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PHIA.AS - Q1 2014 Koninklijke Philips NV Earnings Conference Call

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OVERVIEW:

PHIA.AS reported that 1Q14 YoverY comparable Group sales were flat and net income was EUR137m.



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PRESENTATION

Operator

Welcome to the Royal Philips first quarter results 2014 conference call on Tuesday, April 22, 2014. During the introduction hosted by Mr. Frans van Houten, CEO, and Mr. Ron Wirahadiraksa, CFO, all participants will be in a listen-only mode. [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 Investor Relations

Thank you. Good morning, ladies and gentlemen, welcome to this conference call on the first quarter results for 2014 of Royal Philips. I'm here with Frans van Houten, our CEO, and Ron Wirahadiraksa, our CFO. In a moment Frans will make his opening remarks and will take you through our strategic achievements as well as through our main financial performance highlights for the period. Ron will then provide more details of 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 7 a.m. 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 a decision in the first quarter of 2013 to sell the audio, video, multimedia and accessories business, also known as the AVM&A business, we report the profit and loss on this business under discontinued operations and the net assets for the business in the balance sheet on the line assets held for sale.

The cash flow of the audio, video, multimedia and accessories business 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 consumer lifestyle sector level does not include audio, video, multimedia and accessories related information.

Discussions with potential buyers are ongoing and we remain confident that we will be able to sell the AVM&A business this year. We will provide you with more detail once we have an announcement to make.

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 EUR20m.

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

Frans van Houten - *Koninklijke Philips NV* - CEO

Thank you, Robin. Welcome, and thank you all for joining us today. Our financial results in the first quarter reflect a challenging start to the year. Significant currency impacts, headwinds in markets such as China and Russia, and the healthcare market in the United States, as well as our decision to temporarily suspend production at our healthcare production facility in Cleveland led to flat comparable sales growth and a decrease of 130 basis points in our reported EBITA margin compared to Q1 2013.

Our multiyear transformation program, Accelerate, continues to show strong traction driven by a solid innovation pipeline, investments in future growth and a company-wide focus on improved operational and financial performance. We're also taking comprehensive measures to raise the efficacy of our quality management system to Philips's excellence standards in close collaboration with industry experts.

Our overhead cost reduction program remains on track to deliver the additional EUR250m of savings in 2014. And our Design for Excellence program delivered well over 100 basis points of margin improvement on the cost of goods sold since its start, thus helping to partly offset the negative currency impact.

As a reminder, our Design for Excellence program aims to improve the value proposition for our customers and to substantially increase the annual cost savings in our bill of materials. We target to deliver EUR1b of gross cost savings by 2016 of which we estimate around one-third will be achieved in 2014.

Let me now walk you through a selection of our other business initiatives and achievements that underpin our aim to deliver on our mission to improve the lives of 3b people a year by 2025 through our innovations in healthcare, energy-efficient digital lighting solutions and consumer products that improve personal health and wellbeing.

Let me start by speaking about some exciting developments in healthcare. In January, we announced a new business group focused on healthcare informatics, services and solutions. This new business group is addressing major changes in the healthcare markets which are seeing a shift in focus to preventative care and care continuity versus procedure-based care.

Our teams are working closely with our customers on an aligned business model that includes integrated hardware, software and services. For example, we work closely together with the Westchester Medical Center in New York to achieve clinical transformation and innovation in care delivery and facility design.

We are making solid progress on digital health and earlier this month in India we launched a tablet-based ultrasound and ECG that connects to the cloud. Leveraging big data and collaborative workflows, this allows new models for primary care in which care can be provided in distributed settings by collaborating with specialists using Philips's tailored health solutions.

In line with our ambition to be the technology solutions partner to hospital systems, our US sales team have rolled out a new go-to-market model in the first quarter to realize an enterprise level integrated account management approach which will come into effect as of Q2 and will provide more value add to our customers.

In Australia, we have installed our cableless IntelliVUE Guardian patient monitoring solutions at a major hospital in Melbourne. The combination of Philips IntelliVUE Guardian embedded algorithms and clinical decision support tools enabled the hospital to monitor patients more closely in lower acuity settings such as the general ward and not just in high acuity settings such as the intensive care unit.

Addressing the growing need for healthcare in growth geographies, we have launched an innovative integrated defibrillator and patient monitoring solution; it's called the Efficia, in India and Malaysia. This solution was developed and designed at our Bangalore innovation campus to meet the growing needs in value segment. We've also set up an innovation hub in Nairobi, Kenya, which deals with key challenges like improving access to lighting and affordable healthcare and develops innovations to meet the needs of the rising middle class in Africa.

