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PRESENTATION

Operator

Hello, and welcome to Signify's Second Quarter and Half Year Results 2023. Throughout the call, all participants will be in listen-only mode and afterwards, there will be a question-and-answer session. Please note this is limited to one question plus one follow-up. Today, I am pleased to present Eric Rondolat, Javier van Engelen, Thelke Gerdes. Please go ahead with your meeting.

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

Good morning, everyone, and welcome to Signify's Second Quarter 2023 Earnings Call. With me today are Eric Rondolat, CEO of Signify; and Javier van Engelen, CFO. During this call, Eric will take you through the second quarter highlights, after which Javier will present the company's financial performance. Eric will then come back to discuss the outlook for the remainder of the year.

And after that, we will be happy to take your questions. Our questions and presentation this morning. Both documents are available for download from our Investor Relations website. The transcript of this conference call will be made available as soon as possible. And with that, I will now hand over to Eric.

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

Thank you, Thelke. Good morning, everyone, and thank you for joining us today. So let's start with some highlights of the second quarter 2023 on Slide 4. We continue to face softness in the consumer indoor professional and OEM channels, and the recovery of the Chinese market was slower than we originally anticipated.

On the other hand, the outdoor professional and professional connected lighting businesses saw a positive traction. Gross margin was strong, thanks to price discipline and effective and COGS management. Our fixed cost did not keep pace with the overall volume decline. Our Digital Products division was most exposed to these challenges, while Digital Solutions showed more resilience. Our supply chain lead time reduction in working capital improvement measures supported free cash flow performance.

On the next slide, Slide 5, we see signifies overall Q2 performance. Our installed base of connected light points increased from $170 million in Q1 to $190 million at the end of Q2. LED-based sales were 84% of our total revenues. Nominal sales in Q2 were EUR 1.6 billion, translating into a nominal decline of 10.5% and a comparable sales decline of 8.6%. The adjusted EBITDA margin decreased to 8.3% versus 9.5% in Q2 last year. We continued to improve our gross margin as we benefited from positive pricing as well as effective measures to reduce the cost of goods sold.

As seen in Q1, the top line decline resulted in an under-absorption of fixed costs which mainly impacted our Digital Products division, while the Digital Solutions and Conventional Products divisions, both demonstrated operating margin resilience. Net income came in at EUR 45 million compared to EUR 248 million in Q2 last year. And finally, free cash flow was EUR 88 million, mainly due to a lower cash flow -- cash outflow from working capital helped by improving supplier lead times. As a reminder, Q2 last year included a non-operational gain and cash proceeds from the disposal of real estate assets of EUR 194 million in the net income and EUR 194 million in free cash flow.

Let's now move on to our divisions, starting with Digital Solutions on Slide 6. Nominal sales in Q2 were EUR 974 million with comparable sales showing a decline of 5.7% against a high comparison base of 11.6% in Q2 2022. During the quarter, the outdoor segment and especially the public segment continued to grow, but we faced a more challenging indoor professional business and softness in agriculture lighting as high energy costs continue to put pressure on the yields of our customers. We are pleased with the adjusted EBITDA margin of 10%, an improvement of 50 basis points from last year, which is mainly attributable to gross margin recovery from lower cost of goods sold and continued price discipline.

On the next slide, Slide 7, I would like to discuss a couple of business highlights of our Digital Solutions division. We upgraded the lighting of two scanline series. We installed 3D printed fixtures made of 55% of recycled polycarbonate materials. In addition, the lighter materials resulted in 28% CO2 emission savings during transportation. We also retrofitted all 1,800 light points of the doubling port tunnel with Philips inserted trays. We developed a plug-and-play kit consisting of new gear and LED trays that could be used to retrofit each feature at the site in just five to six minutes.

This was the lowest CO2 footprint solution as the void transportation back and forth to and from the factory and also as we were able to reuse components of the old fixture, including the entire housing. The project was part of the high-risk government's energy efficiency plan and was partially funded by the European Green Deal.

Let's now move on to our next division, Digital Products on Slide 8. In the second quarter, the Digital Products division saw a comparable sales decline of 12.1%. This was mainly driven by continued weakness in the consumer connected segment, the OEM business and top line weakness of our Chinese Klite business. The adjusted EBITDA margin was 6.9%, a decrease of 370 basis points, impacted by lower fixed cost absorption due to the volume reduction.

