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Schneider Electric SE (SU.FR)
Q3 2020 Sales and Revenue Call
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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to Schneider Electric Third Quarter Results with Hilary Maxson, Chief Financial Officer; and Amit Bhalla, Head of Investor Relations. At this time, all participants are in a listen-only mode until the question-and-answer session of today's conference. [Operator Instructions] I would like to inform our parties that today's conference is being recorded. If you have any objections, you may disconnect at this time.

I'd like to turn the call over to Amit Bhalla.

Amit Bhalla  
Vice President- Financial Communication & Investor Relations, Schneider Electric SE

Thank you very much, operator. Hello to everyone and welcome to our Q3 revenue results. I'm very happy to be here with you today, joined by our CFO, Hilary Maxson, who will be taking all of you through our business highlights and our financial results. We will make sure to keep time for some questions at the end of the presentation. You can follow the presentation on the webcast, but otherwise, it's available on our website in case you are dialing in just through the phone.

With the usual disclaimer on slide 2, which I must point you to words, I would like to get started. And I'd like to hand over the floor to Hilary.

Hilary Maxson  
Executive Vice President and Chief Financial Officer, Schneider Electric

Thanks, Amit. Good morning and good afternoon, everyone. Great to be here with you today to comment on our Q3 revenue numbers which showed a strong rebound, another demonstration, I think, of the resilience we spoke to on the H1 as we go through the uncertainties of this ongoing crisis.
Starting with slide number 5, I'll start with some highlights on the top line for the third quarter. First, I'm glad to report that Q3 sales shifted to positive year-over-year organic growth of plus 1.3%. Both businesses showed sequential improvement versus a tough Q2 which we believe represented the trough in our sales, Q2 earning, as a consequence of the coronavirus lockdowns we witnessed. You'll also see, there's a divergence in performance in the quarter with energy management shifting to year-over-year growth, while industrial automation is still in negative territory.

In terms of geography and you're aware we have a strong balance across our geographical footprint, North America, Asia Pacific, and rest of world, all shifted to year-over-year growth for the quarter with only Western Europe still negative. We're happy to see this broad-based sequential recovery and I'll speak through some of the factors behind that as well as our expectations for the future throughout the presentation. And while the current environment is still uncertain and only getting more uncertain in the past weeks, we're upgrading our 2020 target and I'll follow up on that at the end of my presentation.

Turning to the next slide, let's now go into more detail and I'd like to start with our strategic growth pillars. As we've mentioned consistently, our execution priorities are more products, more software and services, and better systems. First, on products, we continue to leverage our unrivaled partner network, our innovation, and our multi-local set-up to drive mid-single digit growth.

In Software & Services, we continue to grow services, field services and digital services, with positive performance in both energy management and industrial automation. Internally-developed software was also positive for the quarter while AVEVA was down with its performance impacted by the early renewal of a large contract in 2019 and some deal slippage. In its trading update issued on October 12, AVEVA reiterated its full year outlook.

Strong growth also continued in assets under management, an important metric we follow to track the potential for increased digitization and future possibilities within our installed base. In systems, our focus remains on profitable projects and management of our margins from pipeline to execution. The mid to late cycle portion of our systems business particularly in Industrial Automation continues to be impacted negatively largely driven by oil and gas, further exacerbated by impacts from coronavirus. We continue to develop our pipeline for systems in BMS, data center and infrastructure.

Turning to slide 7, and as we've mentioned a few times previously, one point becoming more and more apparent from the coronavirus crisis is that it's been an accelerator of digitization. Effectively all of the customers that we speak to nowadays have digital agenda as part of their top priorities. We also see an increasing number of customers focused on sustainability where digital plays a key role. We have around 50% of our business within the flywheel of digital and services that we shared with you in July.

Customers can enter this circle at any point, and then we and they have the opportunity to move across the wheel, from picking and choosing a few connected products to a full plug and play solution to drive their sustainability, efficiency and resilience. This also leads to a more sticky and ongoing relationship with our customers across the full lifecycle.

Turning now to the right-hand of the slide, we continue to shift more and more of our world-class product portfolio to digital. It's no surprise that many of our new offers come with a menu of connectivity options, and our R&D focus is geared more and more towards digitization.
To give you some examples of our recent launches combining innovation with digital, I'll start with PrismaSeT, our new generation of LV switchboards featuring native connectivity to the cloud for enhanced simplicity, power availability and fire prevention. And our new generation of compact circuit breakers also with native connectivity and in the same footprint of our previous models to simplify retrofitting.

We spoke in the H1 and at our recent innovation summit about the significant innovations in SF6-Free or our gas-free medium voltage offer. But I think it's worth mentioning again as it well represents our focus on innovation for sustainability and digitization. The SM AirSET switchgear is a key innovation to one of our most popular classic product ranges. It uses air now for vacuum interruption instead of SF6 gas and comes with a number of digital connectivity options. I'll just mention that those products are all coming from energy management where I was recently CFO, so super excited to see those launching in the market.