We are shifting from a products to a solutions company as we partner with our Healthcare customers to deliver better outcomes over multiyear engagements and leverage new recurring revenue models. In that respect, Philips and MEDSI, Russia's largest network of private clinics, have set up a multiyear partnership that will provide MEDSI hospitals with the latest Philips healthcare equipment and technology, hospital management and consultancy services.

In consumer lifestyle, we are taking global innovation platforms and bringing them to market in a way that's locally relevant. In line with our mission, we are empowering millions of consumers to make healthier choices everyday in areas such as nutrition, oral healthcare and in air purification.

In China, we recorded strong sales of Philips air purifiers and also kitchen appliances and Philips AVENT feeding solutions, which are designed for Chinese infants, are growing at double-digit rates. Philips's leadership position in oral healthcare in North America was further strengthened with extended distribution of the latest high-end propositions like the Philips Sonicare FlexCare Platinum and Sonicare Diamond Clean Black.

Globally the Philips air fryer family is now available in more than 100 countries, making Philips the world's number one low-fat fryer brand. Just to illustrate this, in our home market, the Netherlands, we sold in the first quarter of 2014 double the amount of air fryers as in the same period in 2013.

In lighting, our leading position in LED lighting products and systems is based on our continuous investment in intelligent connected lighting solutions, serving both consumers and the growing professional market for integrated systems and services. Let me give you now some compelling examples.

At the Light and Building Fair in Frankfurt, we launched a full range of smart connected lighting systems for homes, businesses as well as cities. Our new systems connect people, places and devices in homes, at work and in cities across the world, and through big data applications unlock more value. And the feedback of our customers has been fantastic; they recognize how we are changing the way people experience and interact with light.

Through connected LED lighting, we foresee a future where lighting innovations connect seamlessly with smart controls, networks, devices and apps to positively benefit and improve lives and drive new business value. We broadened our Hue portfolio of connected lighting for the home with the introduction of Hue Lux, a bright white light only version of the Philips Hue as well as novel Philips Hue 3D-printed luminaires and the Philips Hue Tap, an innovative kinetic wireless switch which is powered by its buttons being switched.



In the professional domain, Philips has introduced a connected LED lighting system for supermarkets where individual lights transmit their location to a shopper's smartphone. Such systems will enable in-store location-based services to help drive sales, customer loyalty and enhance the shopping experience.

Exploring new business models, we have teamed up with Ericsson to jointly launch an innovative connected LED street lighting model. The partnership addresses two major issues that cities are facing today, providing citizens with improved network performance in dense urban areas, as well as high quality public lighting that is energy efficient.

We are also joining forces with ABB to simplify the integration of connected lighting systems and building device control for commercial buildings. Combining Philips's expertise in LED lighting systems with ABB's knowledge of building automation will offer the ability to control a commercial environment while delivering up to 80% energy savings compared to conventional lighting.

And while we continue to invest in innovative new lighting solutions and models to fuel organic growth, we also entered into an agreement to acquire 51% of General Lighting Company, a major lighting company in the kingdom of Saudi Arabia. This joint venture will bring together Philips's expertise in LED technology and the benefits of our global supply base with GLC's deep local market knowledge and strong commercial capabilities. The joint venture will enable us to offer a full range of LED lighting solutions and strengthen our footprint in the region, while at the same time creating growth opportunities in sustainable technologies to reduce energy consumption.

Lastly, I would like to draw your attention to exciting adjacencies that build on our strength and provide attractive potential for future growth. Examples of these emerging business areas are digital pathology, point-of-care diagnostics and horticultural and city farming lighting solutions. We are stepping up investments in these promising emerging business areas to unlock fast growth into these largely untapped market opportunities where our technologies and expertise open up new solutions.

Looking ahead, we expect the remainder of the year to remain challenging as major currency market headwinds and the temporary production suspension in Cleveland continue to impact our business. And although we are pursuing a number of mitigation initiatives, we can no longer expect to fully recover from the financial impact of these issues in our healthcare sector this year. For the other sectors we do expect improved results over last year.

Over the course of the year and in the long-term, we will maintain a strong focus on our Accelerate program to drive actions that improve gross margins, drive productivity, lean out our customer value chain, rationalize our industrial and distribution footprint, speed up innovation, improve our IT platform and improve customer service. As I mentioned earlier, we will focus on our comprehensive efforts to raise the efficacy of our quality management system and embed Philips's excellence standards across the organization.