Next, on Slide 9, I would like to talk to some business highlights of digital products. We launched a new home monitoring technology in WiZ and the home monitoring technology combines lighting and security in an integrated approach as light, sensors, and cameras can be combined to detect motion and prevent and deter intros. The new smart home monitoring with indoor camera is the first of many home monitoring products to come.

We are also planning to expand or home monitoring into (inaudible) this year, and we'll make more announcements after the summer. We have introduced new ultra-efficient A-class LED outdoor lights for both plunging and solar applications. These new lights offer a durable and energy-efficient performance and can generate energy savings of up to 50% versus previous LED light.

Let's move now to Slide 10 and talk to conventional products. Overall, we are pleased with the execution of our last company standing strategy fully offsetting the cost pressure we were facing last year and bring our margins back to the historical levels. The comparable sales decline of 15% this quarter still reflects a strong pricing carryover effect, which will reduce over the course of the next quarters, gradually bring the comparable sales performance to the underlying volume decline. The adjusted EBITDA margin recovered to 20.5%, an improvement of 500 basis points versus Q2 last year as headwinds we saw in 2022 have turned into tailwinds, namely energy, transportation cost, and forex.

Next, I would like to discuss our sustainability performance on Slide 11. We remain on track to reduce emissions across the entire value chain by 40%, driven by our leadership in energy efficiency and connected lighting solutions, which significantly reduced emissions during the use phase.

Circular revenues remained stable at 29% on track to reach our 2025 targets of 32%. The main contribution was from serviceable and upgradable luminaires, including the first serviceable Horticulture product (inaudible).

(inaudible) revenues increased to 28%, also on track to reach our 2025 target of 32%. This was driven by the performance of Cooper's tunable products supporting the consumer well-being portfolio and by the continued strength of our safety and security portfolio. Finally, the percentage of women in industry position continued to improve to 30% on track to reach our 2025 target of 34%. This was mainly due to the acceleration of hiring practices for diversity across all levels.

On Slide 12, I would like to describe our new virtual power purchase agreement contract. So together with Heineken, Nobian, and Philips, we secured a renewable electricity guarantee from the Mutkalampi wind farm in Finland. This 10-year agreement will deliver 330 gigawatts hour of renewable electricity per year to the consortium. This is the equivalent of the electricity required to power 40,000 households and helps to avoid over 230,000 tons of CO2 emissions per year.

The facility helps power our operational electricity usage in Europe, excluding Poland, for which we already have an existing agreement in place. But with this new facility, we now cover nearly all of our operational electricity use in Europe. I would like now to hand over to Javier, who will discuss our financial performance in more detail.

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

Thank you, Eric, and good morning to everyone on the call. Let me dive straight into the key financial highlights on Slide 14, where we are showing the adjusted EBITDA margin bridge for total at Signify. As you can see on the slide, our adjusted EBITDA margin decreased from 9.5% in quarter 2 2022 to 8.3% this year. The combination of volume decline and fixed cost under absorption impacted the adjusted EBITDA margin by a negative 3.4 basis points percentage points.

In line with previous quarters, a large part of this was offset by the combined positive margin impact of mixed pricing and cost of goods savings. More specifically, continued pricing discipline contributed by a positive 1.1 percentage points, while year-on-year cost decreases in raw materials and logistics also contributed with a positive 1 percentage point. Currency effects did not play a big role on adjusted EBITDA margin level. The negative contribution of 20 basis points was mainly related to the depreciation of emerging market currencies, which are fully offset through price increases in their respective markets in order to maintain gross margin.

On Slide 15, I'd like to discuss our working capital performance during the quarter. Compared to the end of June 2022, working capital reduced by EUR 143 million or from 10.5% to 8.9% of sales. Inventories decreased by EUR 347 million as a result of improving supply chain lead times and inventory discipline. Receivables reduced by EUR 189 million due to both our efforts to minimize overdues and due to the lower year-on-year sales level. Payables were $422 million lower, coming down to more normalized levels, while at the same time, we are driving down inventories. As lead times further normalize, we continue to see the potential to further reduce our working capital to historical levels of low to mid-single-digit percentages of sales.

On Slide 16, I would like to briefly summarize our first half 2023 performance. Overall, we saw a comparable sales decline of 8.9%. This on the back of 2 years of strong recovery from COVID. While we continue to see a strong performance and market share gains in outdoor professional lighting, comparable sales growth was impacted by weakness in indoor professional lighting and the consumer and OEM segments. Versus first half 2022, the adjusted EBITDA margin declined by 140 basis points.

