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MANAGEMENT DISCUSSION SECTION

Amit Bhalla
Senior Vice President & Head-Investor Relations, Schneider Electric SE

Hello, and welcome to Schneider Electric's Q2 Revenues and Half-Year Results. From Paris this morning, we have Jean-Pascal Tricoire, Chairman and CEO; and Emmanuel Babeau, Deputy CEO and CFO. The release and presentation are on our website and on the wire. We will have a Q&A following the presentation. So, with the usual pointing out on the disclaimer on slide 2, I'd like to pass on to Jean-Pascal to take us through the strategy part of the presentation.

Jean-Pascal Tricoire
Chairman & Chief Executive Officer, Schneider Electric SE

Thank you, Amit. I'm very happy to be with you this morning to share about this milestone of half-year 2018. And I'm going to move straight to slide 4 just to, yeah, really emphasize a very strong H1 2018 with an operating profit progress of more than 11% in organic terms, which confirms, by the way, the H2 that we had had in 2017, so 12 months in a row with an increase of operating profit at double digit. And this is based on two things: first point, a margin which is increasing by 50 bps at the top of the guidance we had given at the beginning of the year; and the second point is really on an accelerating growth which is developing all around the world.

So, going into the central column of this slide, again, organic growth of the adjusted EBITA of 11% beating by large the indication we had given or the guidance we had given of 7 points, a margin at 14.4%, up 50 bps. And if you take a longer view, over three years, an expansion of the margin in current terms of almost 2 points, on inorganic terms of more than 2.5 points. So, a persistent and continuous improvement of the margin in line with what we had described two years ago in our Investors Day.

Then this is, of course, boosted by an accelerated growth or a stronger revenue growth in H1 of 7%, actually 7.6% if you include the non-consolidated debt issue in our accounts. And this is funded on our two business: Energy Management, which is growing by 7% in H1. And if you go into the detail of Energy Management, well, the good headlines is that Medium Voltage is back to growth, so selectivity, as we said, is over, on Q2 is actually growing by 3.2 and that proves the end of selectivity. Low Voltage, at more than 9% in H1. Actually, if you integrate debt issue, which again is not consolidated, is double-digit growth. So we are clearly taking market share in these very profitable business of Low Voltage.

On Secure Power, accelerating in Q2, you'll remember that we are questioned at times in the past two years about the dynamics of Secure Power, but Q2 at plus 5%, while frankly we're facing in that business some tension on deliveries, on shortages, on components, so we could have delivered more in a perfect supply chain world. And this is complemented with our other business, which is Industrial Automation which is really growing fast and well at plus 10% in H1. And there again, we are taking market share.

So, quite easy to summarize H1. All region and all business grow in Q2 and show the great health of the portfolio. Now, focusing on shareholders, that drives to a net income up 7% at more than €1 billion, first time in our history, all-time high. And we keep delivering on our commitments to shareholders. Share buyback in progress. We have a program of €1 billion following the divestment of DTN last year. We've done one-third of it with 2.3 million of shares in H1.

And remind you that H1 was active in signing or closing operations. Of course, the signature of the agreement of buying Larsen & Toubro in India, which will make of India our third-largest country for the group, and the closing of two operation in software, AVEVA, that we closed in H1; and IGE+XAO, which is supporting in Energy Management.

So, on the base of that strong H1, on that accelerating growth that we see all across the geographies on the portfolio, we raise our target for adjusted EBITA organic growth for the year to 7% to 9% to be compared with the previously declared 7% target for the same parameter.

What is the growth based on? And, again, remind you that Schneider is all about Energy Management and Industry Automation (sic) [Industrial Automation] solutions targeting to supply to our customers full efficiency solutions, energy efficiency and process efficiency.

On Energy Management, which is growing 7% during H1 is benefiting from the fundamental phenomenon of energy transition. We see an acceleration of every electrification on energy consumption on everything which is IT which is powered by AI, storage, big data, analytics that part of our portfolio is the fastest growing. And we have an unparalleled and un-comparable offer to service business. Then we see an acceleration of electricity as a vector of consumption of energy. You see it, of course, in the very media published or media publicized, electrical mobility. But you see that everywhere, particularly in temperature control, where the way to control temperature would it be cooling or heating is becoming more and more electric, you see a massive push for energy efficiency all over the world characterized by digitalization and, of course, where the grid is sometimes not completely reliable and people want to get more autonomous, a trend to distributed decentralization of energy which pushes the generation which used to be upstream of the value chain, downstream into the natural territory of Schneider.

The other megatrend that we are addressing at Schneider is Industry 4.0, which is today boosted by software, Internet of Thing and automation. So, the combination of those two make that we propose to our customers full efficiency solution, energy solution, process solution, integrated in EcoStruxure with its [indiscernible] (00:07:25) connected products, controls and advisors on software.

In H1, we keep – we actually accelerate the deployment of our strategy which is very simple and [ph] very revving (00:07:41) on all engines, more products through our largest and biggest network of partners around the world, plus 7 points. More services, close to 10%, plus 9% on digital which is growing faster than the group. The strategic focus for the next period – for the next months is more the same, which is more new products, more innovation to our partners; acceleration on services, software, EcoStruxure; acceleration of cross-selling; and keep leading Corporate Social Responsibility and be the preferred partner of our customers who are going into the direction around the world to supply them with digital and power solutions to answer that need.

So, going into the detail of that, I'm going to go fast through a set of more explanatory slides, but more products in H1. We see products revenue up 7.3% and actually accelerating as we go forward. In Energy Management, that portfolio goes up 6.6% if you take all the products from Medium Voltage, Low Voltage, and Secure Power. Product sets are really growing in all regions. Remind you that the tremendous success of Schneider is what we do on the home, on small buildings segment which is a segment we've been consistently developing and growing in the past years, on the back of acquisition, we did long time ago that we have now consolidated and that we are boosting with a lot of innovation, a lot of new products.

So, that used to grow in the past two years by mid-single digit. That has clearly accelerated in H1, what we said into small electricians, small buildings to a level of high single-digit growth. So, great success that we have there. And we keep growing very fast in some targeted segments on products that we are systematically addressing across geographies. That's complemented by products of automation, which have been really growing fast in H1. And across all board, we grow particularly in connected products. So, those products that used to be unconnected are now getting connected and looking for more value at the level of advisors particularly.

When we say advisor, and to make sure there is no confusion, advisor is a generic name that we have in EcoStruxure for analytics or AI module that we sell on the top of our systems to deliver value on the top of connectivity. So, when we speak about advisors, we are not speaking about physical people, we are speaking about virtual pieces of code that bring value from our systems.

One thing I want to mention here in this slide is the alliance that we have made with Somfy and Danfoss, which is a convergence of what we do in the environment of home to supply consistent systems and make sure that our customers, when they buy things, objects coming from all of our companies can find them converging on any of our applications.

Going to next priority, more services, you remember that the growth of services at the slowdown last year, and that was due to a cleaning of a situation or rebooting of a situation in the U.S., we are back to cruise speed in services, 9% in H1, growing in all regions. This is getting accelerated by the digitalization of what we do. Once we are intervening on the installed base of our customers, we plug that installed base to go from one short service to a 24/7 contacts on a lot of value delivered around asset performance, condition monitoring and predictive maintenance, which is complemented with very successful value proposition that we deliver today around the world, which is energy and sustainability services, helping our customers base on the profile of their consumption to source the best source of energy and particularly, renewable energy.

You know that Schneider is part of the RE100 group of more than 100 companies actually, moving together to source to be getting its energy from renewable sources. And we are the biggest provider, particularly in North America, of advisors on the digital platform that helps you doing that. So, what do we want to do here is continue to track and penetrate the installed base of our customers, which is still vastly underserved and continue progressively in the head count investment that allows us to deliver those services.

