed to the sequential improvement and maybe also in Q4? Or don't you see a pre-buy effect in lighting ahead of the upcoming elections?

That's the first one.

Eric Rondolat - *Signify NV - Chief Executive Officer, Chairman of the Board of Management*

No, we don't see a pre-buy linked to the election. The increase of the transportation cost is linked to the situation in the Middle East in the fact that the routes are getting a bit longer. So that's basically what is creating this. No specific pre-buy.

Sven Weier - *UBS AG - Analyst*

But just saying because I think we've seen evidence in other industries for that. So that's not just this part, but let's see. And then on -- just coming back to the -- that cost savings bridge where obviously, you have the 2/3 in 2024. I mean, how much of that 2/3 is in Q4 specifically? I mean, I guess we can't just add up the indirect savings of the first nine months and deduct it from that. So there's probably other stuff in there. But what is the absolute amount we should bake into the bridge for Q4 specifically?

Zeljko Kosanovic - *Signify NV - Chief Financial Officer*

Look, I think on the cost savings dynamic, I think there is, of course, an acceleration and carryover effect. So what you will see in Q4 is first -- in Q3, we did have a carryover of the first effect coming through in Q2, and then we have an acceleration. So look, we track the cash of the savings on a monthly basis. So I think the full -- the indication that I mentioned of 2/3 is including, of course, the Q4, which would contribute more, obviously, than what we had seen in Q3. But sequentially, we also have -- as this is a higher quarter in volume terms, we also do have additional costs that are coming in combination to the savings coming through, that are linked to the volume increase.

So all in all, I think it's going to be an acceleration, a higher portion in Q4 than Q3 and Q3 being higher than Q2.

Sven Weier - *UBS AG - Analyst*

Now it's fair to say that clearly more than 50% of those savings are in Q4? Or would that overestimate the effect?

Zeljko Kosanovic - *Signify NV - Chief Financial Officer*

It would be less than that because we already have, as I mentioned -- again, if you look at the run rate of September, if I just take the month of September, it's already showing an acceleration. So you do have a carryover effort. So it will be less than what you're indicating for Q4.

Sven Weier - *UBS AG - Analyst*

And if I may chip in another quick one just on Chinese competition, because you talked about Chinese competition in China. What are we observing Chinese competition in Europe? I guess, so far, it's probably more on the consumer side. And how would you expect that to change if tariffs go up further in the US?

Eric Rondolat - *Signify NV - Chief Executive Officer, Chairman of the Board of Management*

That's a good question. Very difficult to answer at this point in time because it's based on a lot of different hypothesis. What we have seen already is when the tariff increased the first time. You had, of course, less exportation of China to the US overall. So we've seen the Chinese actors more focusing on China and potentially Europe.

Now the fact that the market in Europe itself is increasing probably even more the focus of the Chinese actors on the China market. At the end of the day, when you have thousands and thousands of actors in an industry, what we can expect also, and we have a clear sign that is happening, but not at the magnitude that we would like, we see some companies closing doors, and we see some companies not continuing that activity in lighting. When they don't have a very high level of revenue and there's that sort of pressure on the overall top line, we see some of them exiting the market. What is going to happen if the tariff increase?

Look, we'll see. The jury is still out, but we've seen what has happened already with more concentration on China, with more concentration on some parts of Asia and Africa and also partially Europe. But the market that are today, I would say, the easier target in that case for a smaller type of Chinese competitors are probably the emerging markets, so some markets in Asia, some markets in South America and some markets in Africa.

Sven Weier - *UBS AG - Analyst*

I mean, I guess on the professional side, we could also argue that the barriers to entry are much higher, right? So where do you see these competitors on connected, for example? I mean, is there still quite a big difference between you and them? Or how do we see the Professional barriers to entry in general?

Eric Rondolat - *Signify NV - Chief Executive Officer, Chairman of the Board of Management*

Yes. On connected, it's totally different. Our connected business has been performing extremely well on the Professional side. So it's also -- it also has grown, I believe, through the crisis in the past four years quite systematically. It's now quite an important part of the business.

Now when you look at the Professional connected lighting business, there are two fundamental elements that are barrier to entry. So the first one is the fact that we are basically putting different type of technologies together. It's not only about mechanics, it's not only about electronics, it's not only about controls, it's not only about software, it's about all of it.

And you can find small companies assembling an LED fixture, but it's much more complicated for these companies to invest in controls, in communication and software. By the way, when you talk about lighting -- connected lighting architecture, let's take what we do specifically in connected street lights, you have a node and you have a cloud backbone software, which is managing all the streets and all the city lights.

Well, it's very -- it's quite energy -- well, it's quite investment intensive to bring that architecture to life. And whether you're a company selling EUR7 billion or you're a company selling EUR40 million, it's the same cost. So these companies cannot develop these technologies and these architectures because it's too costly. That's one. The second barrier to enter is the go-to-market model.

Selling a product from a catalog, from a distance at a very low price is very different than being present with feet on the ground, talking to CXOs and convince them that they have to buy connected lighting. So I think that -- the fact that there are many technologies involved, the fact that we need to have a high-touch go-to-market model are bringing connected lighting in a totally different situation when it comes to competitors than general lighting not connected.

Operator

Claire Liu, Morgan Stanley.

Claire Liu - *Morgan Stanley Capital Group Inc - Analyst*

Just a follow-up on capital allocation. I guess just thinking about the longer-term growth for Signify also in phase of, I guess, more intense competition in some of the markets right now. Would you consider -- I guess, is acquisition a discussion that you'll be having at the Board or management team, would you consider a potential acquisition, maybe expanding to adjacent markets in other areas of smart home maybe? So I guess, yes, would you consider that? And then, if so, what are the potential areas of interest?