We are investing significant resources to implement the Accelerate programs. And while these investments will weigh on the results for a couple of years, they will gradually phase out from 2016/2017 onwards. Even with a difficult 2014, overall I feel that we are very well positioned to achieve our 2016 targets. As you know, these targets are comparable compound annual sales growth of 4% to 6% over the period 2014 to 2016, 11% to 12% reported EBITA margin and an ROIC of more than 14% in 2016. Regardless of the current headwinds, we remain a self-help story and you can count on us that we will work diligently and tenaciously to deliver the massive potential of Philips and to significantly increase the value of our Company.

I will now turn over the call to Ron, to go over our financials in more details.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Thank you, Frans. Good morning to all of you on the call. Let me take you through a bit more detail and color on our Q1 financial performance.

Comparable Group sales in the first quarter of 2014 were flat when adjusted for currency and portfolio changes. On a nominal basis, Group sales decreased by 5% due to negative currency translation effects of 5%. Comparable sales in Western Europe decreased by low single digit as low

single-digit growth in healthcare and consumer lifestyle was offset by a low single-digit comparable sales decline in lighting. This was due to sales declines in LS&E and consumer luminaires.

Sales in North America declined low single digit on a comparable basis in the quarter as healthcare sales declined with single digit due to the soft order book development in the preceding two quarters. However, equipment order intake in North America increased by 5% which, excluding products manufactured at the Cleveland facility, increased double digit. This is encouraging, certainly when considering the rather weak US market environment.

Consumer lifestyle sales in North America declined low single digit in the first quarter due to a market decline in the male grooming category, the fact that new product introductions are skewed towards the second half of the year, and because of the negative weather impact. It is important to note, however, that market shares in consumer lifestyle in North America showed strong increases across categories. Lighting sales in North America decreased mid single digit. Positive performance in LS&E was offset by a decline in professional lighting solutions.

The other mature geographies delivered 3% comparable sales growth, fueled by continued strong performance in consumer lifestyle, most notably in South Korea.

In our growth geographies comparable sales grew 5% in the first quarter driven by China, the Middle East, Turkey and Africa and offset by a weaker performance in certain emerging economies including Russia, Latin America and India. Sales generated by the growth geographies represented 34% of Group sales in line with Q1 of last year.

Reported EBITA was EUR314m or 6.3% of sales compared to EUR402m or 7.6% of sales in the first quarter of last year. The 130 basis points drop was, as Frans explained in his opening remarks, mainly driven by currency headwinds which negatively impacted margin by around 180 basis points, some headwinds in markets like China, Russia and the healthcare market in the US, as well as by the production suspension in the Cleveland factory.

Restructuring and acquisition-related charges were EUR54m in Q1 2014 compared to EUR19m in Q1 2013. Adjusted EBITA therefore amounted to EUR368m or 7.3% of sales in the quarter compared to EUR420m or 8% of sales in Q1 2013.

Net income amounted to EUR137m in the quarter compared to EUR162m a year ago. The year-on-year decrease reflects lower operational results and higher restructuring charges in 2014 which were partly offset by lower tax charges and financial expenses, and one-off gains in results from investments in associates.

In the quarter we had a free cash outflow of EUR345m. This included a one-off pension contribution of EUR273m related to the new funding agreement for the Dutch pension plan under which Philips is no longer liable for future deficits. The remaining net cash outflow is largely explained by an increase in inventories as part of a seasonal pattern we see in the first quarter of the year.

Let me now give you additional color on the performance of each of our businesses during the first quarter, starting with healthcare. I'll start with an update on the situation at our healthcare production facility in Cleveland. We announced on January 28, 2014 that we had initiated a voluntary temporary suspension of new production at the Cleveland facility primarily to strengthen manufacturing process controls.

The remediation plans are progressing according to plan and we expect the factory to gradually resume production in the course of the third quarter. More broadly, we are taking comprehensive measures to raise the efficacy of our quality management system in our healthcare sector to ensure that Philips's excellence standards are enacted consistently.

The business impact on sector EBITA due to lower sales and extra cost is now expected to be EUR60m to EUR70m for the year. As we anticipate that the results of mitigation efforts across the sector will generally be offset by increased currency impact and market headwinds.



Currency-comparable equipment order intake increased by 1% in Q1 2014 compared to Q1 of 2013. Order intake in patient care & clinical informatics increased by double digits while imaging systems decreased by mid single digit, mainly due to the production suspension in Cleveland. Excluding this effect, currency-comparable order intake was up mid single digit.

Progress in US healthcare reform continues as 8m Americans have enrolled now in private health coverage under the Affordable Care Act to date. However, uncertainty remains around the impact this may have on increased demand for services. Healthcare CapEx is expected to be flat for 2014 with an uptick in IT and down for diagnostic equipment. Healthcare construction is expected to remain flat through the remainder of 2014.