More digital, third priority. Of course, it's a development of EcoStruxure that we are pursuing here. So, we are continuously developing applications within open ecosystems. So, we've got more and more developers working on EcoStruxure. We have a very good traction of our digital offers across market. And we are investing also in complementary start-ups to help us innovate at the fringes and the borders of our ecosystem, like Claroty in the field of end-point cyber-security.

Remind you also that we have created a digital committee at the board and they have already gathered into two meetings in the beginning of the year to check, monitor and coach our team in what we do in digital.

On the other side, while H1 was the time of the creation of AVEVA, of which we are very happy, first very good steps. The integration is on track. Cost synergies plans have been put into place. We are building revenue synergies, we're putting together the teams of Schneider and AVEVA in front of a number of customers. And the market conditions are becoming even better at the moment, as oil and gas is kind of reawakening from the crisis we've known over the past three years. So, promising perspective on this side of those key process industries.

When you look at EcoStruxure, the top two layers, the layer of control and advisors is growing above the group average, which is already a strong base. And while the Assets under Management, what is getting connected on our cloud, I am not speaking about all the connectable products that we sell, is growing by 20% and accelerating.

So, with that, what we see is more and more traction for integrated EcoStruxure. The appeal of having one plug-and-play architecture where people can address their double issue of efficiency, energy efficiency, process efficiency and have one repository while you've got plenty of very interesting projects here, including, by the way, more and more decentralized energy like connecting to your demand, a microgrid, a local microgrid to improve the reliability of your supply and also to improve the sustainability of the energy consumed by our installation.

The last point I want to mention which is creating acceleration in the top line is cross-selling across our markets. And that's pretty much across all geographies. So strong cross-selling between Low Voltage and the rest of Energy Management and – well, power automation, EcoStruxure Power, and everything which is building, residential, commercial and industrial. Very strong traction in data centers and network which as a segment for Schneider is growing double digit totally. So that's a very strong dynamic. I'm going to come back on it afterwards. Industrial and infrastructure, there, again, double digit, very strong there, with a mix of – not double digit – double digit on automation, with a mix of 50/50 between Energy Management and Industrial Automation on utilities, which is mostly a Medium Voltage play complemented by Low Voltage. But cross-selling is keeping on accelerating. Here, you've got a number of examples of segments on projects we have addressed. Proud to say that many of the stadium that we all followed in the past period were powered by Schneider, and this has no relation with the conclusion of the Cup, but we'll come back on that one later.

Commitment to sustainable development, as you know, we have the Sustainability Impact barometer, whatever, index that we have across the companies where we measure all our progress on those directions, and we are on a good track. We've put here one example of what we do in circular economy, making sure that we help our customers to deal with the end of life cycle of their products. And that's also a very promising place where digitization, of course, is helping a lot.

On the number of recognition during H1 to recognize all of the things we've done, one of the elements we are very proud of is the recognition of the supply chain of Schneider, whatever the tension – the good tension because there was a lot of demand and there is a lot of demand still on our supply chain, going up from 17 rank to 12th rank on the worldwide scene as the best 12th supply chain in the world. So, keeping on progressing and belonging almost to a top 10 supply chain in the world.

Now I'd like to go into the detail of our portfolio beyond those transversal lines that I just described. And I'm going to comment Energy Management on one side and Industry Automation (sic) [Industrial Automation] on the other side. So if you look at the global picture of Energy Management that in most of the case is selling together Medium Voltage, Low Voltage and Secure Power, growing 7% including Delixi. Profitability above 17%, still increasing by 40 bps, and we want to keep developing that.

Three titles, Medium Voltage – or three activities with the major headlines which are Medium Voltage is back to growth, that means selectivity is finished. Second point is that one year ago we told you we would do a strategic review of what we do in Medium Voltage. That strategic review is done and we've identified actions on the portfolio. Second point, Low Voltage accelerating to double-digit growth and really gaining market share together with the whole chain of Energy Management. And Secure Power leading the charge at the level of the IT segment and reaching in Q2 a growth which is close to 5%, so very good dynamics here.

What we see here as shared priorities is keep working on key targeted segments, maximize the cross-selling between those business, and develop EcoStruxure, EcoStruxure Grid, EcoStruxure Power and EcoStruxure Building as a major vector of digitization of what we do.

So, zoom on Medium Voltage, so growing 0.4% on H1, 3.2% in Q2, so a clear change of inflection. If you remember, Q1 was negative. Adjusted EBITA growing by 110 bps, which is putting us on track to reach or to get to our target of an improvement of operating profitability for the year between 100 bps to 150 bps.

What we see in H1 is a sound execution of our strategy, acceleration of product sales to partners which are common with Low Voltage, acceleration of services. One year ago, we told you we would put into place in the next year, which is finishing today, an organization called Power Systems, streamlining what we do in the field of equipment and projects. And that has been deployed and it performs. And what we see in H1 is a strong contribution in the U.S., in China and in the data center segment.

What are the priorities? Again, well, more of the same: more products, more services, more automation. And I want to insist on the end of the strategic review that we've done on our portfolio, on the €2 billion that we have for review, we've identified €500 million where we need to find solutions to improve the – those €500 million, let's say, are underperforming in respect to the rest, and they are less synergistic. So, we're going to find in the next 18 to 24 months solutions of all sorts to improve the profitability of that business. And it could go as far as partnership, disposal, but make sure that we correct those parts of the portfolio.

Low Voltage, nothing much to say. I mean, plus 10% growth. We are gaining share and in a very profitable business. We are increasing the profitability. Again, one of the stars here is everything we do at the level of the small electrician, home, building, but also in every kind of other segment where the synergies with Medium Voltage are really paying. Data center growing big double digits, so on the back of what we do in Secure Power.

So, what we want to do here is to keep growing our sales through partners, our distributors, our specifiers, our contractors across the world who are strong partners of Schneider; accelerate digitization around EcoStruxure

Power and Building; and keep building synergies or build the synergies from the ASCO acquisition last year which is serving applications like data center microgrid that I already spoke a lot about; and keep leveraging what we acquired in IGE+XAO to develop more software to help our customers deploy their system. No need also to mention that across all that chain, the acquisition of Larsen & Toubro on the plan of integration is a big focus of the period to come.

Finally, Secure Power, and good news on that side that there is a reaffirmed or growing growth as of – on H1. So, acceleration in Q2 to 4.7%. The order intake in H1 is actually double digit. So here due to some issues on the supply chain of electronics, we couldn't deliver everything that we would have wished to. So, that means we are starting H2 with a good momentum. The adjusted EBITA is stable, and that is very largely due to things we had to overpay to – or to pay at the more expensive price to keep supplying our customers who were in demand; components, transportation, airfreight.

The place which is working really well is everything we do in the data center, where all group sales are growing double digit, combining everything we have in EcoStruxure from Building, Power and IT. The sales we do in this space related to Secure Power is increasing mid-single digit, while on the same segment, MV, LV sales are up by a very solid double digit. What we see also is that the smaller Secure Power systems are boosted by the development of Edge. The more our customers go to the cloud, the more they need to beef up the Edge. And that Edge needs to be supported by local power supply.

We see more and more growth in non-IT end market that we synergize with what we do in Medium Voltage and Low Voltage, and services are up mid-single digits.

So, I would say, all the engines of Secure Power are up and running very solidly. So, what are our priorities here, is confirm our leadership in data centers, keep growing the Edge, keep growing the non-IT market, a pretty simple road map for what we have to do.

Finally, Industrial Automation where, of course, dynamic is extremely strong, plus 10%, 17.3% adjusted EBITA margin, 50 bps of improvement in current terms, 10 bps in organic terms. Strong growth across discrete and hybrid, and what we see that process market are starting really to accelerate. Adjusted EBITA margin, 10 bps organic. Well, it has been there again, like in Secure Power, impacted by supply chain tensions on electronics that we had to – somewhere that impacted our cost. OEM grows very strongly across region. EcoStruxure Machine and EcoStruxure Plant is progressing well, the adoption progressing well. Very happy with the integration of AVEVA on the perspective of the company, and all regions contribute to strong performance. So, there again, no mystery. It's about more products through our partners and distributors, and roll out EcoStruxure Plant and Machine, drive synergies with AVEVA, and now that the process industry is accelerating, make sure that we balance opportunities because we have a full lineup from discrete to continuous process.

