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PHIA.AS - Q4 2014 Koninklijke Philips NV Earnings Call

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OVERVIEW:

Co. reported 4Q14 comparable sales of EUR6.5b and net income of EUR134m.



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PRESENTATION

Operator

Welcome to the Royal Philips' fourth-quarter and full-year 2014 results conference call on Tuesday January 27, 2015. (Operator Instructions). Please note that this call will be recorded and is available by webcast on the website of Royal Philips.

I will now hand the conference over to Mr. Robin Jansen, Head of Investor Relations. Please go ahead, sir.

Robin Jansen - Koninklijke Philips NV - Head of IR

Thank you and good morning, ladies and gentlemen. Welcome to Philips' fourth-quarter and full-year results conference call. I am here with Frans van Houten, CEO, and Ron Wirahadiraksa, CFO.

In a moment, Frans will make his opening remarks and will take you through our main strategic and financial highlights for the period. Ron will then provide more details on the financial performance during the quarter. After that, both Frans and Ron will be happy to take your questions.

Our press release and the related information slide pack were published at 7 am CET this morning. Both documents are now available for download from our Investor Relations website. A full transcript of this conference call will be made available by tomorrow on our Investor Relations website.

And before I turn over the call to Frans, I would like to remind you of two things.

Following the decision in June 2014 to combine our Lumileds and Automotive Lighting businesses into a standalone company, and to explore strategic options to attract capital from third-party investors for this business, the profit and loss of these combined businesses is now reported under discontinued operations; and that assets for the business in the balance sheet on the line assets held for sale.

The cash flow of the combined Lumileds/Automotive businesses is reported under cash flow from discontinued operations. Therefore, all commentary that will follow in terms of sales and earnings at both the Group level as well as at the Lighting sector level excludes the performance related to the Lumileds and Automotive Lighting businesses.

Secondly, when we refer to adjusted EBITA on this call, this represents EBITA excluding restructuring costs, acquisition-related charges, and other charges and gains above EUR20 million.

With that, I would like to hand over the call to Frans.

Frans van Houten - *Koninklijke Philips NV* - CEO

Yes. Thanks, Robin. Earlier today, we announced that we generated EUR6.5 billion of sales in the fourth quarter of 2014, which reflects a 2% year-on-year decline on a comparable basis. Our adjusted EBITA amounted to EUR743 million, or 11.4 % of sales, compared to EUR827 million or 12.9% of sales in Q4, 2013.

Our fourth-quarter results underscored that 2014 was a challenging year, and it goes without saying that we are not satisfied with our financial results in 2014 and we have been taking clear actions to improve our performance in 2015 and beyond.

Throughout 2014, our transformation efforts actually continued to show good results, even as we address performance issues, including the delays in our remediation efforts in Cleveland, continued softness in markets like China and Russia, and stronger than anticipated foreign exchange impact, particularly in emerging markets.

Notwithstanding these issues, we are encouraged by the fact that the underlying operational performance in most of our businesses improved throughout the year and in the fourth quarter as we continued to execute on our multi-year Accelerate journey.

Let me start with Healthcare. Our Healthcare results underperformed our expectations in the fourth quarter largely due to soft end markets and the Cleveland remediation program, which I will discuss in a moment.

We were, however, encouraged by another quarter of good order intake growth in Europe, and in most growth geographies, especially in the Middle East, Turkey and Africa; and we believe we also continue to gain market share in areas like ultrasound and image-guided therapy.

Regarding Cleveland, let me start by acknowledging that we have underestimated how much time and effort it would take to solve this. Progress was delayed at the end of 2014 because it took longer than anticipated to complete the necessary remediation at some of our suppliers and to close final audit certification items.

However, we are making good progress now. As you know, we resumed production of iCT and Ingenuity CT scanners in Cleveland Q4, and the updated quality management system recently passed the third-party audit. And we now have resumed shipments of our Brilliance iCT systems to customers.

We are also beginning to ship from our Haifa and Suzhou facilities, initially for customers outside of the United States, with the aim to create a more regionally balanced manufacturing footprint. There is, however, significant work to do, and we therefore expect our global CT system production and shipment volume to only gradually return to 2013 levels by the end of this year.

This has been, and continues to be, an extremely rigorous and costly process during which we have left, and will continue to leave, no stone unturned as we refine our processes and ramp up our production, and also assure the compliance of the supplier base. We expect this ramp up to have some teething problems which we will diligently deal with to assure the highest quality to our customers and full compliance to the quality system.



We have been reporting regularly to the FDA on our progress and are excited about our ability to now build momentum in delivering our strong imaging innovations to our customers once again. As a result, we expect Cleveland to only positively contribute to EBITA from the middle of the year onwards, and we expect a full-year improvement to results by approximately EUR100 million.

Taking a bigger picture view, our Q4 performance does also demonstrate the opportunities across the health continuum, and that our strategic direction towards solution is optimally positioning Philips to capitalize on them.

In Q4, we signed another six multi-year projects, underlining the trend towards partnership business models with large hospital systems. For example, we signed a six-year agreement comprising advanced imaging and monitoring equipment and services for multiple hospitals of the AMECO Group in the Kingdom of Saudi Arabia.

In the United States, we deepened our relationship with the Mayo Clinic by signing patient monitoring and software maintenance agreements for all Mayo Clinic owned hospitals. These agreements include hardware/software solutions as well as services.

In Kenya, we opened our first community life center. This turnkey Philips village health center provides holistic community support, including primary healthcare facilities, medical training, solar lighting, clean water, and hygienic facilities. We have partnered with Image Stream Medical on a comprehensive solution that integrates real time information in and outside the lab.

Throughout, through this partnership, we will be able to offer complete integrated solutions and associated consulting services which complements our offering of live image-guided therapy solutions, clinical informatics and services.

As you all know, we announced in December that we signed an agreement to acquire Volcano, which will expand our global leadership position in the image-guided therapy market, one of the most strategic and promising assets in our Healthcare portfolio.

Volcano's impressive and unique product portfolio is highly complementary to our strong offering in live image-guided solutions, creating an opportunity to deepen customer relationships, gain market share, and accelerate the revenue growth of our image-guided therapy business.

We also see significant scope for immediate cost synergies, which we will reinvest substantially back into the promising image-guided therapy opportunities that we identified.

We continue to expect the transaction to close in the first quarter of 2015, and we expect a seamless integration given the complementary nature of the two businesses.

Let me now turn to Consumer Lifestyle. Consumer Lifestyle continued to perform very well, driven by the continued strong demand for our innovative solutions, as well as successful new product launches. Our focused approach continued to drive sales, in particular in Health & Wellness, thereby improving the product mix and gross margin by another 80 basis points.

Our Mother & Child Care line, which supports healthy development of children, continued to deliver strong double-digit growth, driven by new products that reduce colic, preserve nutrients and vitamins in milk, and help children in the transition to independent drinking.

Our beauty, male grooming and oral healthcare products also proved strong through the holiday and gift-giving season. We continued to gain market share in the rapidly-growing electric toothbrush market as consumers show an increasing interest in their oral healthcare.

