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PRESENTATION

Operator

Welcome to the Royal Philips Electronics first quarter results 2011 conference call on Monday, April 18, 2011.
During the introduction, hosted by Mr. Frans van Houten, President and CEO, and Mr. Ron Wirahadiraksa, CFO, all participants will be in a listen-only mode. After the introduction there will be an opportunity to ask questions. (Operator Instructions) Please note that this call will be recorded and is available by webcast on the website of Royal Philips Electronics.

I will now hand the conference to Mr. Abhijit Bhattacharya, Head of Investor Relations. Please go ahead, sir.

Abhijit Bhattacharya - Koninklijke Philips Electronics NV - Head of IR

Good morning, ladies and gentlemen. Welcome to this conference call on the first quarter results for 2011 for Royal Philips Electronics.

I am here with Philips’ President and CEO, Frans van Houten, and our CFO, Ron Wirahadiraksa. In a moment, Frans will take you through his introductory remarks, followed by Ron, who will shed more light on the financial performance during the quarter. After this, both Frans and Ron will be happy to take your questions.

As usual, our press release and accompanying information slide deck were published at 7am this morning. Both documents are now available for download from our investor relations website. We will also make available a full transcript of this conference call on the Investor Relations website by tomorrow, at the latest.

And with that, let me hand over to Frans to make his introductory remarks.

Frans van Houten - Koninklijke Philips Electronics NV - President & CEO

Thank you, Abhijit. Good morning to you all, and let me welcome you to my first analyst conference call as CEO of Philips.

As you have seen in our press release issued earlier this morning, today is a very important day for Philips. In the last few months, we have clearly stated that resolving the profitability of TV is our absolute priority. Already late last year, in fact following my return to Philips, Pieter Nota and I initiated a team to research robust solutions for TV, going forward.

We are all aware that TV has a proud history at Philips, since 1928. In recent years, however, TV has not performed well, amidst a radically changing industry dynamic. At the same time, as you know, Philips is shifting its strategic portfolio to health and well-being. Consequently, TV had become a value detractor for Philips.

Today, we have announced our plan to separate our entire TV business and move it into a joint venture with TPV Technology, whereby TPV will have a 70% stake, and Philips will own a 30% stake.

This partnership is good news for our trade partners and consumers, as continuity of Philips TV in the market is assured. It will help create the focus, scale, and business model to enable the return to profitability in the very dynamic TV industry. The joint venture will leverage Philips’ strengths, such as the brand, our brand, innovation power, and trade and market access, with the additional scale and manufacturing strengths of TPV.

TPV has, in the past years, acquired our Monitors business and has been successful in running it.

Philips will receive a deferred payment for the transaction, as well as a brand license fee. We have disclosed details of the term sheet in our press release, hence, I will not go into all the details of the agreement now.

I can confidently say that this decisive step is right for the continuity of the Television business. It is also right for Philips’ future in health and well-being. We expect to sign the definitive agreement in quarter 3 of 2011.
The separation of the Television business will require us to evaluate our financial aspirations, on which we will revert during the second half of 2011.

Let me now move on to other topics. I am very excited to lead Philips, going forward, on a path whereby we accelerate the growth and value creation.

Together with my colleagues on the Board of Management, we have already identified our strategic priorities. We need to drive our Healthcare business to leadership in a changing landscape with changing regulations, new competitors, and a geographical mix moving towards growth markets. We need to reshape our consumer lifestyle businesses beyond the consumer electronics legacy to sustainable leadership in consumer, health and well-being markets.

The lighting industry is undergoing an unprecedented transformation, and we need to sustain our leadership position in the new world of LED lighting, as well as capture adjacent value through local lighting solutions.

We want to perform to our full potential in both the mature and high growth geographies. We are convinced that there are significant opportunities for Philips, and I consider today’s platform, if you like, to be a great springboard for the future. There is, however, also much to be done to unlock our full potential.

As you have seen from the quarter 1 2011 figures, our current course and speed is not yet satisfactory. We will focus strongly on accelerating our growth and value creation trajectory. Let me outline, therefore, our near-term execution priorities.

First of all, we will flawlessly execute our plans for Television. Secondly, we want to strengthen operational performance. We will do that by rolling out the new Philips’ business management system, ensuring that the organization has clear and granular plans and transparent performance metrics tracking across 400 business-market combinations.

During the next few months, we will exercise our annual strategy planning process with the same granularity so that there will be a shared commitment between global businesses and local market teams and, hence, better ownership of well-defined plans.

We will also look at our past acquisitions, some of which have not performed to plan, and increase value delivery from them. We anticipate that, in order to achieve the desired acceleration of organic growth and performance, we will need to step up targeted investments in timely and meaningful innovation for local markets, improved operational excellence, as well as market penetration. We plan to update you in this context during the second half of this year.

Furthermore, we see opportunities to address our Group and sector level overhead cost structures, as well as improve capital turns and ROIC.

In our drive to realize our strategic objectives, we will leverage our strong brand presence in growth markets. In this context, we aim to develop China into a home market by moving into this important market more business-creation units, inclusive of innovation resources and business management authority, to enable speed of decision making. We expect these to benefit China, but also the export opportunities from China into other markets in the world.

Overall, as I’m sure you can discern from my words, I see speed of action as a competitive weapon, and I am determined to increase the clock speed and market effectiveness of Philips. To do so, the Board of Management of Philips has extensively discussed and decided to adopt the required outside-in customer-driven performance culture, with higher empowerment and accountability for our teams in the markets, resulting in more effective and timely end-to-end execution. Overall, we aim to stimulate responsible entrepreneurial behavior.

We will be very disciplined in our use of capital and control of costs so that, while maintaining our A3/A minus rating and pursuing our stated dividend policy, we have the cash available to invest in value-creating growth, both organic and through
acquisitions. Furthermore, we will need to keep some cash to mitigate potential risks. We will judge the alternative of returning capital, over time, to shareholders.