While the first half of 2023 benefited from gross margin improvements. This was more than offset by the negative impact of fixed costs under absorption. First half free cash flow was back to positive driven by working capital improvements from lower inventories and improved accounts receivable. At the end of the first half, our net debt-to-EBITDA ratio was 1.9x, slightly above the 1.7x at the end of the first half in 2022. Please note though that the 1.7 multiple last year was positively impacted by the disposal of non-strategic real estate assets in quarter 2 last year. And with this, I'm handing it back to Eric for the outlook and some closing remarks.

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

Thanks, Javier. Let's conclude with the outlook on Slide 18. As stated in our press release this morning, we are continuing to face challenges in some of our end markets. The continued economic softness has led us to apply caution in our outlook for the full year and adjust our adjusted EBITDA margin guidance to 9.5% to 10.5% from previously 10.5% to 11.5%.

At the same time, we are well positioned in terms of free cash flow generation as we started to benefit from improving supply lead times and effective working capital measures. We now expect free cash flow generation to be at the higher end of the 6% to 8% range. We have begun implementing structural measures to adapt our cost structure to the market environment. These measures will enable enhanced performance and a stronger focus on growth opportunities. This concludes our presentations for today. Javier and I and are now happy to answer your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And if you do have a question, please signal by pressing star one on your need. Please ensure that the mute function of your telephone is switched off to allow your signal to reach our equipment. Again, that is star one. The first question today comes from Daniela Costa of Goldman Sachs.

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

Hi, good morning. Thank you for taking my question. Maybe just -- I'll ask two and I'll do them one at a time. Just on the first one, can you comment a bit on pricing. And obviously, COGS seems to be down, but pricing is up as well. What are you seeing in terms of the competitive landscape, given the volume situation, do you expect to maintain positive pricing for the foreseeable future. Maybe you can address that one first.

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

Daniela, I'll take the question on. As we've always talked in the past, if you go back to the whole pricing topic, our focus really has been on managing gross margin as a whole. We've seen in the last couple of quarters that we've been able to bring our pricing or at least to bring pricing to the level that allows us to bring our gross margin back to 39%. Obviously, there has been disproportionate, I would say, on the conventional segment where the impact of the headwinds last year of costs were bigger than in other divisions.

When you now look at the adjusted EBITDA margin bridge, we see that we still have about 110 basis points year-on-year positive impact on top of some cost savings. And I think we are now well positioned from a margin point of view, the recovery where were last year. If you think about what's happening on pricing dynamics in the market from a competitive point of view, we still expect that there will be a little bit of tail being in the next quarter for the pricing that we've taken, again, especially also on the conventional side, we believe pricing levels are probably not reflecting the cost of goods that we've seen in the market.

So at this point in time, from a gross margin, we believe that we are at a good place also at pricing point of view. Now there will probably be some pressure here or there on specific elements if there is a bit of volume to be gained. But at this point in time, we've seen competition still acting, I would say, reasonably in line with the economic reality of some inflation still happening and pricing, therefore, being rather stable.

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

Thank you. And maybe a follow-up for you as well. In terms of inventories and working capital, and you seem to still have quite a bit of room to potentially restock further. Why -- what prevented sort of further unwind during 2Q? And I guess your guidance probably implies you expect that to unwind more strongly in the second half. If you can comment on the dynamics there on the inventory normalization?

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

Yes. Thanks, and I'll take that also. First of all, I think the first half working capital in the first half cash flow signals that we've, I would say, turned the corner from last year where the first half, if you exclude the one time item of real estate that last year was negative this year back to positive, which shows the turnaround of an inventory increase last year to taking inventories down this year, which has been a key focus area.

You're right, Daniela is typically you would know that our second half of the year from a cash flow generation point of view is stronger. You know that in the first half, we still build up inventories for a stronger second half from a sales point of view. By the end of the year, we normally build that inventories as the first half of the next year is obviously slightly lower than the second half of this year. So yes, we expect further release of cash flow in the second half, and therefore, also the guidance where we now got more the upper side of the range.

What basically are the key drivers? Number one, continued reduction of lead times. So we've seen lead times coming down, we have to make sure that we keep on pushing those lead times with the suppliers to make sure these lead times are shortened and that we also, in our own internal systems reflect those, and then the inventory would automatically start adjusting itself. And that's what we expect also in the second half. When we talk to our suppliers these days, we don't only talk about cost savings. We also talk about lead times because we know that has an important impact on the cash flow that we generate.