Philips Sonicare delivered record market share growth, and the new Sonicare 2 series designed to facilitate the transition from manual to electric brushing with an easy start feature, was very well received by consumers in North America.

We also launched BlueControl, the first, the world's first wearable blue LED light therapy device, to treat the symptoms of psoriasis without any of the side effects associated with traditional treatment options. The UV-free, blue-light, light therapy is enabled by 40 high-intensity blue LEDs, with tailored light settings. Designed with the patient in mind, the battery-driven device can be used anytime and anywhere.



And that's a nice bridge to switch to Lighting. In Lighting, we saw continued strong double-digit growth and improving gross margins in our LED-based portfolio, especially in LED lamps, despite the strong price erosion.

The 20% growth in our LED portfolio partially offset the 14% decline in conventional lighting. Our Lighting performance continues to be impacted by challenging dynamics in markets like China, and Professional Lighting Solutions North America.

As you know, we had expected the turnaround of our Professional Lighting Solutions business in North America to deliver profitable growth in the fourth quarter on the back of good order book coverage. However, despite sequential improvement in quoting and pipeline activity across segments, we were not yet able to return to sustainable growth in Q4 yet, as a number of projects shifted out into 2015.

We are confident that our strategic direction, including a market-leading portfolio of LED lighting, innovative connected lighting systems, and a multi-channel go-to-market model are, in fact, correct. But we need to move faster in making the necessary refinements, and have, therefore, taken decisive action to improve performance going forward.

As part of that, we have appointed Amy Huntington as the new leader for Lighting North America, for Lighting Americas, significantly strengthening our North American team to unlock the big potential that we actually see in the North American market.

Further, we continue to make progress turning around Consumer Luminaires in Europe where we saw a significant profitability improvement. However, the overall climate in Europe and the residential construction market in particular need to show improvements to enable this business to start delivering solid higher growth.

As the front runner in digital lighting solutions for businesses, cities, consumers that deliver value beyond illumination, we signed a contract to provide the city of Madrid with 225,000 connected energy-efficient lights. The renewal of the city's entire street lighting system makes it the world's largest street lighting upgrade to date.

The project will deliver more than 40% in energy savings, which will finance the cost of the technology upgrade, providing Madrid with the best quality street lighting for a brighter, safer and smarter city at no additional cost to its citizens.

The new city lighting system benefits from an integrated command center capable of controlling the intensity and the duration of lighting across the city according to where it is most needed.

In New York, we equipped Madison Square Garden with a connected LED lighting system for its facade lighting, which can now be adapted to suit any occasion from celebrating a special event to lighting up the arena in a team's specific colors.

We also won the largest, single-largest LED lamps tender in India in the state of Andhra Pradesh. It involves the supply of 1.5 million LED lamps, which will be provided to more than 1 million households, and leading to energy savings of 80% to 90%, compared to the incandescent lamps that most of these families are still using. By implementing this, Andhra Pradesh state will save an estimated 75 to 80 megawatts per year.

Let me now provide you with an update on the progress we have made in our multi-year Accelerate program.

Over the course of 2014, Accelerate continued to improve operational excellence across the organization, resulting in increased customer centricity, enhanced service levels, faster time to market for our innovations, and better cost productivity.

In Healthcare, Informatics and Solutions and Services, for example, we implemented a new so-called agile software development methodology that quadrupled the annual number of new software releases. This contributed to a record number of new introductions of clinical informatics solutions in the IntelliSpace family at the Radiology Society of North America, a show that was held in Chicago recently.



And in the Consumer Lifestyle business, our deep understanding of local shopper needs allowed us to successfully launch an optimized range of male grooming products in France, meeting key price points in customer needs. This locally-relevant value proposition resulted in a 2 percentage point market share gain since launch and a record number of Philips product listings at retailer Carrefour.

In Lighting, Professional Lighting Solutions enhanced its product portfolio for the indirect channel in Europe. It drove a 60% sales growth thanks to a strong price-performance ratio, locally-relevant value proposition, and a delivery time commitment of only five days.

Our three productivity programs also continued to deliver strong support for our underlying operational performance improvements. Overhead cost savings were EUR35 million for the quarter, bringing the total overhead cost savings for the year to EUR284 million.

Our Design for Excellence program generated EUR123 million of incremental savings in cost of goods sold in quarter, resulting in EUR284 million, accidentally the same number of DfX savings for the full year.

Our End2End productivity program achieved incrementally savings of EUR22 million in the quarter, which brings the total amount of END2End productivity savings to EUR79 million for 2014.

We are actively discussing the sale of the combined Lumileds and Automotive Lighting businesses with potential buyers. We received a number of non-binding bids in December, and expect to receive binding bids before the end of Q1. As such, we are confident that we will complete a transaction in the first half of 2015.

We are determined in our plan to separate Philips into two standalone companies, each one better positioned to capitalize on the highly-attractive opportunities in both HealthTech and Lighting Solutions markets.

As indicated already, the separation process is expected to take approximately 12 to 18 months. We have now informed that we currently estimate total separation cost in 2015 to be in the range of EUR300 million to EUR400 million.

We are still in the early stages, and will, therefore, provide more information about upcoming milestones, new reporting structures, as well as the route to market for Lighting Solutions, and more detail on the separation cost later this year.

In conclusion, ladies and gentlemen, I'd like to reiterate that we are not satisfied with our performance in 2014, and we view 2014 as a setback in our performance trajectory. But we have been taking clear actions to drive stronger operational performance across our businesses, and we expect sales growth and EBITA margin improvements in 2015, as well as beyond.

Looking ahead, we remain cautious regarding the macroeconomic outlook, and we expect ongoing volatility of some of our end markets. We also anticipate further incidental cost in 2015 and 2016, mainly in relation to restructuring and the separation.

Due to these factors, we are tracking 1 percentage point behind on the path to achieving each of our 2016 comparable sales growth, EBITA and ROIC Group targets. We are convinced that this does not change our longer-term performance potential considering the attractiveness of Lighting Solutions and HealthTech markets, as well as our own competitive position.

Later this year as we progress with the separation of Philips and the reallocation of the overhead cost, the IG&S part of Philips, we will update the market about the integral performance targets for each of the two operating companies.

And with that, I would like now to turn over the call to Ron to discuss our financial performance and market dynamics in more detail.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Thank you, Frans. I will now provide you with some additional detail on our financial performance.



Comparable sales of EUR6.5 billion were 2% lower than the same period last year if you take out currency and portfolio changes. Nominally, sales increased by 2%, and this was driven by positive currency translation effects of 3 percentage points and a 1 percentage point due to changes in scope of consolidation.

Comparable sales in Western Europe and North America were stable. Low single-digit declines in Healthcare were offset by mid single-digit sales growth in Consumer Lifestyle and more or less stable sales in Lighting in both Western Europe and North America.

Overall sales in the mature geographies declined by 2%. This reflected tough compared to Q4, 2013, when we received a one-off IP royalty income in IG&S related to patent settlements in our Blu-ray and TV licensing programs.