Currency-comparable order intake in Western Europe increased by 2% in the quarter. The Western European healthcare market continues to show a mixed picture. Southern Europe was able to sustain the recovery we witnessed in the preceding quarter. However, this was partly offset by a continued negative order intake in most Northern European countries. Of note is our expectation that the market in Northern Europe may become lumpier due to some hospitals shifting to larger multiyear contracts.

In the rest of the world, Latin America, Middle East & Turkey and India witnessed strong order intake which was partly offset by countries like China and Russia. Negative order intake in China reflects softer macro indicators, as well as hospital construction delays that are likely to continue in Q2. In Russia, low tender activity continued as a result of a decline in the overall healthcare market.

On a currency and portfolio comparable basis, healthcare's year-on-year sales were down 2% in Q1 2014 due to the factors explained earlier in this call. Home healthcare solutions increased by mid single digit while customer services and patient care & clinical informatics grew by low single digit. Imaging systems declined by double digit.

Comparable healthcare sales in the growth geographies decreased mid single digit in the quarter mainly driven by sales declines in China and Russia. Comparable healthcare sales in the mature markets were down low single digit. Western Europe continued to show a mixed picture. All Southern European markets grew comparable sales or improved their performance trend while sales declines were most notable in a number of the Northern European countries. In North America, comparable sales were down mid single digit in the quarter partly due to market weakness.

Healthcare reported a first quarter EBITA of EUR152m or 7.7% of sales. The adjusted EBITA amounted to EUR173m or 8.8% of sales which is 170 basis points lower than in the same period last year. The decrease largely reflects currency headwinds, the negative effects of the production suspension in Cleveland as well as overall softer market demand in countries like the US, China and Russia.

Consumer lifestyle continued its strong growth trajectory delivering 7% comparable sales growth driven by domestic appliances, health and wellness, and personal care. The growth geographies increased comparable sales by 11% supported by most markets and most notably China and Brazil. Sales in Western Europe were up 1% while sales in North America were down 3%, where solid share gains across the categories in which we play were offset by market declines. Other mature markets recorded 21% growth in the quarter with strong double-digit growth coming from Japan and South Korea.

Consumer lifestyle generated an EBITA of EUR108m or 10.6% of sales in the first quarter both on the reported as well on adjusted basis. The adjusted EBITA margin was 70 basis points higher than in Q1 2013 as improved gross margins driven among others by DfX, other operational leverage and Accelerate cost savings were able to fully offset currency.

Comparable sales in lighting remained stable in the quarter compared to Q1 of last year. Strong double-digit comparable sales growth in automotive and in lumileds was offset by low single-digit sales declines in light sources and electronics and professional lighting and a high single-digit decline in consumer luminaires. The sales decline in professional lighting is largely caused by operations in North America. We expect however that the comprehensive turnaround of professional lighting solutions North America will start to show improvements as of Q3 this year.

The negative sales performance in consumer luminaires is largely driven by its operations in Western Europe where, with few exceptions, the market continues to be sluggish. We do expect that the new connected lighting product ranges as launched at the Light and Building Fair in the first quarter, as well as our partnership with Disney will start to fuel growth in the second half of the year.



LED sales grew by 37% enabling us to build on our leadership position in LED-based lighting products and systems. LED-based products and solutions represented 33% of total lighting sales in Q1 compared to 23% in Q1 of last year.

Excluding OEM sales, our growth geographies showed a low single-digit growth which was offset by low single digit sales decline in Western Europe and a mid single-digit decline in North America. In China, performance was under pressure due to a year-on-year decline in new construction, especially in retail, and tightened controls on government funding of projects.

The Western European construction market is expected to return to growth in 2014. Having declined by 2.1% in 2013, it is forecasted to grow by 1.6% in 2014 reflecting a return to growth in both the residential and non-residential segments.

The US construction market is forecasted to grow by 10% in 2014. Growth is forecasted to be largely driven by continued strength in the residential segment, supported by a clear recovery of the non-residential segment. So far, however, the recovery of non-residential construction spending in the US has not yet materialized. Having dropped below the 50 mark in November and December of 2013 the architecture billings index recovered in the first two months of 2014 and now again points to growth in construction spending within 9 to 12 months.

The reported EBITA for lighting was EUR138m or 7.3% of sales compared to 7.4% of sales in Q1 2013. Despite flat sales growth, adjusted EBITA for lighting was EUR171m or 9% of sales compared to EUR166m or 8.4% of sales in the first quarter of 2013. The year-on-year improvement of 60 basis points was driven by improved gross margins, driven largely by our DfX program and lower overheads costs which more than offset currency headwinds.