I would say the second question is going to be the visibility on economic development and volume developed in the second half. So there's still a lot of variability out there. As we've been seeing that the economy was not recovering as fast. Of course, we have been slightly optimistic on our sales. We have to recover on that. So reliability of the forecast for the second half and lead time reductions are the two elements that will then help us to bring our inventories further down to the end of the year. And as such, also help us to deliver the guidance to the upper end of the cash flow guidance.

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

Okay. Maybe I can ask a follow-up there on the point of like reliability on the forecast and just how you're thinking about the forecasting for the second half on volumes. I know you don't have explicit guidance, but you do have a margin guidance. Is that -- so what's the lower and the upper bands based on in terms of growth?

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

Good morning, Daniela. Look, we've been-- at the beginning of the year, cautious on the top line for two reasons. One is the lack of visibility and still the volatility in some markets on the way they respond to macroeconomic events. And the second element is also a very distorted base of comparison. And I would say, you can go back one year, you can go back two year. When you look at Q3, Q3 was reasonably strong last year in terms of growth, but also compared to Q1, Q3 that was very weak because it's at the specific moment where we could not find the components to deliver our customers. So you have a base effect, which is not negligible.

When we look at the end markets, and that's the way we try to think about growth. We expect the Chinese market specifically to show some signs of rebound in [H2], and that's what we have also in our plans, something which we haven't seen so far. It's so we expected to have the first signs in Q1. We expected a better Q2. It has not happened in China. And if you look at the macro indicators, of construction, non-residential and residential construction. I mean, the forecast have been brought down and then negative for the full year in China.

So there's a question mark on China and whether we're going to be also capable to focus on the growing parts of the business and allocate our results where there is a potential growth. So when we see the second half to answer your question, we see probably a negative performance in Q3. And we have a better compare in Q4, but it will also depend on the end market. So we're very cautious on the top line at this point in time, but we probably are more comfortable on the bottom line since the gross margin has been quite strong and resilient as Javier has explained how we had 220 basis points above where we were in the same quarter last year. You will see that the gross margin was also weak in the second half in 2022. So this is where we're also going to make a difference.

Operator

Our next question comes from Akash Gupta of JP Morgan.

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

Hi, good morning everybody. My first question is on the cost saving actions. When I look at your headcount, I say it's down about 3% quarter-on-quarter and more than 6% year-on-year. So if you can talk about when -- have you already started to see benefit of this lower cost? Or is it something that would be more an incrementally a margin driver for the second half? And are there any other cost savings actions as well that you are looking to pull for supporting the margins in the second half? So that's the question number one.

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

Yes, good morning Akash. When we look at the headcount, the way we report it, we need to be mindful of the fact that it's a lot about the headcount we have in the manufacturing plants. And that fluctuates quite strongly with the volume, especially in Mexico, where we don't have the possibility to have temporary workers. So basically, when the volume goes up and down, we need to recruit and then we need to let people go, and this is why those numbers are quite inflated.

Otherwise, if you look at the attrition, our attrition is pretty much in line with the average. Now we have started to take cost measures of different types and of different natures, which are tactical cost measures in order to adapt to the lower top line. And that has happened in many different places in the group. We will start to see some of the benefits of those, I believe, in the second half. But we also think that we need to take structural measures.

In line with what we've done in the past, which is continue to shrink the central part of the organization in order to resource and to allocate resource in the operating part. So that's a movement that we have started many, many years ago. We think that at this point in time in order to go back into the 25% to 29% bracket that we had given for our non-manufacturing cost, and we believe this is where we need to be. We are going to have to put in place some measures that will allow us to go back into that range. So the measures have already been taken. So some of them, they're tactical. Now we're thinking about more structural measures for the future that will potentially impact a little bit '23, but probably mostly 2024.

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

Thank you. And my follow-up is on exchange rates. Clearly, in the second quarter, it was not that major driver. But when we look at the depreciation in Chinese Yuan, how should we think about FX in the bridge in the second half? Thank you.

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

Yes. I'll take that one, Akash. Look, if you look at exchange rates, fundamentally, what you're mentioning is that clear, right? At this point in time, in the first half of the year, the Euro has strengthened against, let's say, mainly the dollar and the RMB. When you look at the FX dynamic, what we clearly see is we see a positive impact as we are short on the Chinese RMB. We see, in general, a positive impact on our total profitability from the weakening of the RMB.

As you know, it's still one of the currencies in our revised hedging policy that we still hedge again. So part of the benefit goes away because of the hedges that we take just automatically going forward, but it is still a positive. That basically is compensated a little bit by being long on some other currencies. And then the only thing which is left for this quarter, which is different than last year or so is some erosion of emerging market currencies.