Eric Rondolat - *Signify NV - Chief Executive Officer, Chairman of the Board of Management*

Yes. Of course, these are discussions that we have on a regular basis, especially -- probably two or three times during the year where a bit of a strategic thinking and strategic retreat to know where the company needs to operate in the coming years. So we have, indeed, specifically on the consumer business, decided to expand and go also to what we've called monitoring, which is not only security, but you can have now in the Hue ecosystem or in the WiZ ecosystem, you can have cameras. And basically, we approached it with always having in mind our right to win. So we're using existing ecosystem that I established.

So everything is happening under the same app, and it's basically monitoring for lighting and lighting for monitoring. I give always that example which is quite simple to understand, is if you have an intruder, the cameras will see the intruder and all your lights can go flashing red. At the same time, if you have someone moving in the corridor, the camera will see that person moving in the corridor and the light can be switched to different type of scenarios. So the lights can be an alarm supporting security and the cameras can be a sensor supporting lighting. So that's the reason why we believe that there was a very coherent direction between those two different dimensions.

Now, talking about other type of businesses and trying to go into adjacencies, we always evaluate what is our right to win, whether we can create synergies from a back office standpoint that would be substantial, whether we can create synergies from the front office standpoint that would make sense, understanding that when we do those evaluations, we are very, very cautious on front office synergies because they very often make a lot of sense intellectually, but they're very difficult to execute on the ground.

So at this point in time, the only adjacency that we have gone for in smart home is basically monitoring and cameras. Now if you're asking me the question, would it be interesting for Signify to go in HVAC in home, for instance, look, frankly speaking, we don't see what would be our right to win here. We will have to go through an acquisition of an actor who's already well positioned in that segment. And once we have done that, I am not too sure that we can generate the right level of synergy between air conditioning and heating and lighting.

It's not really obvious to us. So that's basically the strategic thinking that we have when it comes to adjacency. Lighting is what we know how to do. If we need to go into adjacent sectors, we need to have a very comprehensive and a very solid strategic reasoning that would make sense.

Operator

Daniela Costa, Goldman Sachs.

Daniela Costa - *Goldman Sachs Group Inc - Analyst*

Thank you for getting me back for the follow-up. My follow-up is actually on Conventional. I know it's now pretty small, but it is still falling and it looks like even falling faster than before. Can you tell us about sort of like how you think about the end life of Conventional? Back at IPO you wanted to be the last man standing.

Margins have remained very high, but you also had a value for eventually at some point potentially fully closing the business. Like how is your thinking on Conventional now about the longevity of the business?

Eric Rondolat - *Signify NV - Chief Executive Officer, Chairman of the Board of Management*

Look, we don't -- we use another expression now, we said we're last company standing. Just to be clear. But look, conventional, yes it's getting smaller. But this year, as you see with the ban of fluorescent in Europe, with the programmed expanding ban of fluorescent in the States, we have a lot of strategic thinking about that business because at the end, it has been also in 2024 a bit of a surprise because the decline has been quite strong even if we can maintain its performance in terms of profit.

We will see that the negative contribution to the overall profit of the group and the negative contribution of conventional to the overall top line, which is going to be probably around 200 basis points for the full year, has been quite, quite substantial.

And it's true that declining between 15% to 20% is different than declining at 30% in terms of how you're capable or how we are capable to stabilize the whole organization. So at this point in time, when we look at Conventional strategically, probably we have three different pieces. One is general lighting and also electronic, the ballast, and that's a business that is going to decline sharply again in 2025. We've seen it in 2024, and it has been the biggest contributor of the decline of conventional. We know how to manage that decline.

We know how to adapt our manufacturing plants in order to do so. But it's a sharp decline, as you mentioned it. I think we need to bring that business down to a lower level. And I think after a while, it will stay at a much lower level than where we are now, and we need to make that adjustment. Then we have two other businesses, one which is digital projection.

That's a business where we have an extremely high market share worldwide. Basically, it's the replacement of lamps or the implementation of lamps in video projections. Well, on that business, we see that at one stage, that technology will not be any more needed. Maybe it will be replaced with LED, and we will not be on that specific game. So probably in the coming years, that business should stop.

And then the third part is specialty business, and that's a business which is having a much better growth profile than the rest. And we think that, that's a business where there can be a bit of investment for the future and the remaining part in conventional. But we are facing probably in '24 and '25, sharp decline. We know how to manage them, and we have a view for the long-term. Now at the end, when I look at the Conventional business, what I'm -- I see that we should be able to generate much more cash with that business than what it would cost us to restructure.

So we have in our mind, and we'll communicate in due time the full amount that we need to restructure that whole business. And we believe that we can generate in the coming years much more cash than what is needed to restructure.

Operator

Tim Ehlers, Kepler Cheuvreux.

Tim Ehlers - *Kepler Cheuvreux SA - Analyst*

Then just one question to wrap up the whole thing. We've talked a lot about China. Is there a thought in the company to maybe exit the market to not be exposed to this difficult market anymore?

Eric Rondolat - *Signify NV - Chief Executive Officer, Chairman of the Board of Management*

Not at this point in time, Tim. We are very involved historically in China, not only on the commercial part and on the market itself, but also with R&D teams, we're manufacturing. All our business have one part of the manufacturing in China. We're very involved in that market. If I take some distance, Tim, on that specific question, do we believe in the Chinese market in the mid to long-term?

Absolutely. We're just going through a difficult period as many others, but there's no exit plan at this point in time on the cable.

Operator

That was our last question. I will now hand it back to Thelke for closing remarks.

Thelke Gerdes - *Signify NV - Head of Investor Relations*

Ladies and gentlemen, thank you very much for joining our earnings call today. If you have any additional questions, please do not hesitate to contact us. Enjoy the rest of your day. Bye-bye.

Operator

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