On this being said, that's the explanation about this busy H1, I'm going to hand over to Emmanuel for the financial part.

Emmanuel Babeau

Deputy Chief Executive Officer in charge of Finance and Legal Affairs, Schneider Electric SE

Thank you, Jean-Pascal. Good morning, everybody. Pleasure to be with you to go through our H1 2018 results. And we're going to go deep dive in our financial performance. Just maybe one preliminary comment on this very strong set of numbers we are coming up with. This is, of course, coming from a conjunction of all our engine powering, and you have seen that in Q2, all our businesses have been growing and nicely growing. You see that all our regions have been growing. We see the accelerated top line growth in Q2 and the very strong performance overall in H1. And, of course, the margin improvement at the top end of our objective. That's really the combination of all that which is giving us this very nice growth.

So, let's go into some detail. And, of course, let's start with the sales numbers. Sales averaged €12.317 billion. It's a plus 1.2%. Of course, we've been very much impacted by the ForEx impact, minus 7.2%. We flagged it at the beginning of the year, we said most of the negative ForEx impact is going to be on H1. That has been the case, almost €800 million negative impact coming from the ForEx on the top line. We do expect a much lower impact on H2 based on the current currencies with a vision for the full year of around €1 billion negative. So, as you can see, H2 is going to be less impacted by the scope.

When it come to the margin, we have negative impact of minus 30 bps for the first half of the year. And here, again, we think that H2 will be less impacted because for the full year, we expect an impact to be around minus 20 bps. Taking the impact out of the organic, this one is a scope, plus 1.4%. We still had some impact due to the disposal of DTN. But, of course, we have the benefit of the acquisition of ASCO and the AVEVA business for four months over this H1.

Now, when you look at the overall organic performance, 7%, even almost 8% organic in Q2. Actually, if you [ph] bill (00:29:00) pro forma with Delixi, you get to this 8%. And you see that for the all H1, we now are clearly neatly growing in all regions. Asia-Pacific, still the star, plus 13%. China has continued to be very strong double-digit growth. And we finished H1 with high-teen growth in China, quite a remarkable performance. We certainly stay optimistic for China for the coming months. But we flagged at the beginning of the year that the growth that we are expecting for H1 would not be sustainable for the full year, but we still expect very nice dynamism coming from China in the second part of the year.

China was not obviously the only country growing in Asia-Pacific in H1, very nice double-digit performance from India, Asian Five doing very well with countries such as Indonesia, Vietnam doing extremely well and Australia, also back to nice growth. So, it's a kind of a full positive scorecard for Asia-Pacific in H1.

North America, second performer, plus 7% acceleration in Q2 at plus 8%. It's, of course, first and foremost, the U.S., but the performance in Canada and in Mexico is good as well, but in the U.S., it's – the confirmation that we are gaining market share in construction, in data center, that we see a much better oriented market when it comes to infrastructure or industry investment and that translates into the number of our U.S. market.

Western Europe now, plus 2%, that is, of course, the big acceleration of the Q2. Remember, Q1 was flat. We moved to plus 5% in Q2, very nice acceleration which was expected, but that confirmed that we have pockets of dynamism in Western Europe and plenty of countries where things are developing extremely well, but I will elaborate on that in a few seconds.

Last but not least, Rest of the World, so the other new economy outside Asia-Pacific, stable nice performance, around plus 5% and we see globally new economy benefiting from increased price on energy or on resources and raw material and that is helping the economy of many of these countries.

So, let's now dig a bit more in some of the region and I'm commenting H1, but I can anticipate one news for the Q3 that no doubt the best performer in Q3 has been France with a two star. But joke apart and coming with Western Europe, France has been flat in overall number in H1. And it's, in fact, hiding the very nice performance both in Low Voltage and in Industrial Automation in France. So, we've been able to slow down by the Medium Voltage backlog which was low and therefore, it was expected. It impacted the overall performance, but clearly, some nice area of dynamism in France.

Excellent performance, I would say brilliant performance in Spain, where we are gaining share, where the economy is also in good shape. Very good performance in Italy where I'm not sure that the economy is going that fast, but we are clearly growing very nicely. United Kingdom, actually, we've been growing in the UK in Q2. We've been saying for quite a while that we had some question mark on the continuation of dynamism in the UK. I think the question marks are still there. And we don't know what's going to happen in the economy. We have a wait-and-see attitude continue because of the uncertainty around the Brexit. But we've been doing pretty well in Low Voltage, even in Industrial Automation in the first half of the year in the United Kingdom.

And Germany, down all together, though this is hiding a very nice performance in Industrial Automation. And like in France, we had very low backlog in Medium Voltage and that explain the performance in Germany.

Moving to the Rest of the World, what I would like to flag here is really the nice news coming from some of the region that has been difficult in the past years, namely Middle East and South America. Middle East probably not coming as a surprise when we see energy price going up, that is, of course, improving the economy of many of these countries. South America, accelerating, not so much Brazil, which is close to flat in fact, but in other countries in South America. Africa continued to be positive and Russia has really been the country where we've been seeing some difficulties, notably because of the sanction, the uncertainties it – all that triggers and that is slowing down the Russian business. So, let's see how things unfold in the coming quarters.

North America, I think I said it, I'm not going to come back on it. And just in Asia-Pacific, to highlight the fact that we maintain our positive view on China for the coming quarters and that China is not the only country growing nicely in Asia-Pac far from that.

A bit of an analysis now on the growth, both at the top line level and the adjusted EBITA. You see that when it comes to the growth, all businesses have been rather stable, but at a very high level in the case of Low Voltage or clearly accelerating in Q2. That has been the case of Medium Voltage. Jean-Pascal commented it, that was absolutely expected.

Secure Power accelerating and the order intake level was even better than that. So, we see a nice performance of Energy Management, north of 7% if you include Delixi now. And Industrial Automation at a fantastic performance, above 10%, again gaining market share clearly in several end-market and in several geographies.

Now, when you look at the margin, all margins are progressing or in the less favorable scenario, they are flat. On Medium Voltage, we stay at 8.4% with a very strong negative impact coming from the ForEx and the disposal of DTN. The organic growth is there. And as we see a much lower impact on ForEx and we are now with the scope impact behind us, we do expect a nice improvement of the Medium Voltage margin in the second half. The organic growth targets didn't change, 100 basis point to 150 basis point.

Low Voltage, already at a very high level, impacted by ForEx, but still a nice organic improvement. Secure Power, stable organic growth. Jean-Pascal said it, we've been facing a lot of headwind coming from inflationary pressure, notably on electronic component and on freight. Otherwise, the performance would have been significantly better, that given, overall, and Energy Management progressing by a nice 70 bps and adjusted EBITA margin.

And when it comes to Industrial Automation, it's a nice progression, 7.3% (sic) [17.3%]. Here, the ForEx has been positive and it's an organic improvement of 10 bps. Again, inflationary pressure, cost on the freight, lower productivity than last year because of the tension, with this kind of increase, when you grow at that speed, but I will come back to that, you start to see pressure on the supply chain. Otherwise, the performance would have been even higher.

Okay. So, now, let's move to the gross margin analysis. We have a nice 40 bps improvement of the gross margin at 39.1%. What have been the drivers for that improvement? Well, first of all, let's pause on the price evolution. So, we could say, on price, we were meeting outside China on transactional to price more than the RMI impact. Well, that has been the case. So, we can say that this, I would say, initial objective has been reached and we have been increasing prices on transactional outside China at a higher level than the net impact of the raw material.

When we look to China, we see the situation improving, because there, we have raw material impact, which is still negative, but we are close to flat in term of price evolution. So, this is an improvement versus the previous year.