As we explained also last time is we do have an effect on those kind of emerging. And we're talking about the Egyptian pound. You talk about Pakistan, we talk about Argentina, we talk about the Turkish lira. Those markets are used to devaluation or inflation pricing. So in those markets, we do get a slight negative in terms of exchange rates, but we manage those markets on a gross margin basis. So they're used to price for devaluation of the currency, and that's how we track those.

So net-net, I would say that impact of FX for this quarter is about zero. The slight negative on the bridge is compensated by pricing in those markets with developing currencies. But for the balance of the year, again, I'm not going to speculate on what happens with exchange rate because the best thing I can do is look at today's spot rate. That dynamic, I think, will roughly be the same. We're going to see still at the current rate that the relative weakness of the RMB will still give us some tailwind, but the same dynamic on emerging market currencies.

The one thing that will help us a little bit further in the next quarter is last year, we talked to you about our hedging policy and the revision of the hedging policy. That hedging policy in the second half should give us a little bit of a tailwind as we have unwound some -- all the exchange rate hedges we had. So if anything, we can expect a slight tailwind from exchange rates in the second half of the year, whereas last year, again, it was a significant negative.

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

Thank you.

Operator

Our next question is from Sven Weier of UBS Frankfurt. Go ahead.

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

Yes. Good morning. I have 2 questions. The first one is a follow-up on the margin guidance range. And I was just wondering if the revenue outcome is the only main factor that defines the range of what other main items have you assumed in the range? That's the first one. Thank you.

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

Yes. It's basically the margins, the gross margin and the cost and the top line. So it's the three components. So the way we looked at it, there is still a possibility, we believe to be well positioned in operating margin for the full year, but we need two ingredients. We need the top line to be aware we estimated and we expect it to be. And then we need to be able also to adapt our cost base.

If that happens, I mean, we'll be able to be well positioned into that bracket. But we need to act very quickly on cost whenever the top line goes down. And this is what we have been lagging in doing this year. We always expected the market to be better. And as that has not come, we are a bit late on adjusting the cost compared to what we do normally. Knights in place, the plans are being developed, and this is going to happen.

Now for the end of the year, it will be mostly still tactical, but it will be taking effect in full year in 2024. So the element that we've looked at is the top line and the cost, we believe that the gross margin will remain strong. So it's just an adequation of our cost coverage by the top line.

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

Okay. Thank you. And the second question I had was just on where you see your clients on the stocking, whether you think the destocking is done and whether you see -- or whether you assume in your guidance range, any kind of restocking at some point in the second half? Thank you.

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

Then we have seen in order of magnitude, very strong destocking on the OEM business. Basically, when the crisis of component broke out at the time, we believe that many of our customers, as the products were not available, made a lot of procurement of different type of products in different parts of the world. So they're receiving these products in the first half of 2023, and they end up having a very high level of inventory, and we've seen a major destocking in the OEM channel. So that's one.

On the consumer part of the business, we have seen further destocking lately. We believe that they are at a level where it should normally remain now stable. The biggest part and the biggest part of the decline on the consumer market was more linked to the market for us, not so much to the destocking, although there's been still a little bit of destocking. We haven't seen that on the professional side of the market. There was not so much destocking there.

Now moving forward, destocking is completely linked to the dynamic of the end market. So I think in the end market hold, we should be done with most of the destocking that has already happened. I don't know on the OEM side of the business, it takes a bit longer for our customers to be able to use their available stock. So we may have some more remnants on the OEM channel, but I think on the consumer and the rest of the professional market, it should be done if the end markets remain at the level at which they are now.

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

Clear. Thank you, Eric.

Operator

The next question today comes from Tim Ehlers of Kepler Chevron.

Tim Ehlers - *Kepler Cheuvreux, Research Division - Equity Research Analyst*

Yes, good morning everyone. Thanks for taking my question. So the first one is related to Digital Solutions. Can you maybe add some flavor there, how connected lighting was performing in comparison to the normal lighting solutions.

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

Yes, Tim, what we have seen in the professional business and Digital Solutions. We've seen a pattern that was also a pattern we started to see in 2020 when the crisis broke, which is relatively weaker than the average retail and hospitality segment with less investments by the customers. We've seen a slightly declining but still positive office and industry segments.

Here, the projects are either happening or there is a delay, but the projects are still there and the firm. And where we have seen a relatively important growth, and that, I would say, is not only in the U.S.A. with the IIGA. It's not only in Europe with the Green Deal, but it's also in other countries in the world where we see similar incentives being brought to the market in order to develop energy-efficient solutions and make the country more sustainable.