I want to also clearly convey to you that, while we exercise stringent discipline, accountability and return criteria in our end-to-end acquisition process, in line with the nature of the transaction, to ensure we deliver the promised value from our acquisitions.

And with that introduction, ladies and gentlemen, let me hand you over to Ron to talk you through the financial performance for the first quarter.

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO
Thank you, Frans. Good morning, and welcome to all of you on the call.

Let me start by talking about the developments in the markets we serve. I will start with Healthcare where, in the US, we see a continuing strong drive from hospitals to reduce operating expenses and become more efficient. We see the positive effects of this to the growth in patient monitoring market where hospitals strive for higher efficiency by investing in newer technologies.

We do not expect major increases in capital expenditure, compared to last year, although access to capital does not seem to be a major concern.

With regard to healthcare reform, there is some concern among hospital CEOs on further reimbursement cuts. Larger strategic and multiyear deals continue to remain important as we see increasing interest.

Some pent up demand was visible in the quarter, but uncertainty remains as to the future economic and market developments in the US.

In Europe, we do see some effects of the difficult economic climate in Southern Europe, as well as austerity measures affecting short-term growth in the UK. The recovery in Germany and Northern Europe continues to remain on course. We continue to see momentum in our growth markets as more investments continue to be directed at these markets, resulting in robust demand.

In the consumer lifestyle markets, Western Europe and the US demonstrate continued cautious consumer sentiment. In the areas where we invested for growth we saw markets responding well; personal care, health and wellness and domestic appliances markets grew appreciably. Also, our growth markets showed robust demand in the quarter.

The home audio and DVD markets continued to shrink, while price erosion in the television markets was severe.

The lighting market overall saw reasonable growth, which was strongest in our growth markets, and for LED-related product categories.

Given the ongoing weak construction markets we are encouraged by the reemergence of growth in the professional luminaires market. Construction growth was adjusted upwards last quarter for both LatAm and Asia Pacific, where the Japanese forecast grew in anticipation of the restoration of earthquake damage.

The continued global trend to energy efficiency bodes well for the mid-term lighting market development. The Consumer business in Europe continues to be subdued as the residential construction market growth in mature markets is flat. But we clearly see growth in green, energy-efficient lighting product categories.

In the Automotive business, demand continues to pick up in all markets, with the exception of Japan.
Let me now move to the Philips Group results for the first quarter of 2011. At the outset, let me clarify that, post the announcement regarding our television activity, we report the profit and loss on the TV business under discontinued operations from this quarter, and the net operating capital for the business in the balance sheet on the line assets held for sale. The cash flow of the TV business is reported under cash flow for discontinued operations.

Therefore, all commentary that will follow, in terms of sales and earnings at Philips Group level and Consumer Lifestyle sector level, does not include Television-related information.

Comparable sales in the first quarter grew by 6%. When adjusted for currency and portfolio changes, comparable sales grew by 4%, compared to the quarter 1 of the previous year. On a geographical basis, comparable sales in our growth geographies grew by 11% in the first quarter. On a nominal basis, sales increased by 16% in these markets.

To clarify, what we mean by our growth markets, these are all markets, excluding the US, Canada, Western Europe and the Pacific countries Australia, New Zealand, South Korea and Japan.

Sales from our growth geographies represent 32% of Group revenues, compared to 29% for Q1 last year.

Revenue performance in the rest of the world was mixed, with North American and Western Europe each showing a 1% increase in comparable sales.

Reported EBITA was EUR437 million, or 8.3% of sales, which is lower than the EUR495 million, or 9.9% of sales, reported for Q1 last year.

The restructuring and acquisition-related charges for the first quarter for this year were lower than the first quarter of last year by EUR31 million. This was more than offset by the decline in earnings from license income of EUR46 million in Consumer Lifestyle, the positive one-off due to a legal settlement related to licenses last year of approximately EUR19 million in Lighting, and additional investments in selling expenses and R&D to reignite organic growth in the Company.

The adjusted EBITA profitability, that is to say EBITA excluding restructuring and acquisition-related costs, was 8.6% in the quarter, compared to 10.9% for Q1 2010.

Including discontinued operations, which had a negative impact of EUR94 million compared to Q1 of last year, net income declined to EUR138 million from EUR201 million in Q1 of last year.

The comparable sales growth of 6% in North America in Q1 2011 is very promising.

Our cash flow from operating activities for the quarter was an outflow of EUR391 million, compared to an inflow of EUR160 million in Q1 of 2010, resulting in a difference of EUR551 million. About half of this was costs due to higher tax payments, and a contribution to reduce a part of the deficit in our US pension fund as legally required. And the other half primarily due to a reduction in the payables position.

With that summary, let me know take a closer look at the performance of each of our businesses during Q1, starting with Healthcare.

Currency comparable equipment order intake was flat in Q1 2011, compared to Q1 2010. Excluding the impact of three large multiyear orders that we received in Q1 2010, the equipment order intake grew by 5% on a currency comparable basis.

Order intake was led by a very strong performance in our growth geographies, where equipment order intake grew by 28%. Order intake for the North Americas was flat.
The Healthcare sector recorded a nominal sales growth of 8% in the first quarter, compared to the first quarter of 2010. On a comparable basis, the growth was 5%, which is encouraging, since Q1 2010 had recorded a growth of 7%.

Looking at the performance per business, the Patient Care & Clinical Informatics business performed well, by delivering high single-digit comparable sales growth with the Home Healthcare business following with mid single-digit growth. The Imaging Systems business grew above 3% for the quarter. Customer Services had a low single-digit growth, primarily reflecting the effects of lower sales during the economic crisis as lower equipment sold during that period now results in a lower transition to service contracts at the end of the warranty period.

The comparable sales growth of 6% in North America in Q1 2011, which was very promising, as well as the growth of 22% in our growth geographies was tempered by a decline in Europe.