Now, let's be clear, in this very inflationary environment, I don't think that we can be satisfied by just meeting this initial objective of pricing up to the level of the raw material inflation for the transactional. And therefore, that means that more actions are needed and more action will be taken to keep increasing price, to face holistically, I would say, the inflationary pressure, not only on raw materials, but on inflation on wages. I'll elaborate on that in a second.

On everything linked to procurement, we talk about electronic component, but we have inflation popping up everywhere in our procurement. We talk about freight and we need to price for that. And we're going to talk about tariff and we also need to price for that and we need to make sure that we absorb the impact of tariff increase.

So, that means that we are, of course, raising our ambition in term of price increase. We need to go and we want to go and we will go much beyond the raw material inflation. It's starting now, since the beginning of the summer, it's going to come progressively. You will have, of course, some impact in H2, but certainly, as we progress to H2, we will see a growing impact of this price increase on the bottom line.

On the non-transactional RMI, I mean to always avoid any kind of confusion, remember it is there, but, of course, we don't track the pricing fees on system. So, you have here by definition a negative amount that is not compensated.

Now, let's move to productivity, 1.4 point of improvement on the margin because of productivity. Last year, it was 1.7 points. So, yes, the productivity is under pressure for all the reason I mentioned. We are seeing increased inflation. We are seeing tension on the supply chain, which is not enabling the same kind of work to optimize the footprint, which creates an inflation like the airfreight. What happen when you are running late because the order intake are growing extremely fast? You need to meet very strong customer demand. You need to deliver where you use airfreight and when you use airfreight, that is increasing your cost and that decrease the productivity.

So, a number of element there that still allow us to generate a nice productivity and a nice impact. That's the main driver for the margin improvement, but just to illustrate the tension that we have been facing because of this very strong growth in H1.

For the rest, really, I mean nothing super surprising. Mix, they're about neutral, so no specific comment to make on the mix here. Labor inflation, I mentioned that, I mean that's one of the component of the inflation that we are facing. No surprise. R&D is going to keep increasing as we keep investing for notably our digital offering. The FX impact is about neutral on the margin and then you have a slightly positive impact coming from the scope.

Jean-Pascal has been already commenting a lot on the Gartner performance and so on. Just one number, productivity in H1 is giving us a boost to the profit of €174 million. It was slightly more than €200 million in H1 of 2017. So, we are, roughly speaking, €30 million below. So, as you can see, still a very solid number, but we acknowledge that we are slightly below the productivity of last year, which was a record one and absolutely exceptional. Remember that, in H2, we were close to €230 million of productivity. So, that was clearly a very remarkable performance last year in productivity.

We're doing a lot of great things on our supply chain and beyond the momentary tension that we are seeing, we keep improving on the long term the efficiency of our supply chain. Some of you went to China to visit how we are implementing our EcoStruxure technology to make our factory more efficient. We continue to build and optimize footprint and to build agility and a really tailor-made approach for the supplier, therefore, I would say the underlying trend of the supply chain remains super positive.

We're going to deliver another solid performance in H2, but we wanted to be very transparent with you on the pressure that we are seeing coming from inflation and notably, coming from the freight cost. Many of you may have heard about tension on freight in the U.S. because of scarcity of truck drivers. I think that other company have been reporting on that element.

So, that give us a gross profit of €4.818 billion. It's up organically by 7.2%. So, slightly faster, of course, than the top line. The gross margin rate is improving nicely as we have seen. And below the gross profit, you see the SFC growing by plus 5.1%. So, yes, we are investing and we're going to continue to invest. We see a nascent promising market. We want to take leadership there.

We are building our leadership in digital. We accelerate in services. We've been also accelerating on marketing and making sure that we optimize our commercial impact in the channels, but we still manage to generate a nice 2 point of difference between the organic top line and our SG&A, what we call the SFC and that generates an extra layer of improved profitability.

That gives an adjusted EBITA of €1.769 billion. It's up plus 3%, but organically up plus 11.1%. And Jean-Pascal said it, it's now 12 months in a row with more than 11% organic growth of the adjusted EBITA. So, very solid consistent performance and adjusted EBITA margin of 14.4%, nicely up 50 bps.

Below the adjusted EBITA, you have other income and expenses. Of course, a lot of volatility on that line. Last year, you had the capital gain on DTN. This year, of course, we don't have that, but you have mainly the acquisition and integration cost for the various acquisition that we have done on which we've been working such as ASCO, AVEVA or L&T, of course. And you have also some impairment of asset and notably, AVEVA has been reporting on that. Some capitalized R&D coming from Schneider Software, which among the synergy on R&D are no longer going to be used and they've been depreciated.

Restructuring, €87 million negative. This is what we said. We are back to normal cruise speed on restructuring. We said for the year between €150 million and €200 million. That's what we are expecting for the year.

Amortization of intangible, minus €79 million, growing slightly versus H1 of 2017. That is due, of course, to the new acquisition that we have made and some of the intangible that we amortized whether on ASCO or on AVEVA. Financial costs, €159 million negative versus €184 million negative. That's a very nice improvement and that's a great work that we have been doing in order to reduce the average cost of our debt. We are now quite neatly below 3%. And that's, I think, a very good news for the future, because we also have been building a long duration for the debt. So, we are well spread over the future in term of redemption of bonds.

Income tax, a 23% effective tax rate for the group, which is in the middle of the 22% to 24% bracket that we shared with you at the end of 2017. The discontinued operation impact, minus €35 million. This is the Solar business here with the loss of the H1 plus still some impairment. I do expect H2 to be much better. And therefore, we expect to come with much better news in H2 on the performance of the Solar business.

Last element, quite marginal, but certainly a nice opportunity to pay a tribute to Delixi, equity investment and minority, it's slightly negative, minus €7 million, but it's made of many, many things. And notably, you know that we have in some JV in China, some minority partners, these JV are doing very well. So, here, we are reiterating the profit that we are making there. But if you just look at the Delixi net income, it's €30 million in H1. It's up €12 million. So, it's a 66% improvement of the net profit with a combination of above 20% top line growth, but also a very nice margin improvement.

Let's move to the cash flow now. Operating cash flow going very, very nicely, €1.5 billion. That reflect the good growth that we are seeing on the business. Of course, when you grow so fast the top line, the question is, well, you're going to see that in the CapEx and in the working capital. When it comes to the CapEx, it's not the case. You can see that the CapEx are very well under control. So, we manage to cope with the increase in volume without accelerating on CapEx, minus €308 million versus minus €351 million last year. That gives an operating cash flow growing by almost €200 million.

And then, of course, the other impact, which is, to a large extent, mechanical and this is the working capital impact and notably in trade working capital, you have a €300 million plus increase. We were expecting that. It's coming for, I would say, two-third from inventory, one-third from the receivable. There is probably a note of cautiousness on the level of inventory at the end of June in order to make sure that we are able to deliver our customer, given the very strong growth that we have in the order intake, but that should be under a more reasonable proportion in term of growth in the second half.

Free cash flow of €350 million, indeed €150 million below H1 last year, which was a record high, but again, despite this very strong working capital component that I describe.

Dividend, that's what we've been paying to our shareholder. Acquisition, that's the – mainly the AVEVA acquisition and the IGE+XAO. Net capital increase, this is share buyback. And on FX and other, this is all the other impact on the cash flow, FX, but also contribution to the pension plans where we have a deficit. And that gives us a net debt of about €6 billion at the end of June 2018. Remember, the vast majority of the cash flow will be delivered in the second part of the year.

We've continued disciplined capital allocation. Many of you have been asking us on the structure on the L&T acquisition. I think we've been explaining that discipline and capital allocation was one, not the only one, but one of the reason for it. We've been paying a significantly increased dividend at the end of H1.

Buyback is on its way. We've been doing a bit more than one-third of the buyback. And nothing has changed on the M&A policy or view. We don't need to do M&A and we just look at M&A on an opportunistic basis if we see things making sense and really strengthening the core of our portfolio.