Lately, we have been launching our green switch in a country like Indonesia. So when we talk about connected lighting, we've seen a good performance in office and industry, but mostly in public infrastructure outdoor type of businesses. In a way, we offer not only the lighting, but we also the controls. And we also offer the software, which is monitoring and controlling the installation.

Tim Ehlers - *Kepler Cheuvreux, Research Division - Equity Research Analyst*

Okay. Clear. Thanks for that. And then a follow-up question to Digital Solutions. You mentioned that Horticulture was somewhat soft still in Q2. Do you expect a recovery there towards the end of this year? Or do you also see or expect some visible impact going forward from horticulture.

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

Yes. Horticulture has a double negative impact to the performance at this point in time because the performance last year was extremely strong. And the performance last year was extremely strong, especially in Q3. And the way this business works is that the decisions are made in the second quarter of the year for the projects that are going to be then implemented in Q3 and Q4.

So we had a high compare in 2022 with a business that was running extremely well. And this year, given the price of energy and still the price of energy in Q1 and Q2, the projects that we normally are able to capture on that business were not implemented by the customers. So we see it's a season that is missed because of the high energy costs, and that will not be recovered in this year.

Of course, with the price of energy going down, our customers now have better return on investments, and we will see that business going back to a different level of normality in 2024. But it's going to be very, very tough in 2023. It has impacted our performance and the performance of Digital Solutions quite substantially in Q2, and we believe that it's going to be pretty much the same in Q3.

Tim Ehlers - *Kepler Cheuvreux, Research Division - Equity Research Analyst*

Okay. Thanks for that. And then one last question regarding the weakness in the consumer segment. Can you pin that to geographies. So you mentioned -- I remember in Q1 that you were not that happy with the development in China from the consumer business. Is that still the case? Or is that a trend you see in other geographies as well? Maybe if you could add some light there, that would be great.

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

Yes, Tim. Let me look at it geographically and from a business standpoint. So what we see today -- so we take a proxy -- we have two proxies, which is one is the residential construction market, which is down in forecast for the full year in U.S., China, and Europe and forecasted to be negative in those three regions for the full year.

We look also at another indicator, which is the home equipment investments, and this is down, and this is also a good proxy for us for our products. So at the end of the day, we have these macro elements that tell us that the market is not recovering in dynamic for what is linked to our lighting industry and to what we said.

Now if I go back to your question, and I give it a different spin and I talk to the businesses. What we have seen, we have seen that our business and our connected consumer business, here, we have two brands, Philips Hue and WiZ, that business was very, very impacted. And probably more so than the non-connected part of the business and more (inaudible) which is operating from a lower base, still had a decent level of performance, but not on the Hue side.

And we're looking at this point in time. So at the market, we're looking at what's happening at the level of our competitors to see how we need to position that offer, positioning it, bringing value and highlighting the value that, that business has in terms of its uniqueness in that ecosystem, but also bringing to our consumer connected market, what we call home monitoring. And this is the association of security and lighting, which has already been launched on the WeZ side and which will be announced at the end of the -- or after the summer in our Hue offer.

And here, the idea is also to be able to use security for lighting and lighting for security. It's not security for security, meaning that you can imagine that you have your home and there's an intruder then all your lots are going to turn flashing red. Why is that interesting? Because sound alarms cannot be heard from a distance as they really kept inside the house, but the light can be seen from a long distance. At the same time, the cameras and the security can be used for lighting because cameras in the home can detect movements and can then activate light sense.

At the same time, that's an innovation that we bring to the market. Our cameras are going to be the first one to be end-to-end encrypted for both iOS and Android. So the market and the consumer market has been slow and even more so on the connected part of our offers, and that's valid worldwide.

Tim Ehlers - *Kepler Cheuvreux, Research Division - Equity Research Analyst*

Okay. Clear. Thanks for that Eric.

Operator

Our next question comes from Martin Wilkie of Citi.

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

Yes. Thank you. Just a couple of questions for me. The first one is on Klite. You've called it out as being part of the weakness in digital products. And just to understand if that's the same reason as China a bit weaker than expected. But I know also Klite sells globally through private label and so forth. Just to understand a little bit more about what drove that Klite weakness?

And then second question was just to understand, you obviously got this new brand you've talked about within Connected Lighting. How does that fit with the Hue products? I look to kind of what you sell from the outside, it looks like there is an overlap, just to understand how you're positioning those two sets of products. Thank you.