In our growth geographies, comparable sales declined by 2% in the fourth quarter. This was due to mid single-digit sales declines in Healthcare and Lighting, which were partly offset by high single-digit sales growth in Consumer Lifestyle.

Country-wise, strong contributions from countries like Brazil, India, Mexico and Poland were offset by a significant sales decline in China, Russia and Saudi Arabia, and this reflected the macroeconomic developments also.

Sales generated by growth geographies represented 36% of total sales in line with Q4 of last year.

Let me now give you some financial details per sector.

Currency comparable equipment order intake declined by 5% compared to Q4 of 2013 in Healthcare. Excluding the impact of our voluntary production suspension in Cleveland, equipment order intake declined by 1% in the quarter.

Order intake in the growth geographies showed a low single-digit increase, where strong double-digit growth in most regions was offset by a double-digit decline in comparable sales order intake in China.

Western Europe achieved mid single-digit growth, with strong growth coming from Spain, Portugal and the Benelux. Comparable order intake in North America was down double digits.

Overall, 2014 was a challenging year for Philips Healthcare in North America. In addition to the voluntary shutdown of our Cleveland facility, we also made changes to our go-to-market model, and this caused a short-term disruption in our performance as we implemented these changes.

The good news is that we have now resumed shipments from Cleveland again, and we're confident that our strategic direction and go-to-market models are correct, given the customer consolidation that is going on.

With the majority of change behind us, sales force productivity is now increasing. We expect this optimization to pay off over time. In the fourth quarter, our LED sales increased by 20% year on year, and now represents 37% of total Lighting sales compared to 31% in Q4 2013.

As Frans said already, we are pleased to see the continued improvement in the gross margins of our LED-based portfolio, and specifically in LED lamps, despite the strong price erosion.

Sales of our conventional lighting portfolio declined by 14%. As you know, the conventional lighting decline is an intrinsic dynamic in the lighting industry. Because of our leading position and our proactive stance in rationalizing our conventional lighting and manufacturing footprint, we are very confident that we will keep to reap the maximum benefits from the golden tail. We adjust our remaining conventional manufacturing footprint on a regular basis in line with the decline in conventional lighting.

Let me now provide you with some additional detail on the EBITA development in the fourth quarter. Slide 20 and 21 of the presentation material that we posted on our website this morning provides an overview of the main drivers of adjusted EBITA when compared to the same period of last year.

You'll see that our underlying operational performance contributed 30 basis points to the margin in the fourth quarter, and this was 90 basis points for the full year. This is a demonstration that our Accelerate program continues to improve operational performance, and drives efficiencies supported by our three productivity programs.

The gross overhead savings amounted to EUR58 million year on year, but as we showed, the savings in this bridge net of increases in non-manufacturing cost, the net effect versus the last-year period is zero; and the increase in non-manufacturing cost was equal to the overhead cost savings.

Design for Excellence, or DfX, which is aimed at reducing cost of goods sold, delivered EUR123 million of savings year over year. Our End2End productivity program generated EUR22 million of savings year over year. These cost savings were able to more than offset negative pricing effect of 240 basis points, as well as wage inflation and additional investments in future growth.

The operational improvement was more than offset by the drop of 150 basis points in the adjusted EBITA margin which was caused by currency headwinds of 60 basis points, as the benefit from the strengthening of the US dollar was offset by adverse swings in various emerging market currencies, most notably the Russian ruble and the Argentinean peso. The voluntary production suspension at the Cleveland factory negatively impacted the EBITA margin by a 100 basis points.

Tax charges amounted to EUR16 million, and were significantly lower than the same period last year, largely due to lower earnings and application of favorable tax regulations related to R&D investments. For 2015, we expect the effective tax rate to be in the 28% to 30% range.

Bottom line, we generated a net income of EUR134 million in the quarter compared to a net income of EUR412 million a year ago. This decline is largely explained by EUR443 million of higher incidental items and lower earnings of EUR84 million which were partly offset by lower tax charges and higher results from investments in associates.

The return on invested capital was 4.5%. Excluding the Masimo provision in Q3 and the additional provision for ongoing legacy legal matters we took in Q4, the ROIC was 8.4%.

In addition, it is important to note that as a result of the decision to move the Lumileds/Automotive business to discontinued operations -- this business no longer contributes to the returns whereas its assets are still accounted for in the net operating capital of prior periods -- this reduces the ROIC by about 140 basis points.

Inventory as a percentage of sales increased by 180 basis points to 15.5%, which can largely be explained by currency impacts, production ramp up at the Cleveland factory, and the consolidation of the General Lighting Company, GLC. That was the acquisition that we did earlier in the year.

In the fourth quarter, we generated a free cash flow of EUR559 million, including a one-off pension contribution of EUR49 million, as part of the new funding agreement for the Dutch pension plan, under which Philips is no longer liable for future deficits.

For the full year, we delivered EUR897 million free cash flow, excluding the EUR400 million one-off pension contribution in the Netherlands.

By the end of 2014, we completed 41% of our EUR1.5 billion share buyback program. We continue to take a disciplined approach to capital allocation that allows us to fund growth while maintaining a solid capital structure.

Looking ahead, overall market conditions continue to show a mixed and fragile picture. We expect overall market conditions in 2015 to be similar to or slightly better than they were in 2014.

In the US, healthcare reform has led to more than 20 million new healthcare enrollees since the Affordable Care Act was signed into law, with the 2015 open-enrolment period underway, and set to conclude on February 15.



Enrolment strength, combined with higher [procedures] volumes, have driven only modest growth in the healthcare equipment space. But the value-based care transition has pushed providers toward delaying new equipment purchases.

2015 CapEx in the US is forecast to remain flat, although new hospital construction is expected to grow by mid single-digit.

Growth in the Chinese healthcare market decelerated substantially in 2014 as government anti-corruption efforts continued and efforts to favor domestic innovation hampered the premium segment of the market. It is expected that the Chinese healthcare market environment in 2015 will be quite similar. Overall, we estimate the global healthcare markets to grow low single-digit in 2015.

The overall US construction market is expected to grow high single-digit in 2015, of which non-residential construction is forecasted to grow by 11%. The Architecture Billings Index continues to point to growth in the non-residential construction market as well. While lower than the 53.7 mark reached in that Billing Index in October, 2014, the 50.9 November level was above the 50 threshold.

The Western European construction market is forecasted to grow by 2.4% reflecting a slight improvement versus 2014. Nevertheless, overall sentiments and market expectations in Europe remain quite uncertain and vulnerable, so we remain cautious.

Next. To the anticipated EUR300 million to EUR400 million of costs related to the separation that Frans referred to earlier in the call, we currently expect restructuring costs in 2015 to be around EUR250 million.

In addition, we expect the costs related to the disentanglement of the combined Lumileds/Automotive Lighting business to amount to approximately EUR50 million in the first quarter of 2015. This will be accounted for in discontinued operations.

