



Annual Report 2019

Message from the CEO

“Philips continues to make progress to unlock its full potential as a leader in health technology. Our innovations are driving better health outcomes and increased healthcare productivity, while offering a better experience for consumers, patients and healthcare professionals.”

Frans van Houten, CEO Royal Philips

Dear Stakeholder,

In 2019, we continued our transformation as a focused leader in health technology, pursuing our vision of making the world healthier and more sustainable through innovation. I am pleased with the resilience of our businesses as we recorded 4.5% growth while addressing significant headwinds. We made good progress against our strategic imperatives – driving customer centricity and operational excellence, focusing on quality, growing our core businesses, and pivoting to become a solutions company. Our purpose is clear, and so is our firm belief in our potential to grow and create more value, while doing so in a sustainable manner. Reflecting our confidence in the road ahead and the importance we attach to dividend stability, we propose to maintain the dividend at EUR 0.85 per share.

Innovating with purpose

Time and again, customers tell us they like our strategy and the comprehensive view we take of healthcare along the health continuum – delivering innovations for consumer health, precision diagnosis, image-guided therapy, hospital and home care, leveraging informatics and artificial intelligence. They are keen to engage with Philips for innovations that can help them deliver on the Quadruple Aim – better health outcomes, improved patient and staff experience, and lower cost of care. This is reflected in the sustained growth in the number of long-term strategic partnerships we have signed, e.g. with Inspira Health (USA) and Klinikum Stuttgart (Germany), with solutions and recurring revenues now accounting for over one third of total revenues. There is also substantial interest in how we can contribute to care outside the hospital setting – through solutions that support healthy living, prevention and home care.

Aging populations and the growing incidence of chronic disease, coupled with resource constraints, are necessitating a shift from a volume-based approach towards value-based healthcare models, including care outside of the hospital. I firmly believe that innovative health technology – a growing market with scope for margin expansion, in which Philips has strong positions – will help address these challenges, providing better outcomes and productivity gains, as well as extending access to care to those in need.

Our goal of improving the lives of 3 billion people a year by 2030, including 400 million in underserved healthcare communities, infuses our innovation drive with true purpose, as we strive to make the world healthier and more sustainable, in line with UN Sustainable Development Goals 3 (*Ensure healthy lives and promote well-being for all at all ages*), 12 (*Ensure sustainable consumption and production patterns*) and 13 (*Take urgent action to combat climate change and its impacts*).

Innovating with purpose in mind helps us to create more value for our customers and society – by developing truly relevant solutions. Helping people to stay healthy and prevent disease. Giving clinicians the AI-assisted tools to make precision diagnoses and deliver personalized, minimally invasive treatment. Orchestrating and delivering care outside the hospital, in lower-cost care settings. Helping people to recover, or live with chronic disease, at home in the community. All supported by a seamless flow of data enabled by connected care and health informatics solutions.

Increasingly, AI will enhance the quality and efficiency of care, providing clinical decision support, helping clinical staff to spot emerging risks, and freeing up valuable time for healthcare professionals to focus on their patients. We work with clinical partners around the world to develop AI-enabled solutions, like our IntelliSpace AI Workflow Suite, that are secure, firmly grounded in scientific research, and rigorously validated in clinical practice.

In the consumer domain too, connected personal health solutions like our Philips Sonicare Teledentistry service help people to manage their health with actionable insights, coaching, and where needed, support from care professionals.

Determined to deliver the full benefits of data-enabled care, we have significantly stepped up our activities in informatics and data science in recent years. Today, around one in two Philips R&D professionals is active in these fields, and most of our acquisitions since 2015 have been designed to strengthen our informatics capabilities.

As a purpose-led innovation company, we have made sustainability a cornerstone of the way we do business, as recognized once again in the global 2019 Dow Jones Sustainability Indices (DJSI) list. Increasingly, our customers ask us to help them tackle their sustainability challenges; we believe that, more and more, this will become a competitive differentiator. In 2019, we took another step closer to becoming carbon-neutral in our own operations by the end of 2020, with both our US and Dutch facilities now 100%-powered by renewable energy. We also issued our first Green Innovation Bond under the Philips Green & Sustainability Innovation Bond Framework developed together with Rabobank; the proceeds will be used to help finance our expenditures on green innovation, the transition to the circular economy with zero waste to landfill, and becoming carbon-neutral in our operations.

How we performed in 2019

Our financial performance in 2019 was robust, despite a profitability improvement that was below our plan. Comparable sales growth was well within our target bandwidth, driven by innovative products and solutions across our businesses and strong revenue increases in our growth geographies. Profitability improved, though well short of the 100 basis points of the past three years, impacted by tariff headwinds, the underperformance of Connected Care, a decline in license income, and investments in growth. We ended the year with a comparable order intake that grew a further 3%, on the back of strong 10% growth in 2018, and delivered a free cash flow of over EUR 1 billion. Last but not least, our share price rose 41% in the course of 2019 to a 19-year high, outpacing many of our key peers and reflecting investor confidence in our strategy and portfolio of innovative health technology solutions.