Reported EBITA for innovation, group and services amounted to a net cost of EUR84m compared to a net cost of EUR65m in Q1 of 2013. The increase largely reflects higher investments in our emerging businesses and a step-up in Accelerate-related costs, most notably the transformation of our IT landscape.

Our cost savings programs are progressing according to plan. We are on track to deliver EUR250m of additional overhead cost savings in 2014 and our DfX program is also on track to deliver additional procurement savings over the historical run rate. Together, these programs will continue to contribute to margin improvement and help to partly offset headwinds such as those from ForEx.

Inventory as a percentage of sales improved by 60 basis points to 14.9% at the end of Q1 2014 and this was driven by all three sectors, most notably healthcare. Return on invested capital improved to 14.5% at the end of Q1 2014 compared to 7% excluding the CRT fine in Q1 2013. The strong improvement was driven by an increase in earnings and a lower average net operating capital, mainly due to lower fixed assets partly offset by higher working capital.

As far as capital allocation is concerned, we have commenced our EUR1.5b share buyback program in October 2013. At the end of March 2014, 14% of the program was completed.

Ladies and gentlemen, let me briefly summarize before opening the lines for questions. Clearly, 2014 will be a challenging year in which financial performance will be back-end loaded and which is not without risks given the uncertainties related to currency and market headwinds. For the longer term, we remain confident in our ability to further improve our performance by continuing our strong focus on the Accelerate transformation program. While market conditions continue to pose significant headwinds, we remain firmly confident that we will be able to achieve our 2016 targets.

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



QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Andreas Willi, JP Morgan Cazenove.

Andreas Willi - JP Morgan Cazenove - Analyst

Yes, good morning, everybody. My first question is on lighting and here particularly on luminaires where the strategy doesn't really -- doesn't seem to be really working looking at the top-line growth you're doing relative to what the market and peers are doing. At the Frankfurt Light and Building you had a strong offering but you don't seem to be able to fully commercialize this or get the benefit of sales growth. Maybe you could give us some more pointers what you're doing there to drive sales growth both in professional and consumer. Obviously I appreciate you still have issues in the US in professional. But a lot of your competitors enjoy actually quite good growth in professional luminaires again also outside the US.

Frans van Houten - Koninklijke Philips NV - CEO

Thank you, Andreas, good morning. Thank you for referring to Light and Building, indeed we had a very strong offering there with many new innovations for all segments, outdoor, office, indoor and consumer markets. We expect that that will drive sales growth going forward. It does take some time for all these innovations to fully hit markets.

We saw growth outside of the United States, we continued to see negative impact from our professional lighting in North America, the old GEN Light acquisition where the restructuring, the transformation that we are doing takes longer to get to full fruition. We now expect that the second half of this year we'll see a recovery. I acknowledge that we are not seeing the same growth as our competitors in North America. Outside North America actually we are doing pretty good.

Consumer luminaires remains a story where Asia is doing exceedingly well and Europe is still in the doldrums. Also there the recovery of consumer luminaires in Europe takes longer than expected, which is not good. But we remain confident that that eventually will become a good business. So there's still work to be done.

Let me reiterate that I'm very confident that the lighting sector overall is on the right path to continue to drive increased performance this year and on track to its targets for 2016. We also still are very confident that the strategy to lighting systems and solutions is a great strategy as the profit pool will migrate to that sector and we are the strongest player in that field.

Andreas Willi - JP Morgan Cazenove - Analyst

And my follow-up question is just to clarify on your commentary on improving performance. You said earlier lighting and consumer are expected to have an improved year-on-year performance. Is that underlying or a reported basis? And would you expect the Group overall to improve on an underlying basis compared to the 10.7% of last year? Thank you.

Ron Wirahadiraksa - Koninklijke Philips NV - CFO

Yes, Andreas, this is Ron, good morning, thank you for the question. So as Frans and also I indicated, 2014 will be a challenging year. And last time we said the 2014 year will show a modest step on the reported EBITA improvement. That looks very challenging. Underlying, encouraged by consumer lifestyle there will be a year-on-year improvement we anticipate and for lighting we are on track as Frans said for 2016, so it's reasonable to expect also that that will slightly improve.

Andreas Willi - *JP Morgan Cazenove - Analyst*

So your comment that 2014 we should expect an underlying improvement for the Group driven by lighting and consumer?

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

No, you asked me about underlying the lighting and consumer part. I said on a reported EBITA, so reported EBITA. So, we should anticipate that certainly consumer lifestyle will show an improvement and lighting as Frans said is on track for 2016. So reasonably we would assume that 2014 will also show somewhat of an improvement.