For IG&S, we expect reported EBITA for the full year 2015 to amount to a net cost of around EUR900 million. The increase versus last year is mainly driven by additional costs in investments in Innovation, higher costs, and a decrease in IP royalty income. In addition, IG&S will absorb the earlier-mentioned separation costs of EUR300 million to EUR400 million as well as about EUR50 million of restructuring costs and other incidental items. On an adjusted EBITA level, this therefore implies a net cost of around EUR450 million.

Let me briefly summarize before opening the line for questions.

Market volatility in various regions remains a concern to us in 2015. The euro exchange rate will most likely be more favorable for us, but certain developing-market currencies are expected to continue to represent headwinds.

Overall, we anticipate operational performance improvements in all our businesses, which are expected to improve adjusted EBITA by at least 100 basis points. But for overall 2015 performance, we'll be back-end loaded, with Q1 expected to show a slow start to the year.

With that, let me now open the line for your questions which Frans and I will be happy to answer.

Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Simon Toennesen, Credit Suisse.



Simon Toennesen - *Credit Suisse - Analyst*

My first question is on Cleveland. You obviously said that you are shipping products again. Can you just --? In order just for us to quantify, can you give us an idea as a percentage of total -- those shipments account for; i.e., of the product ranges that you're usually shipping, how much of a percentage do the current shipments account for versus, let's say, 2013 levels?

And the second question is on the contribution impact of Cleveland. I think you said EUR100 million from H2 onwards. Can you just clarify that again? And how much was the Cleveland contribution in the past; just maybe to also quantify as a percentage the impact?

Thanks very much.

Frans van Houten - *Koninklijke Philips NV - CEO*

All right. We're going to bare our souls here (laughter). Fair questions. Let me first reiterate that I'm happy that we are back in business and shipping, not only from Cleveland, but also from [Haifa] and [Suzhou].

We've also flagged that it will take us time to make the whole operation robust. We want to be very sure that we now stick to the new quality management system in place, and that also applies to our suppliers.

So we will see a gradual ramp up, and we will only at the end of this year be back to capacity on an aggregated level between the three production locations, because going forward, we will have a distributed regional manufacturing setup, and no longer being single-sourced out of one location.

You ask at what kind of percentage of capacity are you. I don't want to be too precise, because obviously, it fluctuates week by week; but a rough indication is that we are currently only at about 10% of the overall capacity that we would like to be, reflecting that slow ramp up as we go gradually into a higher production mode.

We said that 2015 will show an improvement of the EBITA related to the CT category, as produced in Cleveland, Haifa and Suzhou, by approximately EUR100 million, and that that is back-end loaded.

In fact, the first half of the year still has a year-on-year negative impact, and that is caused by the fact that last year, even though we we're not shipping new machines out of Cleveland, the field was still installing production out of 2013 with revenue recognition in the first half of 2014. And therefore, there is a trailing effect, if you like, where we don't see the year-on-year improvement yet in the first half of 2015, but only in the second half of 2015; or let's say we've said from the summer onwards.

So I hope with that, Simon, I give you enough color on this whole dossier. We will diligently work to really now get this back to full satisfaction.

Simon Toennesen - *Credit Suisse - Analyst*

Thanks very much. Can I just have a very quick follow-up on Healthcare? You said, I think -- or, Ron, you said that you expect growth in China to be similar to 2014 levels. Can you just say what the overall growth for your Healthcare sales in -- organically in China was in 2014? And whether that was -- your comments were referring to the market growth, or for you?

Thanks very much.



Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Yes. Thanks for the questions. My comments referred to the market growth in China, so we see a similar situation unfold in 2015. I guess what we're saying, as you know, don't bank too quickly on China lapsing back to what we have seen before in terms of growth. It's going to be really on the very modest growth side.

Now we've also said this is due to the government initiatives, not in the least by stimulating local innovation. And of course, we ourselves have to come back from where we left it all with Cleveland, as Frans just elaborated upon. So the market growth is not going to be very significant.

Now if you look at the growth in China in the fourth quarter -- sorry, for the full year, this year was minus 13%. Now in there, of course, there's a significant part of CTs because China has been always a very important CT market for us. So that is what we need to come back from.

Nevertheless, the growth in China for this year in our Healthcare business, it will probably be for the reasons mentioned, particularly because of the Cleveland comeback gradually over the year higher than market growth. That's how I would guide it.

Simon Toennesen - *Credit Suisse - Analyst*

Great. Thank you very much.

Operator

Andreas Willi, JPMorgan.

Andreas Willi - *JPMorgan - Analyst*

My question is on your commentary on 2016 and the 1% you're tracking below your plan. I'm a bit confused about this 2016 commentary. And also, given that you have the separation ongoing, does it make sense at this point in time to comment on that, and given you're going to have new targets anyway?

But what exactly do you want to say in terms of when you say you're tracking 1% below? Because you could say I'm tracking below but I'm doing something to catch up. Or is this just a formal reduction of the margin target we should just break down into the two new companies when we look at the 2016 potential?

And what do you include for incidentals in that 2016 number? Because without knowing that, it's very difficult to have a view on what it means.

Thank you very much.

Frans van Houten - *Koninklijke Philips NV - CEO*

Hi, Andreas. Good question. So first of all, let's explain once again what it means that we are tracking 1% point below on growth and profitability.

We want to be transparent to our shareholders of where with current insight we expect to land in 2016, such versus the original target that is 1% lower. Obviously, that is caused primarily by Lighting and Healthcare, and to a degree to IG&S, where some of the separation costs land. Let's for now say it's about equal, equally split around those three factors.

Consumer Lifestyle continues to perform very well and is not causing this adjustment, this trading update.

You're right in observing that it doesn't make at this time sense to set new targets because we are in the middle of the separation. And it depends, of course, on the separation perimeter on how exactly the assets allocated and also balance sheet will pan out. And therefore, we said in our press release that we prefer to come back later in the year when we're further progressing on our separation to talk about HealthTech and Lighting Solutions and the performance outlook for that.

And likely at that time, since we are then very close to 2016, we would like to create even a longer perspective, because we strongly believe in the long-term opportunity of the HealthTech market and the Lighting market where we are positioning ourselves for success.

I must say I was also encouraged by, let's say, the trends in the United States for value-based healthcare, accountable care and outcome based, which is exactly aligned to our strategy of being a partner to hospital systems to drive better productivity.

Okay. Let me not digress and get back to your question.

So we give transparency on where we expect to land in 2016, and the main drivers are Healthcare, Lighting and IG&S. And later this year, we plan to more formally update the targets.

Andreas Willi - *JPMorgan - Analyst*

That's very clear. And a follow-up just to clarify on Ron's earlier comment about 100 basis point improvement. I didn't quite catch what exactly that relates to in terms of is that the Group adjusted EBITA margin?

Frans van Houten - *Koninklijke Philips NV - CEO*

Well, we were proud -- if you'll allow me to digress a little bit, we were proud that despite all the headwinds, in 2014, we saw the operational result improve by approximately 90 basis points. Right? It was improved because of overhead cost reduction, the procurement program and our productivity drives; and then, it was offset by headwinds like currency and what have you and incidentals.