And lastly in industrial automation, our EcoStruxure automation expert is another great addition to our EcoStruxure software portfolio. It creates a digital twin for automation that allows for a simpler and more efficient experience in designing, operating and modifying installations. Through this offer, customers can realize between three to five times reduction of their engineering time.

Turning to slide 8, and before I turn specifically to our Q3 financial performance, I'd like to speak on some near-term trends and longer term opportunities in our end markets. We already shared during our H1 call that around 80% of our end markets are positioned either neutrally or more positive in the aftermath of the coronavirus crisis. There are some segments remain challenged.

Starting with building, around a third of this end market for us is residential where we continue to see accelerating positive trends across most of the world. This strength is both across new build and renovation and home improvement helped by increased consumer spending and working from home trends.

We've also seen good recovery in commercial and industrial building activity over the past months and accelerated interest in healthier and smarter buildings. However, we do think the outlook on new CapEx for office building is still uncertain for the near term. Longer term, buildings represent a significant portion of the world's energy usage and carbon emissions. And it's only through innovative and efficient newbuild, renovation, and digitization that we expect this can change. Government stimulus particularly in the EU is focused on building upgrades to support sustainability and modernization.

In the data center market, demand continues to remain strong helped by increased trends and working from home, further digitization, and IoT. I think about data center in two different buckets. The first is hyperscale, which is around 25% of our data center business, and then we have the business of smaller enterprise data center and [ph] colos 00:09:39. Those categories are, of course, driven by the key trends both short and long term mentioned on the slide.

One point I'll particularly note is that 50% of IoT processing is now expected to be at the edge by 2024. And we start to see more and more signs of demand in smaller data centers and the edge as latency becomes noticeably more important. And there's also more concern about local resiliency and data security. And we're well positioned to benefit from that trend in edge computing.

In infrastructure, noticeable near-term trends for us are in electric utilities through smart grid and a renewed focus on transforming toward a more sustainable world. Wastewater and mobility markets remain impacted by coronavirus.
Longer term, we see significant growth in electricity as a percentage of the energy mix, driven by sustainability, which of course is also driving step changes in renewables and EV infrastructure. And of course, infrastructure needs in the emerging markets are also a big catalyst.

In industry, where we've now shifted oil and gas from where it was in infrastructure prior, we continue to see a challenge with mid- to late-cycle CapEx being negatively impacted by coronavirus and oil prices. However, this is an area where we see demand for digitization to drive efficiency, sustainability, and resilience. Longer term, shorter supply chains to drive sustainability and support resilience, as well as an expectation of four times efficiency in automation are key drivers.

I'll turn now to our detailed top line performance for the third quarter. I'm on slide 10 now. In Q3, revenues were €6.5 billion, up one 1.3% organic. Asia Pacific led the overall recovery with North America and Rest of World also slightly positive.

Western Europe was still down at minus 88% with differing performance by countries. I'll get some specific commentary on organic Q3 performance in the following slides. Scope and tax were slightly positive due to the consolidations of our recent acquisitions with Software, L&T, and ProLeiT, mostly offset by disposals of Converse and the deconsolidation of a medium voltage business in Russia as previously disclosed.

FX impact was negative around €300 million in Q3 and full year impact is now estimated at minus €600 million to minus €700 million on the top line and around minus 40 basis points on adjusted EBITDA assuming current rates for the rest of the year. This impact is largely due to the strengthening of the euro against a majority of currencies.

If we turn to slide 11, let's now look at our business -- our results by business starting with Energy Management. Revenues in Energy Management were at €5 billion, an increase of 2.5% organic. Scope impacts were limited to L&T and RIB contributions offsetting the disposals. Positive pricing actions contributed to this growth and we expect to have net positive price for the group for full year 2020.

Q3 results were also impacted by distributor restocking after Q2 particularly toward the end of the quarter. Excluding these factors, the underlying rebound from Q2 was primarily due to positive trends in residential construction and renovation and from activity restarting in commercial and industrial buildings across many sectors following lockdowns in Q2. As expected, healthcare, life sciences, and datacenter demand And data center demand remain positive, although data centers sales are still impacted by a high base in 2019.

On slide number 12, turning now to geographies. We saw positive sales in all geographies for Energy Management in Q3. Highlights were China and India, both with double-digit growth for the quarter and the US. There's a lot of detail on this slide that I'm actually going to speak through in the following slide showing key countries.

So, slide number 13. As I said, all regions were positive for Energy Management with many countries turning positive as well. North America was up 2% for the quarter driven by the U. where we saw demand for residential offers accelerating further and a primarily broad-based recovery across all of our end markets. Nonresidential showed an encouraging restart and we saw some sequential improvement in services.