Well, that's it for the detail. Back to you, Jean-Pascal, for the guidance.

Jean-Pascal Tricoire

Chairman & Chief Executive Officer, Schneider Electric SE

Yeah. So, well, we have done a very strong H1. In terms of dynamic, we have a very strong momentum. It's very well balanced between products and solutions, actually products slightly overgrowing what we have in solutions. So, we are upgrading our target. And you remember that the core of our target is our operating profit. So, between 7% and 9%, respect to around 7% initially. On that base, on the balance of growth, 5% to 6% respect to 3% to 5% initially, because, again, we are starting H2 with a pretty strong tailwind in every direction. And we are attached particularly to keeping on improving the profit. So, maintain and actually narrow the guidance of 30 bps to 50 bps organic improvement of the adjusted EBITA, recognizing anyway that there are some headwinds coming in front of us, like the uncertainty of the geopolitical environment; tariffs, which are not dominant, but which are raising [indiscernible] (00:51:44); and inflation that we are actively, actively combating with pricing that we started last year and during the first part of the year, but we are going to accelerate in H2.

So, well, we are riding very powerful waves at the moment, that energy transition in Industry 4.0 in a world where the economy is pretty well aligned and positive in all parts of the world, and firmly decided to increase our profitability while also gaining market share to create the ground of a more solid place with our partners and with our end-users.

And I would say, with that optimist note, I would open the place to questions.

QUESTION AND ANSWER SECTION

Amit Bhalla
Senior Vice President & Head-Investor Relations, Schneider Electric SE

A

All right. Thanks, Jean-Pascal. So, I think we have a lineup of questions on the line as well, but we start maybe from the room. So, Gaël, over to you. We try to keep it one question, one, two questions, and so that we can accommodate everyone in the timeframe.

Gaël De Bray
Analyst, Deutsche Bank AG (France)

Q

Thank you. Good morning. Gaël De Bray from Deutsche Bank. Two questions really. The first one is about Industrial Automation. I find it a little bit surprising not to see any operating leverage for the division given such a stronger growth environment. I mean, we've generally seen a much better margin momentum at some of your competitors and I guess they've been facing the same sort of issues in terms of inflation, in terms of shortages of components, electronics and so on. So, could you perhaps elaborate a bit more on the mix headwind potentially you had in the first half, comment a little bit more about the digital investments you've been doing and also in terms of how you see all these headwinds trending in the second half of the year?

The second question relates to Larsen & Toubro. I think they've just published relatively good numbers yesterday. I mean, can you give us a little bit of an update on how you see this acquisition, obviously, in light of the recent numbers? Thank you.

Jean-Pascal Tricoire
Chairman & Chief Executive Officer, Schneider Electric SE

A

Okay. Well, Gaël, thank you for that question. On Industrial Automation, while you mentioned the comparison, it's very important for us to grow that business. We consider that – you know that in Industrial Automation, the market share is sticky for the future, would it be on a machine or would it be within the end-user standards at a plant. So, we've got a very good traction at the moment for EcoStruxure Machine and for EcoStruxure Plant. For us, at such a level of profitability where we are today that we can keep improving, it's really important to have such a strong dynamics of top line, right, and it's accretive for the company. It's one of our best business [ph] at China (00:54:50).

So, I think it's fair to say that you need to compare both things, right? Personally, we don't pay our shareholders in percentage. We pay them in euros, dollars, whatever, but in really solid profit which are a combination of growth and percentage and really, this is a business where your presence, the conversion of customers is really important. That's one.

Second point on the margin, on the first part of the year there, there is really an element on the supply chain. And I know we speak some during this review today about the supply chain. I think what we have to integrate is that supply chain is facing those kinds of issues when you have moment of breakthroughs or ruptures in the sales trend and here, two years ago, we are kind of flat. Last year, it was [ph] more free (00:55:50) and then, suddenly, we are moving to very high levels, by the way, on certain lines of products, we are not speaking about 10, you are speaking about 200. You are speaking about new lines of products which are getting very solid traction.

So, those moments are the moment where you need to correct. And we've decided to privilege our customers, not to privilege at any cost, but to make sure that they would get delivered. We don't want the machine manufacturer not to be able to deliver a machine because the product would be missing.

So, we had to do some pretty big things in H1 to make sure that the customer satisfaction of our customer would stay at the top. By the way, I'm very proud of what we have achieved in this space. We, as you know, measured for now a number of years the customer sat of our customers every quarter and Industrial Automation is a place where we've been the best.

Now, I think we are entering a new period now in H2, which would be much more favorable from the point of view, because we've resolved a lot of issues that we had now for 9 months, 12 months. I think we started to speak about that second part of the year last year. I think most of the issues are behind us.

On the other side, on EcoStruxure, you spoke about the digital investment, EcoStruxure Machine and EcoStruxure Plant, seeing the dynamics that we have here, we are putting more people to support the strong growth we have here. And I don't I think we are the same – the only one speaking on the market of investing to support what is happening in the field of Industry 4.0. For us, this point in time was a convergence of those things, but you know Schneider or you've been knowing Schneider for a long time, seeing that we have probably one of the strongest dynamics in the sector today respect to where we are 15 years ago on a very profitable business, on a business, which is very important for the future is something very important to me.

And don't forget that unlike some of our competitors, a part of continuous process is quite significant in our portfolio and this one was less dynamic not because of us, but because of the end-market. And that's just starting really to come back up, which means that on everything which is discrete on hybrid, our dynamics are much better, really much better than some of the figures out there. And again, I mean, if you think beyond a few months, that's really important in that kind of industry, because it's sticky. It's not a one shot or so.

On L&T, I don't want to comment, frankly. Today, we are in the process of putting the two companies together. We are still two different companies. Of course, have very severe regulation on the topic everywhere in the world, but we believe, of course, that India will be one of the largest market for electrification and automation in the years to come. We have already built in the past 15 years a strong presence there, very diversified, with some business that we do only in India, by the way, we are really Indians in India. And the combination of L&T gives us a full coverage of segments of territory in a market, which promises to be the places of the highest development in the years to come. I can't really speak to that. It's not – but all the things we say at the time of the acquisition are really confirmed.

Emmanuel Babeau
Deputy Chief Executive Officer in charge of Finance and Legal Affairs, Schneider Electric SE

A

And we confirm that the Indian market is in good shape and we've been growing nicely. So, no surprise that L&T is also doing well and it's good news.

Jean-Pascal Tricoire
Chairman & Chief Executive Officer, Schneider Electric SE

A

And, I would say, it takes a long time in our business to develop. I see most of my time at Schneider has been developing new markets for Schneider. I had the privilege to be at the beginning of China and the beginning of some other countries. And India has been a thing which is very recent for us and we've been really successful at doing it. I mean, there has been a very good response of the Indian market.

But face it, we are still not mature as we are in other emerging countries, like I spoke about Indonesia, we've got 30-plus years in Indonesia of very strong focus, market in Latin America, many, many years. So, we are just at the beginning of our story in India and it's successful and it has a lot of possibilities for the future.

And it balances also our exposure, right? Some people sometimes look at us and say, China, no, right, China is only a part of what we do and we are balanced across many countries. There is no other company, I would say, which is so balanced in between areas today and all of those regions are delivering very solidly at the moment.

And we have momentum, right, we don't see, like, kind of shaking.

Amit Bhalla
Senior Vice President & Head-Investor Relations, Schneider Electric SE

A

All right. We move to the next question. I believe we have 8 or 10 questions. So, can I request just to keep it to one question, so that we can accommodate as many. We'll take one on the video now.

Operator: We will take our first question from Andreas Willi from JPMorgan. Please go ahead.

Andreas Willi
Analyst, JPMorgan Securities Plc

Q

Yeah. Good morning, everybody. I have a question on what you said earlier on connected products and that's going well and that's a driver for also your share gains in the Low Voltage business. Maybe you could elaborate a little bit more. What does it do to kind of average selling price versus as the portfolio moves to more connected products? Do you fully recover the higher costs of making these products connected?