So if you keep that context, then between 2015 and 2016, we expect to further improve our operational result of each division, each sector. And this is where Ron flagged that for 2015 that's going to be approximately a 100 basis points of operational results improvement.

Andreas Willi - *JPMorgan - Analyst*

For the Group underlying?

Frans van Houten - *Koninklijke Philips NV - CEO*

Yes, Andreas.

Andreas Willi - *JPMorgan - Analyst*

That's very clear.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Okay. So you can also look, Andreas, at page 57 of the deck where we have basically outlined for 2014 the 7.5% of incidentals. As you know, we're not proud of most of that, but that at least indicates.

And then we showed you 2015 and 2016. So it's a bit too early to guide for 2016 itself, but what I said over 2015 was 100 basis points adjusted EBITA improvement. I also flagged EUR250 million in 2015 for restructuring, and EUR300 million to EUR400 million of costs for [the separation into HealthTech and Lighting Solutions] (corrected by company after the call). Those are some of the main incidentals that we're looking.

Andreas Willi - *JPMorgan - Analyst*

Thank you very much.

Operator

Gael De Bray, Societe Generale.

Gael De Bray - *Societe Generale - Analyst*

Firstly, looking at the profit bridge in the slideshow, how do you explain that the contribution to profit from overheads and end-to-end savings was actually much lower in Q4 than in the prior quarters? So that's question number 1.

And then secondly, one of your competitors today just indicated that it would likely benefit from a 30 to 40 bps positive impact on margins in 2015 related to the FX changes, so using the current currency rates. So I guess I'm curious to hear from you on this as well.

And the last question, the final question is on Lighting. It seems that the LED-based sales growth was just about 20% in Q4, so I think that's probably one of the slowest quarterly growths ever achieved by the business. That would be great if you could comment on that.

Thanks very much.

Frans van Houten - *Koninklijke Philips NV - CEO*

All right. Let's divide the work here and have Ron comment on the FX.

Let me start with the overhead cost. Look, overhead cost reduction is not a linear process for the year. We deploy measures to the organization, we encourage them to go as fast as possible within a year; and then it comes let's say with puts and takes through the year.

In fact, I have here an overview quarter by quarter. I think it was EUR70 million in Q1, EUR61 million in Q2, EUR68 million in Q3 and EUR22 million in Q4. Right?

So it comes with puts and takes, and that will also happen in 2015. You know that we have announced a raise in the overhead cost savings at the Capital Markets Day back in September. The teams are now working very hard on that.

We have passed it with, let's say, our social partners, the works councils. We feel good about our ability to again achieve these productivity improvements to the tune of the -- let's say overall the 100 basis points that Ron flagged across the three programs.

Ron, maybe you take the FX?



Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Yes. So what Frans said is, of course, correct. In overhead savings, this comes in lumpy. There were some more investments in Q1 and Q4. I think the better thing to look at is that we made more than the committed target for 2014, something we're proud of. And we're going to give this continuance, as we have already flagged in earlier communications.

Yes. On the ForEx, of course, you've seen EUR30 million negative. Why was that? Well, three basically underlying reasons.

One, we sold less than anticipated because this is versus earlier guidance that we expected it to break even, slightly positive. So sales was less, so that the influences your footprint, if you will, your sales footprint.

Two is the ForEx rate change. Of course, the US dollar impact was very positive, but then we have these emerging market currencies that offset them, and that doesn't help. And unfortunately, we had also a somewhat larger balance sheet revaluation at the end of Q4. That was on some of US obligations, including the Masimo claim, and also some of the emerging markets where we saw strong year-end decline.

Now if you ask me what is for 2015 on the horizon, I think it would be around break even for us. We have to bear in mind that we also -- there is also that same competitor you mentioned, flagged: Too early to see tailwinds because also of some of the hedging contracts that we did. So I would say -- I would put it at this moment around break even at prevailing rates.

Now the uncertain factor is still the emerging market currencies. And of course, we're doing our best; not only looking at hedging, but also, we're looking at pricing actions where we can, which is tough, taking costs out and looking at more the footprint rearrangement where possible.

So there's a lot that we do to try to manage that, but particularly emerging markets over the past year, that has been proving somewhat volatile.

Frans, you want to --?

Frans van Houten - *Koninklijke Philips NV - CEO*

Yes. Let me comment on LED-based sales growth. If you look at the last two or three years, then we have seen ups and downs in the growth rate. It is true that Q4 is the lowest of, I think, in a sequence of about eight quarters.

It's of course also the case that the underlying base of LED business is becoming more significant, which would cause it to become normal that the sales growth rate becomes a lower percentage of the total. Now 37% of Philips's business is LED, and that's already significant.

We continue to expect strong sales growth in LED. I would not take that the Q4 is now the new normal. We expect strong uptakes both on the consumer side as value propositions actually become quite affordable.

We are now in product ranges and price points where consumers will see the opportunity to make switch. And in the professional side, of course, [you will give me all the way], all the time to talk about the energy efficiency, and that's highly attractive.

So let's not consider the 20% the new normal. We continue to drive this hard and we are very optimistic about the quality of this business. And I'm very pleased that the gross margins in LED continue to edge up despite price erosion.

Gael De Bray - *Societe Generale - Analyst*

Okay. Thank you very much.

Operator

Martin Wilkie, Deutsche Bank.

Martin Wilkie - *Deutsche Bank Research - Analyst*

A couple of questions related to the portfolio. So the first one is you obviously announced the acquisition of Volcano back in December.

It's the first sort of larger deal that you've done. In the past, you've said that the Company needs to earn the right to do deals after some of the headaches that the Company experienced after Genlyte and Respiroics, and I'm just wondering if you could let us know do you feel the Company's now at stage where further deals could happen, or was the Volcano deal something of a one-off opportunistic, just so we can understand what the intentions are on the M&A side, particularly given there's obviously many other things happening inside the Company with Cleveland and the split, and so forth.

And the second question was just on the Lighting split. You mentioned about some non-binding bids. There has been some press commentary that the overall Lighting business has received bids from private equities as well. I'm not sure if you can comment directly on that. But just generally, if you can confirm you still believe the best way to do this is to sell components first and separately have that capital markets listing for the remaining lighting business some time in 2016.

Frans van Houten - *Koninklijke Philips NV - CEO*

Yes. Hi, Martin. Well, on Volcano, let me underline again that we think it's a highly synergistic business together with our own image-guided therapy business that has very high market shares and is also highly profitable.

With the Volcano smart catheters, we give -- we combine that with our image-guided hybrid operating suite, and we really get more closer to cardiologists, interventionists every day.

So it was a deal that we wanted to engage on. You cannot always choose the moment that an asset like this becomes available. And since that process was running last summer and fall, we engaged on it.

I don't want to overeat ourselves. We have a lot on our plate, so we will make this deal a big success. We have put a great team of people on it to do the integration. We expect to close this deal later this quarter, and we are very positive and optimistic about our ability to realize our business plan.

Then, of course, we need to work diligently on the Lumileds/Automotive deal which is expected to close in the first half of 2015. That's a well organized process where we feel that we are on track. And so we will not suddenly change our tack to do a --

Yes. So we'll take it carefully step by step.