Reported first quarter EBITA at Healthcare was EUR199 million, or 10.1% of sales, compared to EUR166 million, or 9.1% of sales, in the same period of 2010. This was largely due to lower restructuring and acquisition-related charges. Excluding restructuring and acquisition-related charges, EBITA was 10%, which is below the 10.7% in the same period last year.

Consumer Lifestyle nominal sales grew 4%, compared to Q1 of last year, while on a currency comparable basis, sales were flat. This was primarily due to the decline in license income in the quarter.

We are pleased with the continuing momentum of sales growth for the Personal Care, Health & Wellness and Domestic Appliances business, which for Q1 2011 have all demonstrated double-digit comparable sales growth.

Audio, Video, Multimedia and Accessory sales declined in the quarter, largely due to declining markets, as well as portfolio choices for profitability.

From a geographic perspective, sales in our growth geographies grew by 11%, which is encouraging. This was, however, offset by declines in the mature markets, mainly due to reduced license income, excluding which sales in mature markets would have been flat.

The reported EBITA at Consumer Lifestyle declined to EUR119 million from EUR170 million, mainly due to lower license income in the quarter, compared to last year. Excluding restructuring and acquisition-related charges, the adjusted profitability of the sector was 10.1% in the quarter.

While on Consumer Lifestyle, I would like to spend a couple of minutes to talk about the performance of the Television business. The price pressure we have seen in the market over the past couple of quarters has been unprecedented. This has led to an operating loss in Q1 of EUR106 million.

On page 13 of the press release, we have provided a simple reconciliation of elements that are adjusted from this loss to arrive at the net income of discontinued operations of a loss of EUR87 million.

At Lighting, after a subdued Q4 2010, we are pleased to see a return to growth. Nominal sales in the quarter grew by 5%. On a currency comparable basis, sales in Q1 2011 grew by 6% over Q1 of last year. Sales growth was led by our growth markets, where sales grew on a comparable basis by over 7%.

On a more granular basis, sales in India, ASEAN and the Middle East continued the strong momentum, with strong double-digit growth. Sales in North America continued to recover with a mid single-digit growth in the quarter. After a weak Q4 2010, Europe saw a healthy return to growth, registering a mid single-digit comparable sales growth.

When taking a deeper look into each business, we continue to see strong sales for our LED products, with growth of 27%, compared to the same quarter in the previous year.
Sales of professional luminaires, despite a weak construction market, showed growth for the third consecutive quarter, and registered a double-digit growth, although pricing was under pressure.

Lighting Systems & Controls had a robust quarter, with comparable sales growth in the high teens. The Lamps business returned to a mid single-digit growth, while Automotive had slightly lower growth, mainly due to the situation in Japan. Sales in Consumer Luminaires continue to remain weak, registering a high single-digit decline.

The reported EBITA at Lighting dropped to EUR193 million from EUR245 million in Q1 2010. This was mainly caused by additional investments in selling expenses and research and development expenses to drive growth.

Besides these expenses, the results of the first quarter of 2010 had a one-time gain, due to a legal settlement, of approximately EUR19 million. Excluding restructuring and acquisition-related charges, the adjusted EBITA profitability was EUR198 million or 10.4% of sales.

Reported EBITA at GM&S was EUR74 million, largely in line with the annual guidance given in this regard. Adjusting for incidental charges and gains, EBITA was EUR75 million.

Our actions to reduce inventories have shown modest results. The inventories, as a percentage of MAT sales in Consumer Lifestyle, showed the highest reduction, when compared to Q4 of 2010. For Lighting it remained flat, whereas for Healthcare, it showed a marginal increase, thereby keeping the ratio at Group level flat, compared to Q4 2010.

While on the subject of inventories, I would like to inform you that we have made significant progress in the reduction of Television inventory. We have seen a reduction of almost one fourth of the inventory level from the position as at the end of December 2010. Compared to the highest level at the end of Q3 2010, we have reduced our inventories by about 40%.

Japan has witnessed one of the worst tragedies of our times, and we are very grateful that all our 1,700 staff are safe. As a consequence of this tragedy, we expect headwinds in 2011 impacting our revenue and supply chain. We have a dedicated team working to mitigate the consequences and risks. We're not yet in a position to give a quantification of these risks, but will do so later.

Ladies and gentlemen, let me now sum up where we stand at this point of time.

Our performance in Q1 2011 has seen us return to growth. However, we are not at the run rates to achieve our financial aspirations. It is our priority to accelerate our mid-term growth and profitability trajectory. Investments will be required to achieve this. We will provide a further update in the second half of 2011.

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

**Questions and Answers**

**Operator**

(Operator Instructions) Simon Smith, Credit Suisse.

**Simon Smith - Credit Suisse Europe - Analyst**

I’d like to ask -- well, I guess before I ask a question, I’d like to say congratulations on getting a transaction done on the TV side. It wasn’t actually what I was going to speak about, but very nice to see that happen at an early stage.
My question was really with relation to margins. We've had a quarter here which, if we break it down on to the underlying level, we've seen margins come in light in your core divisions of Healthcare and Lighting, anywhere from 100 and 140 to 240 basis points, so a quite significant undershoot on margin there.

And then, if I look at the outlook statement, I think you've already said you're not going to quantify it, but you talk about the Japan effect, and then you talk about the investment effect. So it doesn't feel as if we should expect an improvement in those trends, going forward. And yet, we have these statements alongside margin guidance which, for the Healthcare business, would imply a significant step up. And if you're to get to the middle of the range in the Lighting business, at least a maintenance of where margins have been in the past.

So clearly, it's still at an early stage, but I wonder if you can give us any assistance in understanding where we should be placing margins, going forward?

Frans van Houten - Koninklijke Philips Electronics NV - President & CEO

Yes, Simon, Frans here. Thanks very much for your congratulations; I appreciate that. In fact, let me just say a few words on it. We started late last year on it, and I think we have now created a construction that's good for the future of TV, but also it allows Philips to focus on health and wellbeing.