Our Diagnosis & Treatment businesses performed well, with improved revenue and earnings, supported by a strong flow of innovations designed to help clinicians deliver a precision diagnosis and targeted therapies. In Diagnostic Imaging we finalized the revamp of our CT and MR portfolios, including the introduction of an industry-first 'Tube for Life' guarantee with our Incisive CT imaging platform. In Image-Guided Therapy, 2019 saw the landmark one-millionth procedure performed with our Azurion platform. And we continued to add depth and reach to the Azurion success story, with the launch of innovations like FlexArm, for optimal visualization across the whole patient, IntraSight for seamless integration of our smart catheters in the platform, and regulatory clearance to launch Azurion in China.

We are particularly pleased by the continued strong performance of our smart catheter portfolio. We also have high expectations of innovations in the areas of precision diagnosis solutions and enterprise diagnostic informatics, the latter strengthened by the recent acquisition of Carestream Health's Healthcare Information Systems business.

Our Connected Care businesses had a challenging year, even as we retained market share. The businesses posted modest growth, though profitability decreased. The fundamentals remain solid – our Connected Care businesses have leading market positions and good scope for margin expansion. We have taken decisive actions and expect these to gradually become visible in performance in the course of 2020. In January 2020, I appointed Roy Jakobs as the new leader of the Connected Care businesses to further drive the turnaround. Several new innovations – such as the next-generation IntelliVue MX750 and MX850 patient monitors, our expanded SmartSleep solutions, the latest iteration of our IntelliSpace Enterprise Edition healthcare informatics platform, and our HealthSuite digital ecosystem – will support accelerated growth, while stronger execution will help improve value creation.

Personal Health rebounded well from a slower 2018 with higher revenue and earnings, driven largely by the performance of our Oral Healthcare and Personal Care businesses on the back of portfolio extension and increased market penetration. We are now reviewing options for future ownership of the Domestic Appliances business. Our Personal Health businesses that are focused on oral care, personal care and mother & child care will therefore continue to play an important role in our health continuum approach, through connected products and services that support people's health and well-being.

Transforming to win

In the face of considerable geopolitical and macroeconomic uncertainty, with strong tariff headwinds, we continue to look first and foremost to improve operational excellence. We remain firmly focused on meeting our customers' needs, while at the same time taking action to innovate compelling solutions, improve the supply chain and boost productivity.

As we step up our transformation, we continue to be guided by our three-pronged strategic roadmap: *Better serve customers and improve quality; Boost growth in core business; Win with solutions along the health continuum.* We are making steady progress on our commitment to quality and operational excellence, as demonstrated by improving quality indicators, customer Net Promoter Scores and lower waste. The standardization and digitalization of internal processes, leveraging the Philips Integrated IT landscape, is leading to higher productivity and agility. Our continued focus on boosting growth in the core has delivered market share expansion in the Diagnosis & Treatment segment in particular. Revenues from solutions, long-term contracts and service business models – including new business models, such as software-as-a-service, pay-per-user and technology managed services – now stand at over one third of sales.

Acquisitions have played an important role complementing our organic growth, and we are pleased with the performance of most of these, for example in the area of Image Guided Therapy, where we are now able to ‘innovate the procedure’ with solutions consisting of combinations of systems, smart devices, software and services, as opposed to being restricted to capital equipment only. With the planned divestiture of the Domestic Appliances business, we are completing the strategic pivot to a health technology-focused portfolio. Domestic Appliances is a strong business that has made a good contribution to Philips, but is not a strategic fit for our future as a health technology leader.

To get the best out of our people and make sure our organization is set up to deliver for our customers and realize our vision, we overhauled our operating model – the Philips Business System (PBS) – in 2019. The renewed PBS touches every aspect of our business and will make Philips a simpler, faster, customer-focused solutions company – a learning organization that aspires to the highest standards of quality in everything we do. Driving a customer-focused culture, where people take ownership and collaborate to deliver with quality, speed and agility, embracing Lean and continuous improvement, is an essential ingredient of the PBS.

Outlook 2020 and beyond

Looking ahead at 2020, we continue to see geopolitical and economic risks. We aim for 4-6% comparable sales growth and an Adjusted EBITA margin improvement of around 100 basis points, with a performance momentum that is expected to improve in the course of the year. During 2020 we will issue guidance for the next medium-term period, when we expect to continue to gradually step up growth and expand margins and cash generation as we execute our strategy.

In conclusion

I wish to thank our customers, shareholders and other stakeholders for the support they continue to give to Philips. I would also like to thank our employees for their engagement, perseverance and hard work over the past year.

Energized by our purpose, I remain confident in our ability to perform while we transform – delivering innovative, sustainable solutions that meet the needs of our customers and consumers, at the same time laying a rock-solid foundation for an even brighter future as a leader in health technology.

Frans van Houten, Chief Executive Officer