Now on your point on Lighting, and the rumors in the market, well, I can say, of course, that the rumors underline that this is an attractive business and that people see value in it, and that pleases me.

At the same time, rumors should not become runaway rumors. That's not healthy. It's very early days. We have said that we will first do the separation process, and it takes us 12 to 18 months. Only then do we know exactly the perimeter of the Lighting Solutions business. And I don't only mean sales and profitability, including the allocation of IG&S, but I also mean separating the balance sheet of Philips including, let's say, the liabilities. And only then when we have clarity on that can you engage in a process where somebody can actually make a bid.

So I consider this as a rumor that states that there is interest of the market, but we need to be very clear that there is no bid. There cannot be, because there is no clear perimeter and we have not started any process. We are just preparing ourselves for the separation.

And then later this year, let's say in the second half of this year, we expect to be in a better position, as we then know the carve-out perimeter, the separation perimeter, to update the market on the next steps, next steps that will include any option, right? And I've always said a likely option is an IPO, but it is not the only option. And I'd like to leave it at that.

So we should not get ahead of ourselves and we'll just put the statement of interest through the press and on the stack. And I'm happy that people are interested and we'll deal with it in due course.

Martin Wilkie - *Deutsche Bank Research - Analyst*

Very good. Thanks for that.

Operator

Ben Uglow, Morgan Stanley.

Ben Uglow - *Morgan Stanley - Analyst*

I had three questions. One was Frans. Could you just give us a little bit of color, just market sense, on the other parts of the North America, and particularly the US diagnostic portfolio? How are things going at the moment in ultrasound, patient care, home healthcare, etc? And what sort of growth are you seeing in those businesses at the moment?

Second question is: You've been very clear in saying that you are going to have to offer some form of incentives and discounts around Cleveland and the CT business in order to get the order book rebuilt. What I was curious to know is, is that just for CT, or is it going to -- is there a reputational or a knock-on effect across the portfolio; i.e., are you going to have to be more aggressive on discounts in other parts of the overall imaging business?

And the third question was -- I guess it's a delicate one, but it's a follow-up to what Martin just mentioned; rumors or press reports, etc. I fully appreciate you can't comment on that. But thematically, what I'm curious to understand is if one was a financial or a trade buyer of lighting assets, wouldn't they prefer to have Automotive, Lumileds and Lighting Solutions all together rather than already broken apart? If that's an issue that you're able to comment on, I'd be very appreciative.

Frans van Houten - *Koninklijke Philips NV - CEO*

Yes, sure. Hi, Ben. I think we can answer all three questions. Let me start with the first one.

So the North American business, we have all three sectors there. Consumer Lifestyle had a very good quarter where we saw strong sales of our oral care business, our personal care business, and so I was happy with the performance of Consumer in North America.

On the Lighting side, we saw strong performance on the lamps business and we already said in our commentary both Ron and I did that Professional Lighting Solutions, the old Genlyte, did not perform as we wanted to. We have an increase in the order book but we did not deliver all the details. And overall, we felt that we had to intervene, and we have appointed Amy Huntington as the new leader for lighting for the Americas.

In Healthcare, we actually have -- are not proud of the whole year, but we did see some strength in the fourth quarter in ultrasound and in patient monitoring. And that makes me happy because it shows that Brent Shafer as the CEO of North America, he stepped in the healthcare role in the middle of the year when I also intervened in the overall leadership, that team is coming together; ultrasound and patient monitoring strong. That's pretty good. We also won the Mayo Clinic who will also equip all their hospitals with our patient monitoring equipment, so actually that looks good.



Now on your point, we do have to rebuild confidence around the CT portfolio. From a competitive point of view, we have seen some activities of bundled deals. Then, of course, if you cannot deliver a CT, that also have some effect on the bundle deals, so that is unfortunate. We expect that we do have to make a good effort in 2015 to regain momentum in that business. Of course, we start by delivering against the existing order book, but as we have flagged, it will take us certainly some efforts.

And when it comes to combined deals, yes, it may have a knock-on effect, although, when you look at the European order intake, and this is interesting, we had a solid mid single-digit order intake in Europe, and that also was including deals around diagnostic imaging. So it also shows that when we have our act together that actually we are performing with good order intake also for diagnostic imaging, and that, I think, is a very positive sign.

Then on the third part of your question, yes, I'd love to talk a little bit about the upstream/downstream equation that you refer to. We strongly believe that the lighting market is undergoing a fundamental change.

Now you can say the old component was a light bulb and the downstream was the fixture in which you screw in the light bulb. The new component is not the light bulb but it is a packaged LED; and the new application is an integrated fixture with controls and LEDs built in. We believe that the LED business, the component business, as a semiconductor business, will benefit from a consolidated scale in the world, and over time LED, packaged LED makers, will look for industry consolidation and strive for a very high market share in packaged LEDs.

Our Lumileds and Automotive business is very well positioned as the strongest patent owner in the world in a great high-end position to actually drive and be a platform for growth in packaged LEDs. Right? And Automotive and Lumileds are together because, in fact, automotive lamps will become the components for automotive lighting.

But the profit pool for Lighting Solutions is in these large-scale and integrated solutions doing complete cities, doing complete buildings, having smart home solutions. And the value is no longer in the vertical integration, but the value is in how you drive integrated systems.

And with intimacy with your customer base, you start eating into the adjacencies of controls. We are seeing that we replace the labor of the electrician and we capture that value in our integrated solution. I don't want to make this too long, but we now have office lighting system that is low voltage, powered over Ethernet, plug and play, easily configurable; and actually, you don't need an electrician to install it. Right?

So you pay a bit more to Philips, but you save on the electrician and the overall building cost, and you get the most -- you get actually a smart grid lighting solution in your office, including office management solutions.

So very exciting. So Lighting Solutions need to focus on the application and should allow the components -- we allow the components business to participate in this market share gain that typifies the semiconductor business.

So we think we have the right strategy and we will make Lighting Solutions as part of a process later this year when we have defined the carve out, the separation perimeter, and we are in a better position to talk about the strategy to give lighting access to the market directly.

Is that quite clear, Ben?

Ben Uglow - Morgan Stanley - Analyst

Yes. That's very helpful. Thank you, Frans.

Operator

Daniel Cunliffe, Liberum Capital.



Daniel Cunliffe - *Liberum - Analyst*

A quick question on the US healthcare orders. We've heard from Siemens today, GE on Friday, that US orders were up, I guess, mid to high single digits versus -- I think Philips talking about double-digit decline, so around about a 15 point difference. If you could just break out how much is due to Cleveland, I'm assuming 8 points, as you said, it was a 4 point headwind for the whole division. So how much for Cleveland? I guess 8 points is probably about right. How much was share loss and also how much was weaker pricing? Just what makes up that difference?

That's the first question.

The second question on -- again on US healthcare. Going forward, as Cleveland recovers, do you anticipate to be above or below the market growth which you expect to be flat through the balance of 2015?

And that's the two questions. Thank you.