As to your question on margins, I think we need to take this straight. Vision 2015 is a good roadmap, and it contains an excellent set of targets, which we aspire to achieve. Both Ron and I are quite ambitious and eager to get on that run rate.

At the same time, today that run rate is not yet in sight, and we have a lot of work to do to get there. We believe that we do need to step up performance, and it will require some targeted investments.

We have launched a granular business management system to get much more insight in where we are performing and where we leave money on the table. And as we do that in the next -- and go through all these businesses in the next quarters, we think we'll be in a better shape, in the second half of this year, to give you all an update on our trajectory to achieve our financial aspirations. So not in the short term, but definitely eager to get there.

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO

Maybe to add to that, Frans, is if you look at our gross margin, we have seen about an 80% basis points decline. About EUR19 million of that was related to what I said earlier on a legal settlement in Q1 of last year in our favor. And I would say the other half is related to some small material cost increase that we have seen.

Furthermore, in comparison with last year, we have invested somewhat for growth. So this pertains to your question on the margins.

On the outlook for Japan, as I said, we're not in a position right now. We have not seen a lot of impact in the first quarter, but we expect to see, and are assessing, the impact that it will have in the next quarter, and probably mostly in Q3. So we need to update you at a later stage on where we stand with that.

I hope I have provided an answer to the question you raised.
Simon Smith - Credit Suisse Europe - Analyst
Could I just ask for a follow-up clarification on the margin side then? From what you're saying there, we should really then be thinking about margins on an underlying basis for the Healthcare and the Lighting business to be down on where they were last year. Obviously, you don't, as yet, have the full understanding of the plans that you'll be putting in place. But as a gut feel, from what you said, would that be fair?

Frans van Houten - Koninklijke Philips Electronics NV - President & CEO
Well, Simon, we are not giving a guidance. In fact, we are committed to long-term value creation, and we think there's work to be done to accelerate our performance.

We'd like to talk about the business in terms of trajectory. I see a lot of unlocked potential in Philips in all the sectors. And with that, I think we can give you an update in the second half of the year, as with regard to our long-term strategic aspirations.

Simon Smith - Credit Suisse Europe - Analyst
Thank you.

Operator
Mark Troman, Bank of America Merrill Lynch.

Mark Troman - BofA Merrill Lynch International - Analyst
Just following on from Simon's question, obviously you've decided to ramp up the investments in SG&A and R&D in Q1. Is it fair to say that that's going to accelerate, or is that a reasonable indication of run rate, subject to more detailed business assessment?

I'll just leave it at that one, thank you.

Frans van Houten - Koninklijke Philips Electronics NV - President & CEO
I'd like to reiterate a few points. As Ron and I have gone through the business in our startup period, we are really quite excited about the potential that Philips has, and we are very eager to accelerate that run rate. I don't think -- we would not be talking about acceleration if we would not believe that that potential is there.

We have looked at 400 business market combinations across our businesses and geographies. It is clear that some are performing very nicely, very beautifully, and some others are behind. And so as we go into deep diving those, I think we'll find corrective action. This is why we give the heads up that some targeted investments may be needed.

At the same time, we can be positive about what we call the green units that are performing very well. So overall, it may take us some quarters, but we do believe that an acceleration of the both growth and profitability trajectory is possible.

Mark Troman - BofA Merrill Lynch International - Analyst
Okay, can I just follow up on that? Could you just comment on the pricing trends? We know about TV, I guess, but within the Healthcare, Lighting and other parts of Consumer, Frans, what pricing trends are there, and what do you think you can manage?
Frans van Houten - Koninklijke Philips Electronics NV - President & CEO

I think this is different in the various sectors. I think we talked a little bit about Lighting, I think Ron did, where we saw a good growth in Professional Luminaires, but a somewhat depressed margin. And the lower margin in that business is partially because of higher costs of materials, which we will pass on to customers; if you think about copper, phosphor and steel. And we also believe that, going forward, we can improve that.

The margin in Healthcare actually is normal. And Lifestyle as well, we don’t see any pressure on the margins. And, of course, in TV, you know the story, and that is why we dealt with it.

Mark Troman - BofA Merrill Lynch International - Analyst

Sure, okay, thank you very much.

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO

Maybe a little color on that, on the gross margin side to put it in perspective. So in Q1, gross margin Healthcare was flat year on year; the gross margin of Lifestyle was down by 6 points because of the TV impact; and in Lighting, as I elaborated earlier, we had about a 1% decline.

Mark Troman - BofA Merrill Lynch International - Analyst

Thank you very much.

Operator

Andreas Willi, JPMorgan.

Andreas Willi - JPMorgan Cazenove - Analyst

My question is on the license income, which you guide down for the second quarter, and then flat for the second half. That still leaves the year at roughly EUR100 million lower license income than last year in the Consumer business.

Previously we have been guided to maybe a gentle decline, over time; it seems to drop by EUR100 million in one go. Maybe you could give us some more information there, and where that’s going in the medium term, excluding potential license income that’s coming from TV?

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO

Yes, thanks for the question, Andreas. As we said over the earnings of last quarter, for this quarter Q1 we guided down for EUR50 million. We have also guided down for the second quarter of the year, and for the second half that it would be in line with last year. That in aggregate, indeed, constitutes EUR100 million down, compared to last year.

It remains difficult to predict license income, as we have experienced. Rest assured that we’re doing everything to accelerate also the innovation machine that Philips is, and drive this to higher levels, going forward.
Frans van Houten - Koninklijke Philips Electronics NV - President & CEO

Some of the license income is related to optical patents. Those optical patents are, in the future, going to yield lower returns, as consumers are taking to the Internet rather than to optical disk. So I think we need to take a cautious stand to the future with regard to license income.