And when you sell a connected product, can you track and kind of prove that that triggers then a higher attachment rate or higher pull-through of services or solutions on top or are customers looking at this pretty distinct in a way in terms of buying decision when they buy some of these products and then when they buy stuff that goes on top solutions or so on both in terms of Low Voltage, Medium Voltage, data centers, that will be helpful? Thank you.

Jean-Pascal Tricoire
Chairman & Chief Executive Officer, Schneider Electric SE

A

Yeah. Andreas, thank you for asking that question. It's actually a very interesting question, because connectivity on automation, on supply and digital value is an old story in Industrial Automation, which is getting regenerated by Industry 4.0 and much more interaction between our merger, between IT and OT. But I would say in electrical distribution, it's the beginning of a story. Many, many, the vast, vast, vast majority of everything that were sold in the past in electrical distribution was unconnected. And it doesn't make sense. It doesn't make sense because the OpEx linked to those systems is huge, because people don't know what's happening on which part of their installation.

So, do you see a future where thing would be unconnected? We don't see it. We think we have a huge potential in making sure that things which are in the basement of buildings, in the back of electrical room of plants will be connected and, by the way, interacting in real-time with the grid, which is proposing more and more commercial offers for green, for better electricity and better energy. So, there is a lot of potential.

Second point, that we are clearly leading this sector and gaining share and really gaining share. It took us time to put together our EcoStruxure Grid, our EcoStruxure Power. It's coming all integrated. Our large products like our air circuit breaker called MTZ is, I would say, a software-defined breaker that you can completely upload and download. And that means a lot of savings for our customers to adapt with what they have.

So, now, back to your question, when you sell a connectable product, it sells at a higher price. Does it sell today at a higher margin? The answer is no, because many of those lines of products are in their infancy. So, we build the volumes. And when the volume is coming to the right level, then you've got margins which are exactly comparable if not better than what you have in the old product, but you have just not the old products, but the non-connected products.

But at the beginning, like for any product, when the volumes are lower, you have to embark more cost. And let's face it also, as we are in the infancy, we are still learning. So, the good news with digital is that you can A/B test and you can improve, but that means during the time, you've got more cost into adjusting your product.

There is some cost associated to the fact of selling our Advisors, which are now starting to get a good traction. When we sell Resource Advisor, Power Advisor, Building Advisor and so on – Asset Advisor and so on, you need consultancy with your customers and at the moment, it's entailing cost, but what we are watching, what we are monitoring is adoption. Then, after in terms of stickiness and the capacity to detect new services, it's completely another ballgame. I mean, you go from the one-shot sell to being always connected to your customer.

So, of course, the upgrades are much more obvious. The coming back on the interaction with your customers are completely different, but, look, I mean, it's – first, we need to get connected. And then, after, we need to deliver the services and there is some investment associated to it. But it changes completely the game of Energy Management as we knew it. And somewhere, it was closer to what we have been doing for ages in Industrial Automation except that one world is 95% unconnected, while the other world is probably 95% connected. And this is what we have to ramp up in the next years to come, but we are all very excited to do that.

Amit Bhalla
Senior Vice President & Head-Investor Relations, Schneider Electric SE

A

Okay. Next question, please.

Andreas Willi
Analyst, JPMorgan Securities Plc

Q

Thank you very much.

Operator: Thank you. We can take our next question from Ben Uglow from Morgan Stanley. Please go ahead.

Ben Uglow
Analyst, Morgan Stanley & Co. International Plc

Q

Well, morning, everyone, and thank you for taking the questions. Two very quick ones. Emmanuel, on pricing actions, obviously, we're still net negative pricing in the first half. Can you tell us how you're navigating it in the second half? Any positive signs in China? And is there a realistic scenario? How easy is it going to be over the balance of the year to compensate raw materials? So, that's question number one.

Question number two, obviously, a lot of chat so far around supply chain and shortages. Obviously, we've had new tariffs come in place on capital goods since the beginning of July and things like printed circuit boards, diodes, resistors, et cetera. In the market generally, I'm not necessarily asking about Schneider specifically, but have you become aware of any new component shortages resulting from those tariffs?

Emmanuel Babeau
Deputy Chief Executive Officer in charge of Finance and Legal Affairs, Schneider Electric SE

A

Thank you, Ben. Happy to take the first one certainly. So, on pricing, actually we are compensating raw material inflation on transactional outside China and we always said that that was the objective. So, in H1, we are in line with the full-year objective and I think we keep seeing that on China, things are, as we said, better. Remember prices were going down in the past two to three years. For the first half, we are close to stability, but as we said, the game is different in China. And of course, the growth that we are experiencing there is driving a different play on the margin and with a different dynamic.

Having said that and I said it very clearly, the fact that we are actually today compensating the raw material inflation by increasing price is not enough. That means that we are going to accelerate further on price increase to go beyond raw material inflation compensation and take into account the other area of inflation that I mentioned is a procurement for the supply chain on the transportation cost, on the tariff, as I said.

So, that's an action for H2. It's going to come gradually. It's two, three months in order to have a full impact of a price increase. So, it's going to come. It will have impact on H2. At that stage, I'm not able to quantify what could be the extra benefit coming from it, but we certainly expect some extra benefit coming from accelerated price increase.

Jean-Pascal Tricoire
Chairman & Chief Executive Officer, Schneider Electric SE

A

On the impact of tariffs, on the supply chain?

Emmanuel Babeau
Deputy Chief Executive Officer in charge of Finance and Legal Affairs, Schneider Electric SE

A

Well, that was on the shortage of component I think that – the question – just on tariff, we said that based on what we know for the time being – and I wanted to be very clear – very difficult first to understand exactly what's going to be the full magnitude of the impact. Many, many question has been asked to the U.S. administration to understand exactly how, on which component the tariff would apply, but we believe that for 2018, we could have a negative impact up to €20 million. That's a very maximum, so I'm not saying it's necessarily going to be €20 million, but up to €20 million. The full year impact, of course, would be higher. And there are more measures that are going to come, but then, of course, we're not going to stay immobile and we're going to take action to address as much as we can this extra cost, so I'm not able to anticipate what the 2019 impact is going to be.

Then I think you had a question then on component shortage, I think it's something that we globally manage with our supplier and the supply chain. I'm not sure there is something specific linked to thing that will be impacted by tariffs.

Jean-Pascal Tricoire
Chairman & Chief Executive Officer, Schneider Electric SE A

If I may add to that, Ben, because it's kind of a strategic question. From the beginning we've had a view on our supply chain that will be multi-regional respect to some of our peers because for one reason. Strategically, we are more positioned on the smaller customers, on the more local and diffused customers. And the more you go deep in the – don't forget our global and very diversified presence. The more you go into local markets, the more the standards are different. And even by – I think the best epitome of that is a plug adapter that all of you transport when you go around the world. It's never the same. And that's what Schneider faces, therefore, respect to our peers, we have a very regional set-up in geographies which in a time of, let's say, bit more contentious, tariff issues becomes a real asset because we are already configured regionally.

Ben Uglow
Analyst, Morgan Stanley & Co. International Plc Q

That's very helpful. Thank you.

Amit Bhalla
Senior Vice President & Head-Investor Relations, Schneider Electric SE A

And we'll take the next question, please.

Operator: Thank you. We will take our next question from Daniela Costa from Goldman Sachs. Please go ahead.

Daniela Costa
Analyst, Goldman Sachs International Q

Hi. Good morning. Thanks for taking my question. Two quick things, so the first one on growth – on organic growth. I guess, you moved the target to 5% to 6%, but you did better than that in the first half. So, there's some deceleration implied. Is this just pure comps, or do you think some of those macro-pressures that you're seeing can lead growth to slow down a little bit going forward? And that's my main question.