Canada also showed a rebound to positive growth in the quarter, while Mexico remains slightly down. We continue to recover in North America from the supply chain issues mentioned at the H1. Western Europe had growth of plus 1% for the quarter and similar to the Q2 varied by country. Countries less impacted by coronavirus
in Q2 like Germany and Nordics were positive in Q3, whereas the more impacted countries like France, Italy, and Spain rebounded, but are not yet positive – in positive year-over-year territory.

In general, we saw similar trends with the US with recovery in residential and a pickup in demand for data center. We do see a renewed acceleration of coronavirus cases in Europe in recent weeks, but it's a bit too early to quantify the possible impact.

Asia Pacific was up 5% driven by double-digit growth in China and India. In China, we continued to see broad-based recovery across all end markets, notably real estate, infrastructure, transportation and industry. And India witnessed a significant rebound after the Q2 lockdowns. Australia remained flat while Japan and most of Southeast Asia is still depressed with lockdowns and impacts from coronavirus. Rest of world was up 1% driven by Russia and South America particularly Brazil. Middle East was negative due to project delays in the Gulf, partly offset by good performance in Turkey.

Turning now to slide 15. Industrial automation is a mixed story with strong performance in discrete offers and services contrasted with negative performance in process and hybrid. Industrial automation results were further impacted by the quarterly results at AVEVA that I discussed prior. Overall sales for industrial automation were at €1.5 billion, down 2.5% for the quarter. Scope was positively impacted by ProLeiT and a smaller portion of L&T that we booked in industrial automation. With regards to specific segments, mining was positive, wastewater and consumer packaged goods showed good resilience while oil and gas was negative.

On the next slide – sorry, now, slide 15. In terms of geographies, performance in industrial automation was also varied but with across the board sequential improvement versus the Q2 of this year. Highlights continued to be China and CIS. And again I'll cover the detail in this slide while speaking through the performance of our key countries. So, moving to the next slide, page 16. In terms of country performance, I'll start with Asia Pacific, where the plus 6% growth was driven by strong performance in China, where we saw growth of over 20% for the quarter, supported by domestic manufacturing and materials handling equipment. India had a noticeable recovery versus Q2, but it's not yet in positive territory.

In Western Europe, down 10%, all countries remain negative, but with relative strengths in France, Spain and the UK, driven primarily by the OEM business. In North America, down 7%, the US was relatively stronger, with low-single-digit declines driven by strength in the discrete and OEM markets, as well as software, partly offset by weakness in process markets due to oil price.

In Canada, we started to see some recovery in mining. In Rest of World, the quarter was close to flat, driven by strong performance in Russia, with the recovery there in the industrial markets and in South America, mainly in consumer packaged goods and mining.

I'll now turn away from the Q3 financial performance and give a few additional updates prior to commenting on our full year outlook. Starting with capital allocation. As you know, it's been a busy Q3 for us. We've listed four key acquisitions here, with the three on the left, RIB, ProLeiT and L&T all closing in Q3. All three are now part of our consolidated accounts.

And we signed through AVEVA the $5 billion acquisition of OSIsoft. Although these are all recent, we wanted to give you a quick update. We closed RIB software, our cloud-based construction management platform in July. Since closing, the company has announced a number of major contracts including one with the German Federation Autobahn. We've also now put
together a robust revenue framework by geography and segment to ensure we maximize opportunities from the beginning.

RIB is a key piece of the digital flywheel for energy management and another brick in our ambition to providing the complete digital lifecycle, so from design to build to operate for building. ProLeiT was a smaller bolt-on acquisition in industrial automation focused on food and beverage. Demand levels remain good in Q3, and the integration is proceeding as per plan. L&T, it was a bit long and coming as expected from a regulatory standpoint but with some added time due to coronavirus lockdown's, we spent that extra time preparing for integration particularly in this tough environment, and we feel we have a strong plan, and we’re able to hit the ground running.

Demand trends were good in Q3 particularly in residential and agricultural markets, and we reflected the final cash component of the transaction of €950 million here. With L&T closed, we now expect India to be our third largest market.

And lastly, on OSIsoft, we still expect the deal to close at or around the end of this year. We believe these acquisitions are a cornerstone of our strategy in the future and a key priority for us is successfully integrating this to realize the benefits for our customers and investors.

So, what does that mean for our strategy on capital allocation going forward? The top priorities for us remain maintaining a strong investment grade credit rating and meeting our commitments to investors on dividends. Both of these priorities are based on our strong cash flow generation.

We also remain focused on our disposals program announced in 2018 and expect to have further updates on that in 2021 and to finalize the program by 2022. In terms of acquisition, as I said, we’re primarily focused on the integration of our current acquisitions with only one or two smaller strategic bolt-ons as a possibility in the near-term pipeline.