Frans van Houten - *Koninklijke Philips NV - CEO*

Yes, and to finish the story, Andreas, healthcare will not. And overall for the Group where we said in January we expect a modest improvement, now we talk about a challenging year that is back-end loaded in the second half. The second half will be a lot better of course, but overall we don't make that prediction.

Andreas Willi - *JP Morgan Cazenove - Analyst*

Okay, thank you very much.

Operator

Martin Wilkie, Deutsche Bank.

Martin Wilkie - *Deutsche Bank - Analyst*

Deutsche Bank, a couple of questions. First on currency you talked about the hit in the quarter. In the past, you mentioned that because of your hedging program you don't necessarily see the hit as we can look at the spot rate. Can you just clarify if the point of maximum pain in terms of margin impact has been in Q1? Or should we expect that to be similar or worse in the second quarter?

And secondly, related to that in lighting obviously when you talk about the margin improvement you refer to year on year. But obviously the margin has come down quarter on quarter, i.e. relative to Q4. Is that largely currency? You've talked about some other headwinds in the fixtures business, but more precisely given that we've seen the non-LED business shrink further in the quarter if you could just clarify there's not an adverse mix impact inside lighting as well, relative to Q4? Thank you.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Yes, Martin, thanks for the question. So, let me answer the question on currency. We did not say we did not see much impact due to a hedge last year. What we said there was actually a significant impact but through Accelerate we were able to offset that impact, so there was no reason to use it as an excuse for the performance or even an explanation.

Yes, we do hedge. As we always said we hedge 100% of the committed exposures in the currencies that are not prohibitively expensive to hedge. And then we hedge a certain part of our anticipated exposure. So we can't say that we're immune to ForEx, we said quite the contrary. And last quarter we actually said that we expected ForEx headwinds to be stronger particularly in the first half.



Now that also gives me the second part of your question, what should we expect? So at current spot rates which are closer to last year's second-half rates let's say because the currency was started from Q2 onwards. It's reasonable to expect that most of the impact will be in the first half. There will still be some impact in the second half but it will be more mitigated.

Martin Wilkie - *Deutsche Bank - Analyst*

Right.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Lighting, the decrease in the margin you ask if that's currency or also mix. Well, we've been able to offset the currency as you have seen that the amount has been improved of the underlying performance. So the operational performance has improved. On the reported EBITA through some restructuring it has not.

Frans van Houten - *Koninklijke Philips NV - CEO*

And to your point, how will the mix influence results? I think we have always consistently said that we are very positive about our ability to have a higher margin in LED in professional lighting and in consumer luminaires. So as the mix shifts there it's actually accretive.

We see strong performance in LED in lumileds and also in automotive that remains then the LS&E, the lighting systems and the bulb business. LED bulbs in professional applications also has a strong EBITA. It is especially in the consumer lamps business where of course prices are coming down and they need to come down in order to get to an acceptable consumer price point. There we feel that versus competitors we are doing well. In the near term, consumer lamps will have a dilutive effect but that is a matter of time and overall we believe that we can adjust the go-to-market cost structure to ensure that lamps will remain a good and profitable business for us.

As we said in the beginning of the call, lighting is on track towards its 2016 targets.

Martin Wilkie - *Deutsche Bank - Analyst*

Okay, so in terms of -- you mention obviously bringing the two questions together that that currency impact should obviously be somewhat less in the second half and we shouldn't therefore be overly concerned about mix. And therefore that progression should really kick in from the second half of the year?

Frans van Houten - *Koninklijke Philips NV - CEO*

Yes, Ron also explained that currency impact on a comparable basis to last year was stronger, is stronger in the first half than in the second half. In the second half of last year we already saw currency impacting our results as hedges were running out and the full -- we see that now of course heavily impacting the first half. But then on a comparable basis the impact is not as severe in the second half of this year.

Martin Wilkie - *Deutsche Bank - Analyst*

Great, that's great. Thank you very much.

Frans van Houten - *Koninklijke Philips NV - CEO*

You're welcome.



Operator

Ben Uglow, Morgan Stanley.

Ben Uglow - Morgan Stanley - Analyst

Morning everyone, I had a couple on healthcare. First of all, either Frans or Ron, can you elaborate on the emerging market healthcare situation in terms of orders? So, when I look, you've got North America and Europe essentially improving in a kind of low to mid single-digit range, emerging market or growth geographies overall improving mid single digit, but the division only 1% implying that you've had a very severe downturn indeed in China and Russia. Are you able to talk about the severity of the downturn in China and Russia? And is this something that we see continuing into the second quarter? How big an effect is that going to be over the next couple of quarters? So that was issue number one.