And then the second thing, the strategic review for Medium Voltage is now completed. You seem very happy across the portfolio that you're gaining share and with everything, does this mean that we're maybe now in the next phase more about M&A than revisiting parts of the portfolio like you've done over the last three years – three, four years? And those are my two questions. Thank you very much.

Emmanuel Babeau
Deputy Chief Executive Officer in charge of Finance and Legal Affairs, Schneider Electric SE A

Yeah. On the organic growth for the full year, I believe that we expect another strong six months in H2. We flagged the fact that China would remain very well oriented, but remember that we've been facing high-teens growth in China in H1. So, the simple fact, if you want, is creating some differentiation between H1 and H2. And that explain why we are not necessarily expecting for H2 the same growth than in H1, but we do confirm that we expect a continuation of a very nice momentum on the top line. The guidance is clearly highlighting that and we see what is the final performance.

On the M&A, do you...

Jean-Pascal Tricoire
Chairman & Chief Executive Officer, Schneider Electric SE

A

Yeah. And I will complement what Emmanuel was saying. We've been through a very good acceleration of our top line which is good. And we have to, well, integrate a certain number of uncertainty so that we integrate in what we tell you for the second half, all right? I'm sorry if I'm not being completely able to predict everything in the world, but I think we are all facing the same questions.

On M&A, I would say, frankly, no change. First, it start by – we keep on pruning the portfolio. And now we've zoomed on what we want to do in Medium Voltage, but it's not the only part of the portfolio. We start to screen for what's amazing. In the past two years, we've divested significant number of activities that made our portfolio stronger and better. And it was not only about profitability, it was about the strategic performance of what those things we're doing at Schneider. So, that's number one.

And at the same time, we don't change our approach to M&A. It's going to be – we do M&A only when it brings a very strong strategic value to Schneider and at a very good return inside the portfolio. But we've been very clear since, I would say, Invensys that we are in a new phase of the portfolio. So, Daniela, thank you very much for asking the question because I believe it's important to reiterate this.

Amit Bhalla
Senior Vice President & Head-Investor Relations, Schneider Electric SE

A

Okay. Thanks, Daniela. Next question, please?

Operator: Thank you. We can take our next question from Alasdair Leslie from Société Générale. Please go ahead.

Alasdair Leslie
Analyst, Société Générale SA (UK)

Q

Yeah. Hi. Good morning. And couple of questions, please. Just firstly on productivity, I thought that looked pretty decent despite the negative impact from component shortages and additional freight costs. Can we assume that the kind of underlying productivity was around the usual run rate of 1.7%, 1.8% of sales or perhaps even a little higher due to the kind of sort of strong top line, and just to get a sense of the headwind from additional costs in H1 and how that could improve in the second half?

And then just secondly, just on kind of growth, obviously it was a kind of – you've set a clear goal to prioritize growth for the beginning of the year. You're kind of delivering on that. Does that approach continue as forcefully into the second half, do you still see as many opportunities today to tap as you did at the start of the year? And where is the greatest potential still in terms of further market share gains? You've flagged gains in Low Voltage, can that continue at the same current momentum over the next few quarters? Thank you.

Emmanuel Babeau
Deputy Chief Executive Officer in charge of Finance and Legal Affairs, Schneider Electric SE

A

The productivity. So on the productivity, I said we're still coming up with a very solid number despite of the few headwind that I mentioned. We, as I said, certainly view the underlying productivity remaining strong and therefore we don't see any kind of change in the trajectory on the productivity that we managed to generate in the past until last year. So, yes, we have a number of things to absorb, the tension out there, and I described how it can create extra cost in the supply chain. I think if anything, we are having day after day a more efficient, more powerful tool. So, we are extremely confident on the fact that productivity is going to remain strong, very strong at Schneider. And again, H2 was a record one last year with €200 million of productivity. I'm not saying that we're going to get there, but it should be a nice H2 in term of productivity, and the story continue beyond 2018 for strong productivity generation.

Jean-Pascal Tricoire
Chairman & Chief Executive Officer, Schneider Electric SE

A

And just to correct an impression of – the priority is always – and starting from H1 – on the improvement of operating profits. So, that's how it starts and things. Then after, well, we've been really encouraged by the dynamics that we have for our offers in geographies and the traction that we've had. The mix is coming in different fashion across the world. But we see a continuous traction for what we propose. It comes from several aspects. It comes from the fact that we have a very strong partnership with thousands of partners around the world and we are enlarging their offer so that they can tackle more solution. It comes from the engines of our growth that we have been systematically pushing over the past years. Some of it come with a cost of investment. In services, it's more head count on the road. In digitization, it's more people to convince – or to work together with our customers to architect their digitization. So, there is a cycle time there.

But we see the same opportunities coming in front of us. And as those business gain more maturity, their deployment is getting more profitable. On the top of it, I – because I think we discussed already that, I think in H1, because of this strong acceleration, we faced more issues on the back office cost that hopefully we're going to have in H2.

Amit Bhalla
Senior Vice President & Head-Investor Relations, Schneider Electric SE

A

All right. Thank you. I think we've got another 10 minutes or so, so we'll try to fit in as many questions as we can in that space. Next one, please?

Operator: We will now take our next question from James Moore from Redburn. Please go ahead, your line is open.

James Moore
Analyst, Redburn (Europe) Ltd.

Q

Yeah. Morning, everyone. My first is on SFC and productivity. On the €137 million, you split inflation reinvestment and gross saving last year. I wonder if you could do the same this first half and talk about how you think those pieces move into the second half. And on productivity, you're clear that the second half will be down from the €224 million last year, but will it be below the €174 million in the first half or should we think about similar or up on that?

And my second question is on China. Your high-teens comment, Emmanuel, leaves quite a wide range of options for the second quarter. Can I assume something like a 12% in the second versus 20% in the first? But, more importantly, on China, can you help us on how it looks sequentially in the second quarter versus the first quarter in property and industry on a sort of organic basis, how it's running momentum-wise?

Emmanuel Babeau A
Deputy Chief Executive Officer in charge of Finance and Legal Affairs, Schneider Electric SE

Thank you, James. On China, you can assume it was above 15%, so much higher than what you seem to have in mind.

On the SFC productivity, well, let's be clear, it was less of a priority, but it doesn't mean that we've been absolutely not delivering on that one. So we don't split for that result because, again, that was less the focus. But, yes, there was still some productivity being implemented. And in fact, an idea of the level of effort that we are putting in order to support our digital race and that we are doing as a leader, everything we're doing on services to build the team and the capacity – field services, but digital services as well, and, of course, the marketing investment with a lot of marketing action during H1. So, I'm sure you can make your estimate of inflation. There was still some productivity generate on cost although not at the same level than in the past two years. And the differentiation is what we've been doing in order to make this a great top line performance and build the future, I would say.

Your question on the manufacturing productivity, so please allow me not to enter into whether it's going to be higher that, lower than. I think we said it at – 2017 for the second half was a record high with close to €230 million. And I think I said it very clearly, I don't expect that we can match this very, very high performance, record-high actually for the group. But it doesn't mean that we cannot expect a nice H2 for productivity. So, a good number, but not at the level of last year, as I said.

James Moore Q
Analyst, Redburn (Europe) Ltd.

Thanks, Emmanuel. Just on the China point...

Jean-Pascal Tricoire A
Chairman & Chief Executive Officer, Schneider Electric SE

And if I may on China, of course, there is a – all kind of uncertainty introduced by the noise of the trade war. But I think you have to integrate a few things. I mean, the renminbi going down, which is giving back some competitiveness. Everything around the development of China with other countries, I mean, we very often see the world from the West, but there is more than the West in the world and, therefore, a comparison.

On second point, that story of trade war is pushing tremendously China to invest in its vertical integration and its whole industry. So, we see quite a lot of investment going into creating capability, competing with things that were sourced before from other continents.

So, all of this has to be put in a complete holistic view on what we see. Clearly, we had a very strong H1, which is coming from success that we are very proud, but we are confident for the months to come.