Andreas Willi - JPMorgan Cazenove - Analyst

And my follow-up question on Japan, obviously you said you can’t say too much. But I’m surprised that you see a bigger impact only by Q3, rather than Q2. Is that because it takes that long for your supply chain to use up existing inventories? Maybe you could just give us a bit more color on that, why it will take until Q3 to really see the worst of Japan?

Frans van Houten - Koninklijke Philips Electronics NV - President & CEO

Yes, with pleasure, Andreas. We have put a dedicated team to assess the impact of the supply base, and we have gone quite granular in the analysis.

With granular, you should imagine that we have gone five to six layers deep in understanding suppliers of suppliers of suppliers, if you follow. So it is not our immediate suppliers that are the biggest issue, but some compound and materials suppliers will cause a ripple effect in the supply chain later on. So for Q2, in the latter part of Q2, we may see some of that coming, but as Ron said, primarily in Q3.

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO

Yes, actually, Andreas, maybe to clarify what I said; we’ll see it in the quarters, going forward, but we’ll see a main impact in Q3. But yes, you’re absolutely right, it will be starting in Q2.

Andreas Willi - JPMorgan Cazenove - Analyst

Thank you.

Operator

Martin Wilkie, Deutsche Bank.

Martin Wilkie - Deutsche Bank Research - Analyst

Just a question, you talked about improving operational performance, and listed some things that you’re looking at. One thing you mentioned was past acquisitions; obviously, two of the larger ones you’ve done have been Genlyte and Respironics.

If you could just clarify, was that comment you made reviewing the prices that you paid, and how you would then apply acquisition strategy in the future? Or are there still integration issues with those two deals in terms of where you could see synergies still to be executed on those two transactions? Thanks.
Frans van Houten - Koninklijke Philips Electronics NV - President & CEO

Okay. Thank you. Ron and I have done a detailed analysis of all the acquisitions. We have compared them to our original assumptions on the acquisitions. The cases, as such, are sound, but we have not delivered everywhere on the sales synergies, whereas we have delivered on cost synergies.

So I think that implies already that this is something that we think we can fix by ensuring that we step up the sales synergies of those businesses within Philips. We have, again, some good examples and some bad examples, and we need to make sure that we deliver on all the cylinders, as our favorite automotive comparison is. So we'll see whether we can, on a regular basis, talk about this a bit.

There's another reason, of course, why some of the return on the acquisitions is disappointing and that is, we have just gone through the biggest economic crisis. Balancing for that, the picture is somewhat more positive.

Martin Wilkie - Deutsche Bank Research - Analyst

Thanks. And then just a follow-up. You talked about reviewing overheads and, obviously, there has been some cost reallocated out of Television into both Consumer and at the corporate level. Is that the overhead you're thinking of addressing, or is there a wider opportunity in the Group to look at overall overhead costs?

Frans van Houten - Koninklijke Philips Electronics NV - President & CEO

You should see our comments on cost twofold. First of all, in executing flawlessly on the TV deal, yes, there will be some stranded cost and some disentanglement cost, and we will deal with that fully.

Secondly, we make the observation about overhead costs at Group at sector level, and here is where we think that not all the cost is fully productive. And we would like to unlock that so that we can invest in growth through innovation and market facing investments.

Maybe, Ron, do you have some more to add to this?

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO

Absolutely. So as we said, we're not on the trajectory. Yes, we're making some spend to get us quicker on trajectory and improve the performance in growth and profitability. At the same time, rest assured that we will walk all avenues to see about cost productivity as Frans said, particularly from the complexity-related unrewarded costs, what do these costs bring us, and how efficient can we make them. So it applies, in general, to the costs [chapter], I would say.

Martin Wilkie - Deutsche Bank Research - Analyst

Okay. Thank you very much.

Operator

Ben Uglow, Morgan Stanley.
Ben Uglow - Morgan Stanley - Analyst

A couple of questions. One was on the Consumer Lifestyle division. I think, on the last conference call, Pierre-Jean gave us an idea in terms of margin ranges, what was going on in Audio, Visual and Accessories versus DAP, Health & Wellness and the remainder.

Could you just give us a sense of what the margin trend is sequentially between AVM, Accessories and DAP, Health & Wellness and Personal Care? That was question number one.

Question number two is just returning to the Lighting margin. Even if I strip out the EUR19 million, that's a 2.5 percentage point underlying decline. And what I'd really like to know is, how much of that is simply due to increased SG&A, and how much of it is down to pricing? Is the pricing pressure you're seeing in Professional Luminaires, or even in LED, is that what is driving the bulk of this? Or is it a cost increase?

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO

So for your first question on the AVM, margins are in the mid single digits and for Accessories in the high single digits. So that's for that business.

Ben Uglow - Morgan Stanley - Analyst

So basically unchanged quarter on quarter?

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO

Yes, so it's not for the full year, yes?

Ben Uglow - Morgan Stanley - Analyst

Yes.

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO

Okay. And on Lighting, yes, if you only strip out the EUR19 million, you come to that conclusion. I have also said there has been a slight increase in material costs, and the remainder is for investments in R&D and selling expenses.

Ben Uglow - Morgan Stanley - Analyst

Okay. So the effect of price during the quarter was essentially insignificant?

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO

Well, if you look at material costs and then passing on prices and, as I said in the prepared remarks, there has been some price pressure on the Professional Luminaire side. We have grown there very well, but passing on prices is something that we still have to look at.
Ben Uglow - Morgan Stanley - Analyst
Okay, and we can safely assume that the situation in LED on the pricing side is not what’s driving this?

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO
No, we’re making an [interim] shift, but no, I would say it’s more related on the cost side to the growth and R&D, and on the margin side as I have explained.

Ben Uglow - Morgan Stanley - Analyst
Thank you.

Simon Schafer, Goldman Sachs.