Turning to the next slide, slide 18, we thought it would make sense to give an update on our Tomorrow Rising Fund. As you recall, we decided at the beginning of the crisis to create this fund supported by employee and company funding as well as time and resources with three goals. The first was to respond to the crisis by ensuring those most impacted had access to food, housing, health care, and education. The second was to restart education in countries to support recovery. And the third was to allow our employees to volunteer in various activities. As you can see, we’ve reached well over 1 million beneficiaries. As a group, we’re committed to our social responsibilities and we’ve used our country organization set up to localize specific plans for Tomorrow Rising for the highest impact for the respective geographies.

Turning now to slide 19. I’ve already mentioned the clear acceleration of digital as an impact of the coronavirus and sustainability has also been reinforced on the agenda of companies. Sustainability at Schneider is, of course, at the heart of what we deliver for our customers and also for ourselves. Despite the environment, we continue to progress against the main key performance indicators of the Schneider Sustainability Index. At the end of Q3, we’ve reached 8.6 out of 10 and we expect we can meet our target of 9 out of 10 for the full year.

In terms of customers, I’m showing here a great example of how we support customer sustainability needs. We recently signed a contract with Henkel to address 100% of the electricity demand of their US operation comprised more than 30 sites, and to support them in becoming climate positive by 2040. I’ll also mention that we’ll be having a specific ESG Investor Day event on November 16 to discuss our sustainability strategy further.
Lastly and before shifting to our thoughts on year-end, we continue to be recognized for our distinctive story and culture. Just to pick a few points from Q3, we were recognized by Climate Group’s RE 100 as the First Clean Energy Trailblazer as well as by Gartner as number one supply chain in Europe. In our Lexington Smart Factory in the US earned Fourth Industrial Revolution Advanced Lighthouse Design by World Economic Forum. Lexington is the third smart factory designated as advanced lighthouse and the first end-to-end lighthouse.

I’ll turn now to our views on 2020. First, I’ll preface by saying, we remain in a time of uncertainty from a macroeconomic standpoint whether through governments again imposing lockdowns in some of our key geographies or through some of the upcoming key milestones like the US election and Brexit. However, we do continue to see Q2 as the trough in our sales with this and based on the momentum we see in Q3 results, we’re upgrading our 2020 guidance. For full year, we see our revenues between minus 5% and minus 7%, organic. We’ve kept the range wider than usual to reflect the uncertainties that I’ve just mentioned. And for adjusted EBITDA, we now expect to be between minus 20 basis points and plus 10 basis points organic for the year, another reflection of our resilient performance. And with that, I’ll turn back over to you, Amit, for the Q&A.

Amit Bhalla  
Vice President-Financial Communication & Investor Relations, Schneider Electric SE

Thank you very much, Hilary. And we have exactly about 30 minutes left, so I think that’s probably should be sufficient time to take questions. I’m sure there’s a long list of people wanting to ask questions. So, just in respect of the others, let’s stick to one question for analysts so that we can maximize the number we can take within 30 minutes. So, with that, operator, can we please have the first question?

QUESTION AND ANSWER SECTION

Operator: Our first question over the phone comes from Alasdair Leslie from Société Générale. You may ask your question.

Alasdair Leslie  
Analyst, Société Générale SA (UK)

Oh, yeah, hi. Good morning. I was wondering if you could elaborate a little bit on the comments you’ve made in the statement with regards to price increases supporting organic growth for Energy Management. No sure you can kind of quantify those, but really whether that was broad based or focused on one or two markets and does it reflect kind of proactive moves perhaps ahead of a rebound in input prices similar kind of price cost dynamic or is there something more strategic and value orientated. So, just some context there. Thank you.

Hilary Maxson  
Executive Vice President and Chief Financial Officer, Schneider Electric

Sure. So, I made the comments in terms of Energy Management and I also had suggested – I also said that – sorry I combined them there. But for the full group we also remain to – expect to be positive for the year end.

So, in regards to price increase, we spoke on the H1 about additional costs in Coronavirus. We’ve pointed to around €50 million, for example, additional costs in direct costs only in the H1 and that we were focused on pricing to ensure that we were – or really as an opportunity to cover those costs for this year. So we continue with that with some acceleration of the price increase really broad based in the Q3. To give you a sense of the number there, it’s more than 1 point in terms of price.
On the second half of your question, certainly we see the moves in raw material prices. So, in this year we’re focused on pricing, you know, continue to focus on pricing both for coronavirus efforts as well as strategic pricing, which we continue to talk about associated with innovation. We see the moves in raw materials and we’re preparing the teams for – and I think we’ve proven to be pretty agile around pricing in order to continue to deliver net positive pricing over the cycle.

Great. Thank you.

Let’s move to the next question, please.

Operator: Our next question comes from Andreas Willi from JPMorgan. Your line is open. You may ask your questions.