Amit Bhalla A
Senior Vice President & Head-Investor Relations, Schneider Electric SE

Thank you, James.

James Moore
Analyst, Redburn (Europe) Ltd.

Q

Thank you very much.

Amit Bhalla
Senior Vice President & Head-Investor Relations, Schneider Electric SE

A

Next question, please?

Operator: Thank you. We can now take our next question from Andre Kukhnin from Credit Suisse. Please go ahead.

Andre Kukhnin
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Yes. Good morning. Thanks for taking my questions. I just want to follow-up on SFC first. How should we think about it maybe beyond this year? Is this something that should grow in line with top line? Is that how you see it?

And the second question is on the supply chain tensions impact, if you could quantify that for us in the first half so that we can think about the benefit you could have from having resolved that during first half, that would be great. Thanks.

Emmanuel Babeau
Deputy Chief Executive Officer in charge of Finance and Legal Affairs, Schneider Electric SE

A

On SFC, you should certainly expect us to continue to target a nice difference between the top line and the SFC evolution. So, I'm not saying that every six months period allow for that, because you may have some impact on the top line or a special investment. But I think we've been pretty solid on that trend for several years in a row. Our objective is to increase the margin. And clearly, having an SFC on sales ratio decreasing over time that our global presence, our leadership should enable, is a big objective. So, you should expect on average SFC to continue to grow at a lower pace than the top line.

On supply chain, Andre, I'm not sure I can say much more than what I've been saying. I think we are very clear and you have all the number for H1. We continue to say it's going to be a nice solid productivity, though not at the level of 2017 which was a record high. And I don't think, as I said, we can be more specific than that. I think we're already saying a lot on the drivers or on the various component of the buildup of our margin.

Amit Bhalla
Senior Vice President & Head-Investor Relations, Schneider Electric SE

A

Thank you.

Andre Kukhnin
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Got it. Thank you.

Amit Bhalla
Senior Vice President & Head-Investor Relations, Schneider Electric SE

A

Next question?

Operator: Thank you. We will now take our next question from Simon Toennessen from Berenberg. Please go ahead.

Simon Toennessen
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Yes, good morning, everyone. My first question, Jean-Pascal, is on Medium Voltage and Secure Power. I mean, Secure Power had no growth the past five years, between – up until 2017. Medium Voltage obviously did some form of portfolio change and was sort of down 2% over the past five years. There's obviously structure growth in both businesses, and you've commented, I think, last quarter that Medium Voltage has seen a pretty good order backlog the past six months. You're now saying Secure Power, I believe you said, is growing double-digit orders. How should we think about those two businesses over the medium term? Do you think those can be sort of GDP-plus-type growth businesses going forward as some of the structural growth accelerates within those businesses?

And the second question, just more housekeeping, Emmanuel. If I look at scope, you guided €400 million impact at the beginning of the year. It seems AVEVA is doing a lot better, maybe not versus the interim projections, but from our side, it's obviously accelerating a lot. Why do you keep the guidance? Is there some divestments that I'm missing? And just on FX in the same kind of – in the same area, you're obviously slightly lowering the headwinds but keeping the margin impact the same. Maybe you can just elaborate on the two. Thank you so much.

Jean-Pascal Tricoire
Chairman & Chief Executive Officer, Schneider Electric SE

A

Good question, and thank you for asking it. I mean, on Medium Voltage and Secure Power, I think we are pretty much the only company delivering full energy solution that is reporting those activities separately. And for one reason is that when we speak with a customer, we deliver them together. There are very few customers where you just piecemeal one part of the offer. Maybe if you do just [indiscernible] (01:26:48), it's going to be just Low Voltage and Secure Power. Maybe if you are in a utility, it's going to be mostly Medium Voltage. But for the rest, the core, the core, the core of Schneider, if you want to address industry, infrastructure, building, you need Medium Voltage, Low Voltage, and more and more Secure Power because, well, you need to secure your power, right, especially for electronics, critical processes and those kind of things. So, we see them as one.

And If I summarize where we are today, Secure Power may have been flat in the past two years, but data center had been growing mid-single digit over the year. And on the core of what we do in data center is Secure Power, you don't get that, you don't get the rest to the scale where we are. You don't lead the architectures in those sectors. And if I look at the first part of the year, it's not mid-single digit, it's double digit. So that has been the best growing business of Schneider to a scale that nobody else has in the industry. And it's really important because you need to deploy your solutions on a very large scale with customers that can be sometimes very local, but very often, they can go throughout geographies.

On Medium Voltage, it's all a question if you want to be in industry and building. I mean, if you want to stay in homes, on small buildings, you can stay on Low Voltage and Secure Power. If you want to get access to the biggest part of the market, you need to start with Medium Voltage, but Medium Voltage in the segments which are important for that all value chain that we deploy and we develop. So, I would say, on both cases, probably the fastest-growing thing is – and it really depend on the sectors, but you take data centers, the fastest-growing is Medium Voltage and Low Voltage packages on the back of your presence in Secure Power. In other segments, it's going to be Low Voltage and the Medium Voltage once you are well-reposition, which are having dynamics which are very similar and very close to each other. So, I consider them as very important part of our portfolio.

When you look at Medium Voltage, credible competitors that we have in the places where you have high density of energy, which are infrastructures and industry and building must have Medium Voltage.

I think I answered Secure Power is our anchorage in IT, which is the fastest-growing. A large part of the segments – the largest part of the segments we are covering in power distribution are associating systematically Medium Voltage and Low Voltage and more and more Secure Power.

Emmanuel Babeau
Deputy Chief Executive Officer in charge of Finance and Legal Affairs, Schneider Electric SE

A

And I don't know whether I can help you with the housekeeping. On the scope for the time being, I don't have the element to change the indication that we've been sharing with you. But, of course, in due course, when I have the information and we can share that with you, we'll do that if relevant, if needed.

And on the ForEx, frankly, that's the latest vision that we have based on the current parity of currency. So, I'm not sure I can be more explicit than that. That's what we see for the time being with the current ForEx evolution.

I think versus the beginning of the year, the dollar is a little bit weaker versus the euro but – or stronger, sorry, but the yen is a little bit weaker than what we saw. So, one is probably compensating the other and that's why at the end of the day, we don't have a big change in the overall vision for the year, including on the fact that H1 is close to 80% both for the top line and the impact on the bottom line of the overall negative impact from the ForEx, so H2 will be much less impacted by the ForEx.

Simon Toennessen
Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Thank you, both.

Amit Bhalla
Senior Vice President & Head-Investor Relations, Schneider Electric SE

A

All right. Thank you.

Amit Bhalla
Senior Vice President & Head-Investor Relations, Schneider Electric SE

I think we are getting to the closing time. Before I give it to Jean-Pascal for any closing comments, I just refer you all to one of the slides in the appendix which you can see later which gives all of the dates for the conferences that we have and including an event we are planning in the U.S. in November as well. The IR team is, of course, available to answer questions following this call as well.

Jean-Pascal, any final remarks?

Jean-Pascal Tricoire
Chairman & Chief Executive Officer, Schneider Electric SE

We're going to be meeting you anyway during the various roadshows that we have planned in September. But, look, I mean, let's look at it, I mean, we are coming to a very special time when the world is coming to the direction of those things where we have invested, the electrification, decentralization of energy, digitization of everywhere. The economy is – whatever is the ambient noise, has never been as good as today in the past 10 years.

We are very focused on very synergetic portfolio at the time where a part of the industry is spending a lot of time to take care of their own portfolio. So it's for us to execute and to make sure that we keep delivering on all the engines that we have been explaining to you or prospecting to you in the past years. So, very excited by the time and see you very soon. Thank you.

Emmanuel Babeau

Deputy Chief Executive Officer in charge of Finance and Legal Affairs, Schneider Electric SE

Thank you.

Amit Bhalla

Senior Vice President & Head-Investor Relations, Schneider Electric SE

Thank you.