Issue number two is just stepping back and talking very generally, we've heard mixed things in the last few weeks from your big competitors in healthcare in terms of how Europe is progressing and how the US market's going to look over the remainder of the year. Can you give us your just very general color on whether you think that in developed markets, i.e. US and Western Europe, you believe that the healthcare trend is in fact bottoming?

Frans van Houten - Koninklijke Philips NV - CEO

Okay, yes, Ben, gladly. So we saw a very mixed picture on order intake in the first quarter. Interestingly if I start with Europe, Southern Europe came in strong with a significant increase in orders whereas Northern Europe was weak largely. So, how to interpret that, well, Southern Europe being positive I think has to do with the recovery of Europe. Northern Europe being flat has to do more with the lumpiness of orders; those are getting to bigger orders. When we look at our funnel of opportunities in healthcare in Europe, we actually have reasons to believe that we can look with optimism to the future.

When we then speak about emerging markets again a very mixed picture, India did very well on equipment order intake. Latin America as well, but China and Russia were quite negative in the first quarter. Now, Russia that has to do with the Ukraine crisis therefore is an uncertain factor. In China we have reason to believe that it has to do with timing in the year. We had a strong Q4, Q1 was weaker. We think it will come back later in the year. So that gives you some color on the geographical axis.

If I look at the businesses in healthcare, personal care & clinical informatics, strong double-digit order intake. We see ongoing strong traction on our home health business. It's basically the imaging business system -- imaging systems business that is affected also by the temporary suspension in Cleveland. We think that that is something that will come back over the summer and therefore there's no structural weakness there, it's just a temporary thing that we need to diligently work through.

But strategically we believe that our healthcare business, given that we provide solutions to hospitals along the continuum of care is in fact better positioned than many others. We see that hospitals are keen to get into multi-year partnerships and therefore the clinical IT will prove to be a strength for Philips versus competitors that only have point solutions.

Now, then your second point was mixed messages from competitors. Well, I think I've talked a little bit around it already. Healthcare business this year I think will be a bit more spotty, a bit more lumpy. Strategically I don't see weakness in the longer-term; it's just that we need to work through this.

And maybe a last word about the United States, there Obamacare is continuing to affect the healthcare market. We continue to see hospital consolidation. Overall CapEx in the hospital system is flat but if you dissect it on a more granular level then actually the big irons the big scanners are slightly down whereas IT is being favored, that's logical. What would you do if you merged two hospitals? You're first going to fix your IT business.

Now, as you know in January we announced the establishment of a new business group, Healthcare Informatics Systems and Solutions -- Services and Solutions. We do that exactly to play into the opportunity that the consolidation of healthcare markets are giving us. In that context you also should see the reorganization of our sales force in the United States where we have strengthened how we call on the enterprise level to the C-suite of hospitals in order to benefit from bigger and multiyear order opportunities.

Ben Uglow - *Morgan Stanley - Analyst*

Okay that's helpful, thank you, Frans. Just one quick follow-up, on the projected impact from the Cleveland shutdown, I think I wrote down looking at my notes EUR60m to EUR70m for the year. Isn't that what you originally expected or has that been, has that forecast been changed at all, are you expecting to have a longer effect? Is there any change in that number?

Frans van Houten - *Koninklijke Philips NV - CEO*

No, actually it's the same number. It hasn't changed, except that in January we said that we will find offsets elsewhere (multiple speakers) effect. And given that we also have currency and market headwinds of course you can only use offsets once and we think it is more fair to use offsets against the general market pressures and therefore look at Cleveland in its nakedness and that is the EUR60m to EUR70m of impact.

Ben Uglow - *Morgan Stanley - Analyst*

Okay, I got it. Thanks a lot.

Frans van Houten - *Koninklijke Philips NV - CEO*

All right.

Operator

Gael de Bray, Societe Generale.

Gael de Bray - *Societe Generale - Analyst*

Yes, thanks very much. Good morning everyone. Can I have a follow-up again on healthcare, your performance on China is obviously looking quite rich but I think you mentioned a bit earlier there were some hospital construction delays in the country. So I was curious to understand what's really driving these delays and how long it could continue. And maybe in connection to that, we've seen orders down, not only in China but also in Japan this quarter so are you seeing some increasing competition in these two geographies? That's question number one.

And question number two is in connection with the de-risking of the Dutch pension plan. I think you've mentioned in the past that there would be something like a EUR600m contribution this year, that part of it would be non-cash. Could you maybe say how much is still to come out in the coming quarters in relation to this Dutch pension plan issue? Thanks very much.