Andreas Willi
Analyst, JPMorgan

Good morning, Hilary. Good morning, Amit. My question is about the Q4 implied guidance on organic growth, which implies obviously a slowdown versus Q3.

implies the slowdown versus Q3, you mentioned the restock and some pent-up demand benefiting Q3 and maybe if you could elaborate a little bit more on that range for Q4, maybe what you see in terms of early trends in October, and how long do you believe that pent-up demand and restock will benefit? Has that already completed now until Q4 is more of an underlying run rate versus what we have seen in Q3? Many thanks.

Sure. So, certainly, you can see that the implied Q4 growth rate is a pretty wide range in the guidance, and I think I spoke to that a little bit at the end. We do see rising uncertainties, macroeconomic uncertainties, the potential for increased lockdowns in particular. But no doubt like I said we expect Q2 to be the trough in our sales across the – across the coronavirus crisis.

So, what I would say here is that restocking for us, we would put it in the range of probably a couple of points for the Q3, but we now believe broadly speaking, of course, there’s always going to be some pluses and minuses. But broadly speaking worldwide, we think that our distributors have normalized, their inventory levels at the end of Q3. The range at the end of Q4 like I spoke too is we see and I spoke to them I think in the call some underlying good, good trends of rebound. You can see in the range that quite a bit of the range is still around Q4 that would indicate sequential growth between Q3 and Q4. And Between Q3 and Q4. And again, we do recognize some uncertainties as well.
Any comment on early October?

**A**

So, early October, I would say no major danger signs at the moment. But again, we recognize the major uncertainties that are – that continue to rise.

**Q**

Thank you very much.

**A**

Thanks, Andreas. Next question, please?

**Operator:** Our next question comes from Shane McKenna from Barclays. Your line is open. You may ask your question.

**Shane McKenna**

Good morning, Hilary and Amit. You flagged in the presentation you have – data center capacity continues to grow what seems like an exponential rate. And according to one of your podcasts, we're seeing years of digital adoption in just three months. So, as we sort of add in the emerging demand that we're seeing from Edge data center, where do you see the 15% of revenue for data center and networks in say, two to three years’ time? And specifically with Edge, do you have a particular lead in the end market in terms of product offering? Thanks.

**A**

Sure. So what I would say is we're well-positioned in data center and network, with the most complete portfolio of secure power – power distribution. In terms of Edge, we've made – we've got something we've been talking about for a number of years, and as we've focused our portfolio around addressing that market as well. So I believe that we're well-positioned there. It's been, as you know, one of our fastest growing end markets for NVLD in recent years. Customers are interested in resilience, speed of deployment, and we're well-positioned to offer both.

And then, of course, you'll notice in our H1, we also shared that through AVEVA, we're developing unified control offerings for data centers. So, even more completing the portfolio that we have there. And I talked to the long-term trends in Data Center. We do remain bullish on Data Center in the long term. We've seen in the past couple of years and a lot around the hyperscale, that it can be a bit cyclical. But we think there's enhanced opportunities, as I mentioned, both in the near-term and long-term trends that I showed it in one of the slides. So, I can't give you a specific percentage of sales numbers in the next couple of years, but we do expect it to continue to be an exciting end market for us and where we can add value to customers.
Thanks.

Thank you, Shane. Next question?

Operator: Our next question comes from Andre Kukhnin from Credit Suisse. Your line is open. You may ask your question.

Andre Kukhnin

Good morning. Thanks so much for taking my question. I wanted to ask about Industrial Automation, and wondered if you could give us numbers on how much discrete grew versus the rest of the business in the quarter and year-to-date, and whether that was also held by restocks through a similar order of magnitude that you mentioned earlier for the group.

And just on the exit run rate in the Process side, which way are we pointing just directionally, are we still kind of sequentially declining or is there evidence of finding a trough for that part of the market? Thank you.

Sure. So, in terms of – so, I'll address the first part first. In terms of discrete and OEM, I can say we were in positive single digits there. In terms of distributor restocking, sure, industrial automation, similar to energy management on the product side, will have some impact, although not at the same level in terms of distributor restocking. I think what we really see is a differential between the short cycle business, and particularly, you can see with OEM tend to be on the short cycle side of the business, where the medium and long term cycle and process remains weak.