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

Good morning, Martin. Klite is pretty much the same story on the consumer market, selling also to other customers. A big part of what we do in Klite is to sell to other lighting companies or to brand labels for retailers. So we've seen the same softness as what we see on our part of the business, on the part of the business of big retailers that are brand labeling or other lighting manufacturers.

The positioning of WiZ and here is the following. So Hue is operating with ZigBee and Bluetooth communication protocols. But we believe, and this is why we did the move at the time there is another market, which is based on Wi-Fi and Bluetooth. And that market of Wi-Fi and Bluetooth, and there are some markets in the world, especially in Asia that are very, very Wi-Fi-oriented was not captured by Hue.

So we positioned WiZ which is basically having a different communication, a protocol, Wi-Fi and ZigBee in order to capture that market. It's like you have cars and they have different type of engines. It's a bit the same case here. We have two offers. Those offers go to the same market of destination, but they have two different communication engines. And we see that, that complementarity is necessary because when we're operating in a market where both Wi-Fi and ZigBee are accessible to the market and are wanted by the market, then with two offers, we can segment much better our approach. And so far, Hue had been growing, and WiZ have been growing handsomely, which is not the case this year, given the market conditions, but that combination for us works pretty well.

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

Thank you.

Operator

Our next question is from Joseph Zhou of Redburn.

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

Hi. Thank you. And my first question is related to your other line in the report. And it has gone up quite a lot this quarter. I think normally, the run rate is something like 19 million a quarter, but this quarter it's 29 million. And can you give us some color as to why that line has gone up? And what do you expect for the full year and going forward? Thank you.

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

Good morning, Joseph, I'll take that question. Just to take a step back, the other, when we look at the segment reporting, we try as much as possible to put all the costs back to divisions to get a real sense of profitability of divisions, and we try to minimize keeping costs in others. So what we keep in other, as you remember, is some central costs that we do not allocate whether that is some central functions or (inaudible).

And typically, you're right, that cost is between, I would say, EUR 20 million, EUR 25 million a quarter that we have. In the first half of the year, what we see with is the other thing that stays in that bucket is some adjustments on accruals taken the previous year. So if we take a provision for commissions or provisions for rebates or provision on variable compensation at the end of 2022 at the beginning of 2023, if there's any variation on the actual payments versus what was calculated, that stays in other because we don't allocate that back to the divisions.

Now when you look at the difference last year versus this year, what you see last year that some of provisions that we made at the end of 2021 ended up with a slide release of provisions at the start of 2022. This year, when we take the same exercise, we had to add. So the provisions were slightly lower than what the actuals came in.

And that explains the swing of about EUR 10 million year-on-year. We had a release of about EUR 3 million last year, EUR 7 million kind of incremental cost this year. So that explains the swing. From a forward-looking point of view, as you correctly say, we expect this kind of to be normalized at about $20 million to $25 million per quarter, which would be the run rate that we have. But so the swing year-on-year is just because of the closing out of provisions of the previous year.

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

Thank you. That's very clear. And then also in your release, you have mentioned you have begun to implement some structural measures. And can you maybe talk a little bit about what today's actions are? And also whether the labor inflation has been a big challenge for you.

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

Yes, good morning Joseph. The labor inflation was is something that we had to do in view of the inflation. So we did it. It was totally integrated in the plan. When it comes to structural measures, I've already answered to the question, we will -- whenever we can talk about it in more detail, we will do so. But you need to remember probably two things that are fundamentally important in the way we manage our cost.

First, we manage our cost as a percentage of sales, and we need to be between 25% to 29%. That's one. Second, our philosophy when it comes to our cost structure is to have a lighter central part of the organization to be able to allocate costs in the operating part. I think these are the two fundamental things that we are systematically following when it comes to the cost reduction aspects and that's what we're going to have to do now to adjust our cost to sales.

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

Okay. Thank you.

Operator

Our next question comes from Mark Hesselink of ING.

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

Yes. Thank you. First question is actually trying to look at your medium-term guidance of the adjusted EBITDA margin between less than 13%. Is it still the goal to get back to into that range, taking all the cost measures that you take? And do you need to go back to growth to get to that level again?

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

Yes. Good morning, Mark. So the -- yes, the midterm guidance was for the end of the year. So we had to correct it, as you've seen in the past quarters. Now for us, it's just a matter of realigning the organization to a different level of reality. So we have not given a mid-term guidance at this point in time. I think we'll probably have a Capital Market Day sometimes in the coming quarters where we will give an indication of what is the potential of the company moving forward.