Simon Schafer - Goldman Sachs - Analyst
Actually, I was going to ask a clarifier on the statement of investments that will be required to achieve your targets. Are you thinking the majority of that is basically an increase in organic spend, or are you talking acquisitions as well? I guess I’m just trying to find a balance as to how much of these investments you think will be organically possible, versus how much is M&A driven.

Frans van Houten - Koninklijke Philips Electronics NV - President & CEO
Our first priority was to deal with TV. Our second priority is to accelerate the run rate performance in growth and profitability of our existing business.

With that said, yes, it is organically meant. We will focus very much on boosting the performance of our existing business. At the same time, in Q1, we announced three acquisitions, smaller ones. This may happen in the future, but Ron and my focus is on boosting organic performance.

Simon Schafer - Goldman Sachs - Analyst
Got it, thanks. And my second question, for Ron actually, would be slightly more on the TV business. Just to get a sense by how much your annualized operating expenses may fall, assuming a successful transition or disposal of the TV business. Thank you.

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO
Well, thanks for that question. As you’ve seen, we have reported the TV business, and will do so from now on as a discontinued operation, as an asset held for sale. The costs related to that partly stay with the remainder of Lifestyle and with the remainder of Philips, and we call that stranded cost.

Rest assured that we will address those costs, and then you have also the costs that we will face from the disentanglement. So we will take the measures to address those costs and, right now, we’re first working through the further solidification of the agreement we have with TPV, and we will update you on that later.
Simon Schafer - Goldman Sachs - Analyst

Okay. Thanks very much.

Operator

Gael de Bray, Societe Generale.

Gael de Bray - Societe Generale - Analyst

My first question relates to the cash flow development in Q1. How do you explain the very substantial decline you saw in payables this quarter? And how do you expect the rest of the year to pan out in this respect?

The second question is about the Audio Video business. So you plan to merge that business with Accessories. So do you expect this merger will eventually accelerate the portfolio of choices you will have to make, and maybe lead you to some substantial restructuring pretty soon?

And obviously, in relation to that, what benefits do you expect from this combination, and maybe from the headquarters relocation to Hong Kong?

And maybe a final question, if I may? Just looking at the costs which you have formally reported as part of the TV business and that are now included in the Group's EBITA; that's about EUR30 million this quarter. What exactly are these costs related to, and what can we use as an annual run rate, please? Thank you.

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO

Okay. Your first question on the free cash flow. So this is mainly related to payables. We have a normal seasonality of about EUR600 million to EUR700 million. This quarter, we had some higher cash outflow, so higher cash out due to paying our bills in Consumer Lifestyle; I would put that around EUR100 million. And then we paid also pensions and tax to the tune of EUR250 million, so that explains the difference on the free cash flow.

On AVM and Accessories, Frans, do you want to comment on that?

Frans van Houten - Koninklijke Philips Electronics NV - President & CEO

Yes, sure. The AVM and Accessories supply chain are all entirely in Asia, much of which is outsourced to suppliers. There is a benefit in merging the units being close to that supply chain and sharing an overhead structure.

We are naming the combined unit Lifestyle Entertainment. With that, we are shifting the portfolio gradually to more of the Wellbeing side of Lifestyle. It's slightly over EUR2 billion in size. We think we can make good money in that business, going forward.

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO

On your last question, on the cost of TV and the annual run rate, we can't tell you the annual run rate yet because this will depend on the definitive agreement with TPV, but we felt today we have given you a very good indication by reporting it separately, very transparently, I would say.
The costs are typically for management costs and running services, so that's what these costs are for.

**Gael de Bray** - Societe Generale - Analyst

Okay. Thank you.

**Ron Wirahadiraksa** - Koninklijke Philips Electronics NV - CFO

And as I said, we are really going to address that.

**Operator**

Ilan Chaitowitz, Redburn Partners.

**Ilan Chaitowitz** - Redburn Partners - Analyst

Just two from me. Firstly, just wanted to hit the nail on the head with regard to the LEDs business. We've been hearing some quite concerning commentary from respectable peers with regard to both volumes and pricing.

Philips is still coming out with pretty high growth in this division. I was just wondering if you could help us reconcile the different fortunes, perhaps, that you're seeing compared to some of your competitors. That's the first question.

The second question related to your cash position and, actually, I guess partly as a function of the TV's JV you're going to be even more cash generative than you have been thus far. My question is, you've got over EUR4 billion of cash in your balance sheet; that's not an efficient use of capital. Can you give us at least any idea of where you are moving with regard to your decision on how to deploy that? And if not, can you tell us when we should expect some insight into what you're going to do with that pile?

**Frans van Houten** - Koninklijke Philips Electronics NV - President & CEO

Let me take the first one, and then Ron will take the second question. So yes, our LED business grew by about 27% in the first quarter. We are pleased with that. I think you should remember that our LED business is a combination of both the LED light source, the LEDs, as well as the LED application, both in LED Lamps and in LED Luminaires.

Especially on the LED Lamps and Luminaires, we saw strong growth, and I think some of our peers in the industry are focused much more on the LED light source alone and this is, perhaps, where your point of reference comes from.

Going forward, of course, the battle is not won yet. We are very much aware that there is a tremendous transition going on in the lighting market. Personally, I think that the Philips' strategy to do both light source and lighting application with services in the local market will give us a value-added play in the lighting solutions market. So I'm quite pleased with that direction, but at the same time, I realize that there is a tremendous amount of work still to be done.

Ron, the second question?
Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO

Yes. Thanks for the question. Yes, we have EUR4 billion of cash as per Q1. As we have also disclosed, if you look at the gross debt and you take some of the claims on that gross debt, you come to the net debt of EUR437 million. And then you look at, further down, the pensions, the operating leases and credit-related guarantees, that brings us to an adjusted net debt of EUR2 billion, actually. So I thought I’d give you that as a data point.