Frans van Houten - *Koninklijke Philips NV - CEO*

In North America, the Cleveland effect is, yes, 6% to 8%. So excluding Cleveland, we also had a negative order intake.

Now it's important to note that we do not book the multi-year orders in our order intake. We only book the near-term part of that in our order intake. I don't know how competitors are doing it, but it's good to keep that in mind that when we win a large-scale, multi-year order, that is treated perhaps in a different way from competition.

Nevertheless, I think it is fair to say that in North America, our market shares have suffered a little bit, partly due to Cleveland, and partly due to the transformation that we are doing on moving into an enterprise key account management approach which we believe is fundamental in order to capture the future opportunity of these large-scale deals, and becoming part of the job of helping deliver better outcomes at lower costs for hospital systems and engaging in, let's say also in care beyond the four walls of the hospital.

Now going forward, and I think that was the second part of your question, we want of course to recover. We are totally unsatisfied with 2014. Everybody is excited and geared up to recapture the market share. So our initial level certainly is to grow above. Realistically speaking, it may still take us half a year to really get back to a good performance also on the back of the gradual ramp up in Cleveland and all the work that we need to do.

Daniel Cunliffe - *Liberum - Analyst*

Perhaps just one follow-up question. You -- in terms of impact of resuming shipments, I know you don't usually comment on current quarters, but I guess it would be quite interesting to understand the impact of Cleveland coming back to shipments in January. Has that had any impact certainly on this month in terms of the US orders and the outlook for this quarter?

Thank you.

Frans van Houten - *Koninklijke Philips NV - CEO*

The resumption of the Cleveland shipments have not yet had an effect on orders. We are first delivering against the existing order book.

I've already flagged that despite Cleveland, we were able in other parts of the world to actually gain orders and even expand market share so that it feels perhaps a little bit like a paradigm. But in Europe, we actually expanded market shares.

And so it's not an equal situation across the board. The US situation was partly Cleveland, partly also the transformation of the sales force.

The gradual shipment resumption is expected to take the better part of this year. We have flagged that the first half year on year still has a negative EBITA impact. This is because last year we were still doing sales recognition of shipments from 2013. Sometimes, it takes a while before all these large projects are installed. And we talk about EUR100 million EBITA improvement in 2015 versus 2014, and you can derive that is basically all in the second half of the year.

Daniel Cunliffe - *Liberum - Analyst*

Okay. Very clear. Thank you very much.

Operator

David Vos, Barclays.

David Vos - *Barclays - Analyst*

Two or three questions from my side, please, the first one on Healthcare. Can we just circle back to the Volcano deal and explain in a little bit more detail the rationale behind it why Philips is a better owner of this asset?

If I look at the growth profile, Volcano has been losing some market share. Its existing technology has perhaps come under attack a little bit. So in that context, are you really looking to use your own sales force to drive improvements in cross-selling there, or are you depending very much on their new technologies which are to a degree still experimental?

That's question 1.

And question 2 on LED pricing. You've mentioned a couple of times that that's eaten into the margins a little bit, although you've managed to counteract that through other actions. I was wondering if you could comment on the pricing effects and where that's coming from in the LED space. Is that mainly China? Is it Consumer deals? Do you also see some price erosion in Professional? If we could have some more color on that, it would be much appreciated?

Thank you.

Frans van Houten - *Koninklijke Philips NV - CEO*

All right, David. Let me start with the first question. So, of course, you're right to observe that Volcano's growth had stalled. From a great startup, they had grown into a [EUR400 million] company. That was an excellent job.

Now we have technology in our organization that can help Volcano move into addressing structural heart disease. It's an area where we are strong and where we by integrating with Volcano can expand our offering.

So we have technology on the shelf, in our research labs, that are going to be an injection into Volcano to strengthen their product range and get to higher growth, leveraging the sales channel of Volcano. So that's one source of benefit.

A second source of benefit is the integration of the consoles of Volcano into our image-guided equipment in the hybrid operating room, causing that the hospitals do not need to look at two monitors but rather one, which is a better deal for the hospitals. And it will strengthen our systems integration in the operating room with an integrated offer that our competitors don't have.

Then thirdly, since the sales force of Volcano is constantly present, or at least on a weekly basis in the operating room talking to cardiologists, they are in fact much better placed than we are through our sales force in understanding when hospitals want to upgrade to the next minimally-invasive lab.

We also believe that as Volcano's sales force can actually sell better than what we can do the software applications around heart disease, but also eventually other minimally-invasive therapies in the brain or around cancer treatment, software applications that will become a recurring revenue stream for Philips. But that doesn't really fit so well with the traditional CapEx-orientated model of selling an operating room every once in 10 years. So I see multiple benefits.

And then the last source of important benefit is plain old good cost synergies. Volcano is a listed company. We are taking it off the market. We can adjust overhead cost as we integrate, really relatively fast.

So overall, it's a very strong business case. We have put our best people on it. Our image-guided therapy business is not affected by any of the topics that we discussed earlier. It's a strong business and well performing. And we are ready to go the moment the tender offer is completed and we can expect later this quarter to come to a closing.

If I may, then I'll switch gears to the LED pricing, and maybe to give myself a chance to drink a glass of water I will let Ron answer.

Robin Jansen - *Koninklijke Philips NV - Head of IR*

You can drink a lot of water.

Frans van Houten - *Koninklijke Philips NV - CEO*

Go ahead, Rob.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

So if you look at pricing erosion, particularly LED, it comes from the LED lamps. And that is basically, I would say, across the regions. It's a little bit stronger in Asia where, as you know, price points are typically lower.

So we see strong double-digit-price erosion in LED lamps particularly, so that makes the price erosion of LS&E one of the key business groups, into the mid single digits. If you look at PLS, it's more like low single-digits.

And for Consumer Luminaires, it's somewhat higher because we are also introducing a lot of new products in there which actually goes quite well. You've seen some excitement about our home-connected lighting switch with your TV, etc.

So overall, the price erosion for Lighting in the mid single-digits. We're offsetting that by better material, by taking cost out. And we did improve in LED lamps and systems, our EBITA margin in last year compared to 2013. But, of course, we need still to drive more volume there.

Daniel Cunliffe - *Liberum - Analyst*

Very clear. Many thanks.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Thank you.

Operator

Olivier Esnou, Exane BNP Paribas.

Olivier Esnou - *Exane BNP Paribas - Analyst*

Three questions, please. I'd like to come back first on lighting component disposal process. As you review the bids, are you now purely in a value maximization for 100% of lighting component, or are you still looking at patent sharing and possibly keeping, retaining 40%, or about 40% of the asset, meaning this is part of the adjustment when you review those bids.

That's question number 1.

Question number 2. On the lighting separation cost of EUR300 to EUR400 million, I'd like to have a bit more granularity on that number, if possible. It's quite -- it's like almost a year of EBITA for Lighting now. Is it purely cash, or do we have as well write-down and other non-cash adjustment? And if you could just maybe say a little bit more about what it relates to.