Martin Wilkie

Thank you. It's Martin from Citi. Just coming back to a comment you made earlier in the call about the CapEx being on uncertain in certain commercial and industrial buildings. Just to get some sense there, ordinarily, what sort of lead time can you see in that? I mean, obviously, we know your products are installed relatively late in the construction process, but, you know, through tenders and so forth, you must have some sort of visibility, to just understand ordinarily what sort of outlook would you normally see, you know, sort of how much of visibility do you only have in that business, just to get some sense of when you might know do we see a pickup in 2021? And are there still some risks going into the first half of next year? Thank you.
Sure. So, even through the partner side of our business, you know, with partners and with distributors, we remain close to customers in many cases. You know, the sales process for us is including prescriptions. So, we have, you know, decent indication, I would say, in the short term around projects. So, we look from pipeline all the way into execution. The comments that I made around office building and expecting uncertainty round CapEx there. We can see external signs pointing to this. We can also see with the work from home trends. We can also see with the work-from-home trends. I think the jury is a bit out probably, in the next months, as companies make decisions between there's work-from-home trends, but there's also the health and safety, more social distancing. So, what we can see is – you know, customers thinking through these points, I would say, and that's really the genesis of the comments that I made there.

Thank you, Martin. We go with the next question.

**Operator:** Our next question comes from Ben Uglow from Morgan Stanley. Your line is open. You may ask your question.

**Ben Uglow**

Good morning, Hilary. Good morning, Amit. I hope everyone's well. And I wanted to come back on a previous question and kind of tied into China. And I don't quite understand the fourth quarter guide. If we look at the growth that you've achieved, you've done 1% in the third quarter and you've got – you've sort of suggested that roughly 2 points or something of restock. So you're not that far from zero. I'm looking at a range best case minus 0.5% to worst case minus 8%. So the midpoint of that range that implies minus 4%. So I guess coming back to an earlier question, what is it that's giving you that sort of pause. Why wouldn't zero be the kind of midpoint of your new range? And is there anything qualitatively that you see that could actually be fading a bit in 4Q, is it US non-res or is there anything in your outlook which is making you appear conservative around 4Q?

Related to that is just on China. And can you, you know, the China growth rate was plus 20% in IA in the quarter, double digit in EM. Can you just tell us how you see China progressing into the end of this year?

Sure. So, I made a comment – so, what I would say is I'll remind that we usually give a range. You know, we look back a few years. We usually give a range on our topline of 1 point in the Q3. Here and I spoke to it already, we've checked the range wider to reflect the uncertainties that I mentioned, really government lockdowns, upcoming key milestones with the US election, and Brexit. I do think we're in a higher time of uncertainty from – I don't know if you consider lockdowns, macroeconomics, but let's say the macro economic impact of these points. I do think we're at a higher time of uncertainty than we would ordinarily be which, like I said on the call, is why we left the range wider than usual. So instead of a 1-point range, we've given a 2-point range on the topline. And then I talk through the trends that we saw in the Q3 with mid to late cycle still a bit under stress.
So in terms of China, you know, we talked about the results in China and really the broad-based recovery that we see there. I won't talk to any specific guidance for China in the Q4, but we do expect to continue to see a broad-based recovery in China. We really think that they're back to business. And just as a reminder, we are really mostly a China-for-China business. So, we're mostly exposed to the domestic market, so not as exposed to anything that might happen in terms of export. So, I think from our business perspective, therefore, we see – we still see solid trends.

Okay. Thank you.

Thank you, Ben. Next question, please.

Operator: Our next question comes from Gaël De Bray from Deutsche Bank. Your line is open. You may ask your question.

Gaël De Bray

Thanks very much. Good morning, everybody. Yeah. Since you have a dedicated slide to capital location, can I ask you how you think of all your recent transactions in terms of return in capital employed? Because I calculated a potential dilutive effect on ROCE of around 200 bps beeps in total. So, what's the time horizon in which you expect to be back in your historical return on capital employed range? Thank you.

So, you can see that our recent acquisitions are a little bit outside of what would have been sort of traditional capital goods, I guess, or to the core. We're really focused on our business transformation towards software and services. And with that, for example, with OSIsoft, this is a company that the transaction is at different multiples and you would see in the capital goods space. Although I will mention that it's at a similar multiple to AVEVA, where I think we've felt very comfortable that we've driven value over the past couple of years together as two companies.

So, the way that I think about capital allocation and the way that I think about transactions is really in terms of basically cash-on-cash value-add.

So it needs to have the strategic purpose of course. That's why we want to get into it for the long term. L&T, for example, to me is a great example of a strategic choice. So we have opportunity to build a great platform in India right when they'll benefit from the trends that we – that we continue to and are well-positioned to benefit from digitalization, automation, electrification. But at the same time mixed with the strategic, I'm very much focused on making sure that we get cash-on-cash returns that makes sense. So we did quite a bit of work on the acquisitions to make sure that we believe that there's good value in those from a return standpoint for investors over a reasonable timeframe.
Thank you, [indiscernible] 00:44:19. We move to the next question.

Oh, thank you.