But certainly that the potential that we have is higher than the guidance we have given for this year for all the reasons that we have explained but moving forward, readjusting the company to the reality of what we have in front of us allocating resources where we have growth potential. We have a lot of horizon three businesses, namely LiFi, bright side for the extension of 5G networks where we see a lot of potential moving forward. So if the underlying question is, is there a better potential performance than the one that we're guiding for this year, yes, for sure. In the midterm, we should be able to continue to expand and create value on the bottom line.

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

Okay. And my second question is what are you seeing on market share and maybe taking into account with the current inflationary environment, do you see clients down trading?

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

No. Well, when we look at the market share, it's complicated because of all the different swings that we have seen in the [compare]. What we would say at this point in time is that when we look at the details of the segments, we operate in, there can be slight differences, but we would see it in the following way. We believe that in Europe and especially on the professional side of the market, we are gaining share in a complicated environment. We think that in the U.S., especially because the market has moved a lot towards the stock and flow part of the business, we have slightly lost market share.

When it comes to China, it's a bit more complicated because the strength there has been quite substantial. But I would say that we are stable to slightly losing. And in order to do that, we look at the company that are listed, and we look at their performance in 2019, and we compare in absolute terms, and we compare the performance 2019 to their performance in 2022 or in the beginning of 2023, and we compare it to ours. I mean, that's the best way to do it.

In the OEM business, we believe that we have also worldwide taken market share when we look at the other companies that we can compare with and that are listed because that's the only way to get a reasonable and accurate numbers. Now I could go into more details because behind these global views, we're going to see that in the professional market, in general, we are gaining share on the public part and the infrastructure investments. We are slightly losing share on office and industry, and we are stable on retail and hospitality. So when we go into more details, there are different type of colors that we can give. But that's the way we look at competition and market share, taking a base which is stable and looking at where we are today and where competitors are today compared to the base.

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

Very clear. Maybe just a fall follow-up. On the consumer side, do you see any down trading there?

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

No, not massively at this point in time. What we see happening is on the connected part of the market, we see some offers that come at a lower price, but that's not specifically circumstantially linked to the situation that we see today that has been happening for many, many years when the market is attractive and developing all sorts of actors coming, but no specific and massive downtrading there.

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

Okay. Thank you.

Operator

Our next question comes from Jack Healy of Bank of America.

Unidentified Analyst

Hi. Thanks. Good morning. Thanks for taking my question. Just wanted to expand actually on the previous one to push you a little bit on the down trading. So consumers switching from higher-value, higher-margin products to lower value products potentially. So you mentioned already the connected lighting and consumer softened, but LED lamps grew. Is that an example of consumers trading down? And then is there any difference in terms of region? Do you see any difference in North America versus Europe, for example? Thanks.

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

Yes. So let me go maybe deeper on that one. So what we have seen during the crisis is that consumers were basically -- and let me be a bit simplistic, that were keeping their jobs, so they were making savings. Part of these savings were going to equipment, home equipment, and we benefited a lot from that trend and especially on the connected part of the business.

So if you look at the connected part of the business, it had a fabulous performance over a few years. So we're starting from a very high point. Now when we look at consumers today, consumers today are putting less of their money in home equipment goods. They are probably spending more money in traveling in holidays, which they could not do for two years in a row. When that specific situation is happening and you include on its inflation, there's a little bit of down trading on the connected part of the market that we see customers going for lower cost offers and less to premium brand offers. So this is why we need to reinforce the position of our offer.

We think that for the longer term, the ecosystem that we offer is very strong. We just need to make sure that when customers make their choices, they know it and they don't compare a connected bulb to a connected . So there's probably, at this point in time, a little bit of down trading, when consumers would go less for higher-value product and more for lower-value products. But we believe it's just something which is happening at this point in time, and it's not a longer-term trend.

Unidentified Analyst

Okay. And any difference between North America and Europe and that?

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

I would say the markets where we've been very, very strong in connected lighting. The U.S., we can take Benelux, we can take Dart, we can take the Nordics. We see that pattern pretty much in all those markets where our market share is very strong.

Unidentified Analyst

Okay. Thank you. very clear.

Operator

And that is all the time we have for questions today. I would therefore like to hand the call over to Thelke Gerdes for any additional or closing remarks.

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

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

Operator

That does indeed conclude the signified Second Quarter and Half Year Results 2023 Conference Call. We thank you all for your participation, and you may now disconnect.