Further to that, the stated policy on how we will use cash is we do want to maintain, as a first objective, our A3/A minus rating. Then we’re, of course, committed to driving higher capital efficiency and cash flow yields in the working capital turns, stable dividend policy with a 40 to 50% payout of continuing net income, and the cash we then have will be used to invest in value-creating growth that will be organic, as Frans explained. And through some acquisitions; you have seen us do a few acquisitions in Q1. Some cash to mitigate risks, and then we’ll consider, over time, to return capital to shareholders.

Ilan Chaitowitz - Redburn Partners - Analyst

Thank you.

Operator

Olivier Esnou, Exane BNP Paribas.

Olivier Esnou - Exane BNP Paribas - Analyst

My questions are really on the margin. It was clear that, in the framework of the Vision 2015, from the beginning, the growth was a challenge. But I have the feeling, from your comment this morning, that even the margin of at least 10% seems to be a challenge this year, even excluding TV. Is that a fair understanding of what you’ve said?

And as a follow-on, I would like to focus more precisely on the Healthcare margin, because that’s a division where, in September last year, management actually increased the midterm range for the margin of that division, which was more ambitious than your peers. At the moment, it’s flat, so I was wondering if there was anything that, versus September last year, was not basically going the way you had anticipated. Thank you.

Frans van Houten - Koninklijke Philips Electronics NV - President & CEO

Okay. Thank you, good question. I will take the first part, Ron the second. Vision 2015, that’s a good set of targets. I’ve also said it in the Q1 road show. However, we are not at that run rate yet. There will be work needed, including some investments. Moreover, the intended TV joint venture with TPV totally changes the landscape of Vision 2015.

As we go and implement our granular approach to business management, and try to accelerate growth in profitability, we will be able to update you all in the second half of this year with regard to our aspirations and when we can achieve those exactly.

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO

Okay, your question on excluding TV, the margin. As Frans just said, we will give an update on how we will deal with the financial set of aspirations now that the landscape has changed. But if you take out TV, the margin would come certainly higher in the range.
Olivier Esnou - Exane BNP Paribas - Analyst
Okay. So it’s higher. Thank you. And on Healthcare?

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO
On Healthcare, the target was over the period and not an immediate increase intended for 2010 to 2011.

Olivier Esnou - Exane BNP Paribas - Analyst
So you would say that the plan -- so what has happened in September, in terms of the performance of Healthcare, is in line with what the expectations were at the time?

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO
The performance was, at that time, in line with what the expectations were, that’s correct.

Olivier Esnou - Exane BNP Paribas - Analyst
Okay. Thank you.

Operator
Sjoerd Ummels, ING Financial Markets.

Sjoerd Ummels - ING - Analyst
A couple of questions from my side, please. The first one is on the non-recurring pension contribution. Could you divulge the amount, please?

And the second one is related to the AVM business. Frans already alluded to the fact that, in the licensing income, a drop-off is experienced this year due to a lower value associated with Optical. How should we see this in the AVM context as Blu-ray players and DVD players form an important part of that business mix?

Maybe tied to that question, tying up these two businesses, does that also make it easier for Philips, in future, to actually execute on prospective portfolio actions?

Frans van Houten - Koninklijke Philips Electronics NV - President & CEO
Okay, Sjoerd. Thank you. Good to talk to you. Let me start with the second question, and then Ron will come back on the pension side. Sjoerd, we think it’s logical to combine AVM and Accessories, and we do see the portfolio shift already away from traditional standalone DVD players.

We are growing very rapidly in docking stations. We are actually, with docking stations, in the Apple stores. We are also seeing good growth in personal entertainment such as headsets. The tie-up is to strengthen the unit, to be close to the supply chain. We are committed to this business, and we expect them to make a good contribution to growth and profitability.
It is true that the licensing income is under pressure in this area, but I, in my mind, separate license income from operational business. I want the management team of the Lifestyle Entertainment unit to focus entirely on operational improvements.

**Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO**

On the pension question, you know normally we don’t disclose this, but this time, I can tell you, it’s about EUR120 million.

**Sjoerd Ummels - ING - Analyst**

Okay. Thank you very much.

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**Martin Prozesky - Sanford C. Bernstein - Analyst**

Just two questions, please. The first, just going back to TV. Can you just explain to us what functions you retain, relative to your licensees? Do you retain any obligation in terms of R&D? And what kinds of cost would, therefore, be associated with that in the future? I understand that that might still be up for negotiation, but just to give us a sense in terms of TPV, and also in terms of the other licensees.

And then the other question just on the construction cycle US. Can you just give us your expectations there, and how that will impact Luminaire?

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**Frans van Houten - Koninklijke Philips Electronics NV - President & CEO**

Okay. Well, let me start with TV, and I’m glad that you asked the question, because I think there was a tendency that people think there is still a lot of negotiations to do. Actually, the term sheet is quite comprehensive, and we will move into confirmatory due diligence already in a few weeks from now, which should lead to the definitive agreement; so quite firm.

Then with regard to what we transfer into the JV, well, we basically transfer everything of TV into the joint venture; R&D, the marketing teams, business management, our factories, our sales force, so everything goes.

The part that is so-called stranded costs relates to sector and Group overhead and some shared services. And when Ron earlier indicated that the exact run rate of those costs is still to be determined is because the joint venture, over time, will plan to become more cost effective in, for example, its operating model with regard to IT costs, and so on. And, therefore, some of the transitional services provided by Philips will likely decline, over time, thereby slightly increasing stranded costs, over time.

We have made a very clear statement that we will deal with all these stranded costs, therefore, that should not be a long-term concern.

With regard to the construction cycle, we did say, I think in January, that the Architect Building Index was edging up. There is quite a lag time between that edging up and the full realization in increased sales.

Ron, do we have any particular color on this, or --?
Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO
At this moment, we don’t have particular color, other than what you just said.

Frans van Houten - Koninklijke Philips Electronics NV - President & CEO
Okay, thank you.

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO
There is some timeline.