**Operator:** Our next question comes from Jonathan Mounsey from Exane. Your line is open. You may ask your question.

**Jonathan Mounsey**

Hi. Yes. Good morning and thanks for letting me ask the question. You mentioned during the slide presentation the impact in North America from supply chain issues, I think, probably Mexico. Where do we stand there now? Is it all resolved? Is it all behind us? Can you quantify kind of the impact that we've seen over the period? How much of the growth you might have enjoyed, you've actually been able to capture and is that now totally behind us? Is there even some catch-up potentially as you move back to where the market has been trading?

**A**

Sure. So you're right. In the H1, we talked about an issue at one of our plants in Mexico primarily serving residential really impacted by contagion in that community in particular.

So, as of today, we have largely recovered. But we're now working on recovering the capacity that was lost during that timeframe. So, in the H1, we talked about around half of what we saw in the Q2 in terms of negative for North America driven by that supply chain issue. In Q3, we also continue to have impact as we build up capacity. So there is a – we look to recover that in total over the next month.

**Q**

And is that down in Q4 as a problem?

**A**

In terms of operations, I would say yes. In terms of capacity build and backlog, it could continue into the Q1 as we recover. This is an area that we have big acceleration in demand as well.

**Q**

Thank you.

Operator: Next question comes from James Moore from Redburn. Your line is open. You may ask your question.

James Moore

Good morning, everyone. Hilary, Amit, I've got three quantification questions if I could. You mentioned the discrete [indiscernible] 00:46:48 single. Could you put a quantification on process in hybrid for organic growth in the quarter? Also, on data center please? And finally, on September, could you say if it was a bubble below the plus 1.3 for the whole of the quarter as a single month? Thanks.

So, I think I'll start with your last – with your last first. So, in terms of September, and actually, well, in an ordinary year, anyways, the third month of each quarter is usually, almost always, is the strongest for us. In September, what – particular in this year that we followed, is that we did see sequential improvement across the quarter, which I think is something that we were watching for.

But September, and, again, I don't think this is so out of usual, but was the particular month that benefited most from distributor restocking. And then we also had a big working day impact in September, positive working day impact. So, we closed the month at the high, certainly out of the Q3.

In terms of discrete, I talked through the number there. I'm not going to give a specific number on data center or on Process & Hybrid.

All right...

Okay. Just on the...

... question, please?

Operator: Our next question comes from Wasi Rizvi from RCB (sic) [RBC]. Your line is open. You may ask your question.
Hi. Good morning and thanks for taking my question. I'll just recall, at the half year, you mentioned about running with, kind of, elevated working capital, just in order to be able to continue to supply your customers and maybe that was indicated in Q3. But does that mean you normalize working capital into that strong demand and restock from your customers? Or do you think you'll be running with a higher level for the foreseeable future? Just to be ready for any potential further shocks or lockdowns.

Sure. So, what we talked about in the H1, we talked around the strong free cash flow that we had in the H1 of around €1 billion, even despite the fact that we decided to prioritize inventory for customer delivery and customer demand. In the second – in the second half, I would expect that what we said on the first half around cash flows broadly holds. So we would expect strong cash conversion ratio, for example. Although of course when we're in a growing demand environment, we'll see a bit of the opposite in terms of some working capital with receivables for example or payables that you would see in the negative demand environment.

In terms of inventory, we do expect that we will continue to prioritize customer demand and customer delivery. I wouldn't say that because we want to be particularly well positioned in terms of lockdowns although we've taken resilience into account a little bit but offset by some other factors. But really the idea is to have a finished goods inventory strategy prepared for a customer delivery and demand and making sure that in a demand environment that we're ready to serve customers.

So – and then I think I would add that we have I think demonstrated in the past that we're able to be agile from an inventory standpoint in case there are fluctuations in demand. So it's something that we're staying very close to on a week-by-week basis to make sure that we – that we're really making the right decisions from both a strategic standpoint and from a working capital standpoint.

Right. Thanks. Well, I think we have 2 more minutes. So we're going to take another question please.

Operator: Our next question comes from Alexander Virgo from Bank of America. Your line is open. You may ask your question.

Alexander Virgo

Thanks very much. Good morning, both. [indiscernible] 00:51:39 well. It was just sort of a follow up really on the balance or relative growth of the two divisions within your guidance for Q4 and wondering part curly in light of your comments and the comments around phasing that whether or not we can see a sort of a big hiccup in software growth helping IA in Q4. So, I just wondered if you can give us a little bit more help on that Q4 outlook between the two divisions. Thank you.
Sure. So, I think we gave a decent amount of commentary on the Q3 where we see accelerating trends between the two and probably for the Q4 I wouldn't say that we would guide anything different than that. In terms of AVEVA, we really can't speak further beyond what they put into their own trading update. And I'll just remind on AVEVA that their calendar – their year is different than ours. So, our year – we're entering our Q4. They're entering their Q3.

Yeah. That's right. Next question please.