And third question, please. The US Professional Luminaires development is quite a setback in Q4. Two months ago, you were hopeful for a profit here. And I just wanted to have your thoughts on to what extent you think after almost trying for two years to come back, some really structural issues beyond (inaudible) in the current portfolio. Or what drives you to believe now you can still come back here?

Thank you.

Frans van Houten - *Koninklijke Philips NV - CEO*

Yes. Hi, Olivier. So on the LED component process, we are inviting investors to take a 60% to 80% share of the business. Lumileds will continue to be a supplier to us, to Lighting, so there will be a supply agreement. And obviously, that's important to us. Right?

Philips Lighting Solutions is the largest lighting player in the world and will have a big demand for LEDs, and obviously, Lumileds is a very important part of that and we together do a lot of innovation.

I don't want to let you look inside our deepest thinking around choosing the eventual partner. You'll find out in due course. But we will look at all the factors.

Then the separation cost. We have done many separations in the past, and they typically cost money as we need to separate IT systems; we need to set up new legal entities in countries; we need to shift personnel. We have advisors. We need to set up data rooms. So all of that is cost, and mostly it's cash-related cost.

I am now looking to Ron to see if what I said is correct.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

You said it correctly, Frans. So it's mostly cash. It's exactly for what you just said. It's across many functions: Finance, HR, supply chain, IT structure, real estate, the whole works.

And if you look outside, we're still trying to look at a bit of a relevant benchmark, but this does certainly not seem to be out of whack. So this is for 2015, and then we'll have to see by 2016 what that would look like. Probably lower, but too early to tell.

So that is initially, it's the buildup of a bottom-up plan. And of course, as we move along, progressively we are going to update you. I think this is now a pretty good estimate.

Frans van Houten - *Koninklijke Philips NV - CEO*

Let me also underline that we are trying to set up two lean and agile companies, and that we don't want to have any stranded cost hanging around. So also take the right measures to make sure that we set ourselves up for future success.

Then the third question, Olivier. Professional Luminaires, North America, of course is a setback, disappointing, and we have taken the measure to appoint Amy Huntington to take the team now the next step forward.

However, that does not mean that the measures that we have taken were wrong. No, they were right. What we found in the Genlyte acquisition is a multitude of disparate brands, R&D locations and factories.

Over the last three -- two years, we have taken a lot of action to rationalize that base, to bring products under the Philips brand and the Lightolier brand, to move the sales force to be able to do large-scale projects and key account management, appoint the new agents representing the consolidated brand portfolio, to roll out SAP in that part of the business, and so on.

Now we can all, of course, regret that it wasn't done years ago, but so be it. We took -- in fact, when I was the Interim CEO of Lighting, we started this process. We took decisive action to overhaul this business. It has been very painful. We have lost market share primarily to one of the North American competitors. But we do feel that we have taken the right actions.

Now we need to refine those measures, reinvigorate the whole situation. And we believe that Amy Huntington, that she is absolutely the right leader to do that.

I also flagged that in fact we had orders on hand in the fourth quarter that we were not all able to deliver, and were we -- if we would have had a little bit more luck, I think the results would have looked already different. Of course, luck doesn't count; we need to perform. And that's what we have set up to do.

So we expect a gradual improvement during 2015. We should give Amy some time to get her bearing and to start contributing. But I am convinced that we are able down the road to regain our market share. And I say that with conviction on the back of our product range which in other parts of the world is very strong, is very convincing to professional building owners, to cities, in stadia, and so on. So I don't see any reason why we would not have a positive uptake later on.

Thank you.

Operator

Daniela Costa, Goldman Sachs.

Daniela Costa - *Goldman Sachs - Analyst*

My questions are mostly answered, but if I can just follow up on something on Cleveland. Out of the EUR225 million, can you break down or give some color on how important is the component of, I guess, lost sales versus write-off of stocks and penalties to customers?

And then more generally, how should we think about the time that takes to re-gain this market share? So if you're negotiating a package now for CT scanners and you just went for Siemens or for GE, how long are you locked in? When will you be back? And are you thinking this is in a decade or can this actually be regained quicker?



Thank you.

Frans van Houten - *Koninklijke Philips NV - CEO*

On the first part, Ron.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Yes. So if you look at the EUR225 million, about EUR140 million-plus is from lost sales. You know that we had a stock write-off in Q3, and then we had -- the rest is for consultants and other costs that breaks down the EUR225 million.

Frans van Houten - *Koninklijke Philips NV - CEO*

Now then, time to regain. We have flagged that it will take us the better part of 2015 to get back to volume that is approximate to the level of 2013. So I think that indicates our current conviction that we are able to repair the situation.

I already said we are still getting orders; for example, European deals; for example, the Saudi Arabia deal. So it is not that customers have totally stopped ordering. We'll take this account by account. Some of course have -- the ones that were affected by the delay will remember that more than the customers that were not expecting a delivery and basically are prepared to give us the next shot at the delivery.

So it's a mixed picture globally. We are committed to repair this situation over the next 12 months.

Daniela Costa - *Goldman Sachs - Analyst*

Thank you.

Operator

Peter Olofsen, Kepler Cheuvreux.

Peter Olofsen - *Kepler Cheuvreux - Analyst*

On the Lighting business, you mentioned that the performance was impacted negatively by China and conventional lighting. Maybe on China, the declines that you saw there, was it just a reflection of weaker end customer demand, or were there also some destocking effects? And to what extent was China impacted by customer credit provisions? I recall you had some in Q3, but was that also the case in Q4?

And then on conventional lamps, the issues there, is it mainly a matter of lower volumes, or do you also see some price erosion on that side?

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Yes. So on the China Lighting decline, there was some weaker end demand. As you know, in China, construction is not exactly what it was earlier on, so we feel that. Some new construction, some retail construction, is lagging behind. That definitely impacts end markets, and not only destocking.

So the credit provisions in China are below EUR10 million. We could release some because some people paid us as according to plan, and there was at the end some that we had to hold on to. So that impact is abating.

Price erosion in conventional in China, yes, there is price erosion in conventional. It doesn't take the magnitude of what I earlier said on LED lamps. But conventional China, pricing goes a little faster than across the globe on an average. As you also know, the conventional wind-down is now about 13%, so that is a low double digit, if you will. And in China, that has gone a bit faster.

Of course, because we had to hold back and didn't want to overstock and certainly not see a repeat of Q4 last year, that definitely also played a role in the China performance.

So we're looking forward to the New Year where we're working through this. Customer payment plans apparently on track apart from a few that I just mentioned, and we should see some improvement in 2015.

Peter Olofsen - *Kepler Cheuvreux - Analyst*

Okay. Thank you.

Operator

Thank you, Mr. van Houten and Mr. Wirahadiraksa. There are no further questions. Please continue.

Frans van Houten - *Koninklijke Philips NV - CEO*

All right. Well, I want to thank everybody for joining this call and giving us a chance to answer your questions, and I look forward to meeting you soon again.

Thank you. Bye-bye.

Operator

That concludes the Royal Philips' fourth-quarter and full-year 2015 results conference call on Tuesday, January 27, 2015. Thank you for participating. You may now disconnect.

Editor

Additional Information:

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