Martin Prozesky - Sanford C. Bernstein - Analyst
And just one follow-up on the TV. What is your obligations in relation to Funai? So do you [retain] costs there, and how does that evolve, over time?

Frans van Houten - Koninklijke Philips Electronics NV - President & CEO
All right. So we have several brand license deals. We have a separate brand license deal with TPV in China, with Videocon in India, and with Funai in America. There is a brand license agreement between us and these parties. It obliges the license-taker to certain quality criteria and positioning of the products on which the Philips brand is used. That does not involve a lot of cost for us, but rather is an obligation for the licensee.

Of course, the brand is very valuable to Philips, so we want to make sure that it stays like that. These brand license agreements all provide additional income for Philips, which is currently part of the consumer lifestyle sector.

Did I answer your questions?

Martin Prozesky - Sanford C. Bernstein - Analyst
Yes. Thank you.

Frans van Houten - Koninklijke Philips Electronics NV - President & CEO
Thank you.

Operator
Michael Hagmann, Nomura.

Michael Hagmann - Nomura - Analyst
In your presentation, you were talking about your evaluation of about 400 different business combinations, and I was wondering if you could share with us what pattern has been emerging, and if you can draw some conclusions on how long it will take to
see results out of addressing the underperforming units, and how costly that may be. Is it very costly, or is it something that you can actually more easily solve? Thank you very much.

Frans van Houten - Koninklijke Philips Electronics NV - President & CEO

Yes, thank you. Maybe I can take the opportunity to say a few words on how we see Philips. We see ourselves, post TV, as a strong diversified industrial group. We have about 75% of our business in business to business and capital goods. Philips is a conglomerate with quite a number of individual businesses that serve 100 plus countries.

So how did we come to 400? Basically, if we look at the geographies, we can see about 20 relevant market clusters, and if we look at our businesses, we can see about 20 relevant business segments. 20 times 20 is 400, so this is how we have implemented a granular and transparent approach where we compare run rate performance on top line margin, bottom line market share, Net Promoter Score, with target. And then we can say that some of these 400 cells are actually overachieving their targets, and some of these cells are below, or even way below.

Now that is a kind of inconsistent performance that we do not like. We think that we should fire on all cylinders. In fact, that if you look at Q1, you already see a deviation versus plan in a relatively short timeframe, and obviously, we need to learn and improve.

I dare say this is only good news and not bad news. I think people and analysts have often talked about Philips that there is always something, and we are determined to go to the root cause of that. So rather than throwing a blanket over a business and only look at the sum total, we take the blanket off and we go granular and look at the transparency.

It also allows much more entrepreneurialism and delegation, empowerment, because at the same time, you have accountability and transparency.

So I spent a few more words on it, because I think it is important on how Ron and I look at improving the execution of our businesses.

And as we go through that, yes, in some cases, targeted investments may be needed to get the right products to the market, or to step up some market penetration. But overall, it should be positive news, because we deal with the laggards, and that will be incremental sales and incremental growth, and taking out losses in some of those cells.

Michael Hagmann - Nomura - Analyst

Is there a pattern or a theme emerging in your analysis?

Frans van Houten - Koninklijke Philips Electronics NV - President & CEO

Yes, sorry, I forgot that. Actually, it is all businesses and all markets where there are some cylinders at not 100%. So even the good businesses, in some markets, could do even better. So I don't call these scapegoats, not at all; it's just that people need to be precise and learn that an average result is not good enough. We need to be good in every business-market combination.

Michael Hagmann - Nomura - Analyst

Thank you.
Operator
Victor Bareno, SNS Securities.

Victor Bareno - SNS Securities - Analyst
The double-digit revenue increase in the former DAP looks remarkably strong. The Q4 report already mentioned increased spending for this particular business. Are we now seeing an early impact from the policy to increase spending, or has the strong revenue increase in DAP been driven by other factors? Thank you.

Frans van Houten - Koninklijke Philips Electronics NV - President & CEO
Yes, a good point. Indeed, when Pieter Nota came on board last year, he started to look into the Health & Wellbeing side of our Lifestyle portfolio, so Personal Care, Domestic Appliances and Health & Wellbeing. And clearly, with some investments and some more oxygen in the system, they are able to grow faster. So I do think there is a correlation there.

Victor Bareno - SNS Securities - Analyst
Okay. Thank you.

Operator
Piers Ouvaroff, IVI.

Piers Ouvaroff - IVI - Analyst
I have a very, very quick question for Ron, which is this. Just technically, on the EBITA for last year and this year, has TV been excluded both years?

And then second question; I remember last year that you talked about having had an unusually large number of working days, and what had happened last year is that that had boosted the EBITA, particularly in Healthcare and Lighting. I just wanted to know, is that impacting the comparison between last year’s Q1 EBITA and this year’s as well, please?

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO
Thank you for the question. Let me clarify. There is no more working days or less working days. They are the same QoQ, so there is no impact. And we have given you the calendar, and maybe, Abhijit, we should repeat that for this year. We don't want that to be a surprise.

On TV, TV is totally comparable.

Piers Ouvaroff - IVI - Analyst
Okay, so excluded from both years.
Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO

Yes, it's both years excluded, and there is a reconciliation of the operating result and the discontinued operations result.

Piers Ouvaroff - IVI - Analyst

Okay, so working days were flat year on year?

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO

Yes.

Piers Ouvaroff - IVI - Analyst

Excellent. Okay.

Operator

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

Frans van Houten - Koninklijke Philips Electronics NV - President & CEO

Well, let me take the opportunity to thank you all for joining this call, also on behalf of Ron, and we look forward to meeting you in the future and have this dialog more often.

Thank you very much, and have a nice day.

Ron Wirahadiraksa - Koninklijke Philips Electronics NV - CFO

Thank you.

Operator

This concludes the Royal Philips Electronics first quarter results 2011 conference call on Monday, April 18, 2011. Thank you for participating. You may now disconnect.