**Operator:** Our next question comes from Denise Molina from Morningstar. Your line is open. You may ask your question.

**Denise Molina**

Hi, everybody. I have a question on the digital products that you've been talking about. Just wondering what the margin is on those relative to the non-digital and connected products. If you take the digital switchboard, for example, in the local [indiscernible] 00:53:12 category, are those – do you anticipate those to be higher margin products and is the adoption dependent on greenfield projects like new construction or new plans versus upgrades or retrofits?

Sure. So, you know, I spoke a bit – so taking the second half of the question, I mentioned, for example, in the new contacts offer that, in fact, we've specifically designed it in the same footprint as the prior product. So in fact, the idea with most of our products is that they can both be used from a greenfield standpoint as well as in retrofits. That doesn't hold across the board, but it's certainly something that we take into account.

In terms of margin overall, you know, what we think is that more technology in the products means more value to the customer. And we do expect that we have the ability to either have higher prices or get value across part of or all of that chain that I spoke to in the flywheel of digital and services.

Thank you, Denise. I think we're going to take probably one or two – maybe two more questions. So, operator, next question, please?

**Operator:** Our next question comes from Guillermo Peigneux from UBS. Your line is open. You may ask your question.
Guillermo Peigneux Lojo

Thank you for taking my question. Guillermo Peigneux from UBS. Thanks, Hilary, and thanks, Annette. Good morning, everyone. I wanted to ask on China maybe so many, many debates on both energy management and industrial automation on – first one on energy management. Have you started to see any change of direction driven by maybe some of the less, you know, less incentives that you've seen from the government on the residential and on the financial markets and on industrial automation and specifically to discrete automation? Have you seen an acceleration especially on the more, let's say, cyclical sectors there, maybe consumer electronics or automotive? Thank you.

Sure. So, what I would say, you know, I spoke a little bit before about the trends that we see in China. I think that, you know, like we said, we really see a broad-based recovery in China. I think that was only helped by China is one of the areas where we do see already some direct impacts from the stimulus package that they've put in place. For example, I talked about strength in transportation projects. So, these are areas that I think we see that – where government stimulus is really just an added factor, I would say, in the turnaround.

In terms of starting to see any change in direction due to less incentives by government in energy management, no, I don't think we've seen anything that I'm aware of. In industrial automation, I – you know, I spoke to some of the trends that we see in China there. Again, I think across the board we've seen pretty broad-based improvement. And again stimulus for us is, I think, just a part of what's driving that market. I think it's really back to business.

Thank you.

Right. I think we take maybe one more question.

I think we take maybe one more question.

Operator: Our next question comes from William – excuse me, William Mackie from Kepler Cheuvreux. Your line is open. You may ask your question.

William Mackie

Hello. Good morning, Amit. Good morning, Hilary. Thank you for the time. My final question would be based around how you are using the pandemic or the changing conditions to optimize the structure of the company. The guidance that you've given is very much based at the adjusted EBITDA level. Should we expect any adjustments
to the sustained level of reorganization activity and the associated costs to optimize your manufacturing footprint or supply chain network?

**Hilary Maxson**  
*Executive Vice President and Chief Financial Officer, Schneider Electric*

Sure. So we've spoken on the H1 – in 2020, a lot of what we did up front was focus on tactical savings in the company, so delaying of salaries in certain markets, furloughs, these type of things. But we also talked about the plan for the next couple of years. What we said there was we had an operational efficiency program already going. With the pandemic, we're looking at some additional opportunities that we see from that whether from digitalization or other opportunities to drive around one billion in [ph] FFC 00:58:35 savings between now and 2022. And also, that despite the lower productivity as would be expected in 2020, that we'll drive around €1 billion in productivity, over that industrial productivity over that same time period.

So we are using the pandemic to look at what I call effectiveness through operational efficiency and really using it as an accelerator for business transformation and effectiveness.

**Q**

In your presentation you mentioned selectivity also which has been a feature for a number of years now. Can you quantify the impact of selectivity particularly in the systems business in the quarter?

**A**

So, selectivity, I think what I mentioned is still focusing on good projects. So, I won't give any numbers around selectivity for the Q3.

**Q**

Thank you very much.

**A**

Yes. And yeah, and Will, the selectivity program is over. So I mean that form of selectivity program was over a few years ago, and the focus of course remains on profitable growth and systems. Just sort of to conclude as we are at the end of the hour, I just remind everyone to a point that Hilary made in her presentation around ESG investor event. I think ESG is an important element of our story and we have lots to say. So, that's going to be on the 16th of November.

We will be sending out invites. It's going to be, I would think about maybe around two and a half to three hours in a digital format. So please look out for that. But just mark your calendars so you could join us. Of course, the IR team is available to interact with you further as you need. But thank you very much for your timing today.

**Operator:** Thank you, everyone. And this does conclude today's conference call. Thank you for your participation. You may disconnect your lines.
Speakers, please allow a moment of silence, and stand by for your post conference.