Frans van Houten - *Koninklijke Philips NV - CEO*

Of course, of course, let me start with China first. When I mentioned construction then I was referring especially to commercial construction, road-building and so on, affecting our lighting business, I did not make a specific reference to hospital buildings built, in fact healthcare remains a strategic objective of the Chinese government. I did mention that timing plays a factor where Q1 indeed was relatively weak but I don't see that as a structural weakness. So we expect actually that maybe in the second half of the year China for healthcare can come back.

For lighting it remains very much to be seen because, for example, as online sales is becoming more important for consumers there are less retail store openings and less retail store openings means much less lighting business for us as well. So that is that. Japan actually, we had a flat order intake versus last year so that did not really contribute to a decline.

Then I'm asking Ron to explain the pension situation.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Yes, so we spoke about the EUR600m in contribution, partly in cash and partly in assets. It's still a EUR600m contribution but the cash part of it is larger, there's only been a smaller portion of assets that have gone over so gradually over the course of the year and in 2015 we will complete this transaction. The cash outflow for this in the first quarter was EUR273m, so expect that the brunt of it will be, the majority if it will have been done within this year, I think it will be close to EUR400m.

Gael de Bray - *Societe Generale - Analyst*

All right, okay. Thank you very much.

Frans van Houten - *Koninklijke Philips NV - CEO*

Thanks.

Operator

Olivier Esnou, Exane BNP Paribas.

Olivier Esnou - *Exane BNP Paribas - Analyst*

Yes, hello, good morning. I wanted to come back on the FX first. Can you give some granularity of the 1.8% impact, how does it compare if we look at each of the three divisions maybe?

And the follow-up would be on the savings, Dfx, you said earlier you would achieve about a third this year of the EUR1b, and maybe if you could give an idea if you take the full productivity contribution for the year, where does that bring the number a little bit in terms of percentage of cost of sales, because you must be well above the 1% in total that you mentioned. Thank you.

Frans van Houten - *Koninklijke Philips NV - CEO*

Ron, can you start with ForEx by sector?

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Yes, well, we're not giving the quantified number out by sector but directionally I can tell you that on a percentage basis consumer lifestyle was significantly impacted and it had a lot to do with Russia and the emerging markets. As I said earlier, emerging markets currencies are the ones that have been very much under pressure. Of course also the yen and the dollar we know, but particularly also emerging markets and it's not easy to hedge it all, it's sometimes, or most of the time, prohibitive, mostly by expenses.



Then lighting was -- but as we said in consumer lifestyle we have been able to overcome that in this quarter. In lighting similarly there was somewhat of an impact in lighting and healthcare also had an impact that was a little under the 180 basis points. So of the three of them, you can say that consumer lifestyle was most affected in this quarter.

So overall what we said for the second half being more mitigated in ForEx impact will apply to all three sectors.

Frans van Houten - *Koninklijke Philips NV - CEO*

Okay, let me talk a bit about DfX. Design for Excellence is a program that we have, the name we have used to address the effectiveness of product design and procurement savings. It's a comprehensive effort that started early 2013 and where we said over a three-year period we will realize EUR1b of gross savings.

We saw the first results of DfX trickling in already in 2013 and we've flagged in the introduction today that in the first quarter we saw an impact of approximately 100 basis points contribution to the bottom line.

The way we will look at the procurement savings is versus a baseline as we had historically and then see how much structural improvements we see in the bill of material savings versus the baseline year. Maybe later in the year we can further elaborate on that. We indeed expect that about a third of the EUR1b gross savings will materialize over this year.

Then you also referred to other productivity savings so that's, indeed we have several sources of improvement. We also have the overhead cost savings where we finished last year well over EUR1b and we said in the introduction this morning that we expect to raise that this year by EUR250m, meaning that we will end the year cumulatively a little over EUR1.3b.

Olivier Esnou - *Exane BNP Paribas - Analyst*

Yes thank you, just a follow-up on that. In terms of the DfX productivity, the one-third this year of the EUR1b, is it a cumulative amount including something in 2013 or is it just a benefit of the year, or is 2013 irrelevant anyway?

Frans van Houten - *Koninklijke Philips NV - CEO*

It's a cumulative effect and the complexity when it comes to DfX savings is that we create a funnel of savings in the design of the bill of material for every product category. And then, of course, we need to realize that through bringing out these design changes to the products as well as the negotiations with suppliers.

It's a very detailed and granular piece of work that is not always 100% attributable to a given month or a given quarter, so we prefer to talk about it in a cumulative way as some of the negotiations and the design changes started last year, we see that gradually coming to fruition currently.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Yes and bear in mind that, Frans says cumulatively which of course is correct, we've have quite a small impact incrementally in 2013 so it's good to assume that the brunt of it will still happen in 2014.

Frans van Houten - *Koninklijke Philips NV - CEO*

Yes.



Olivier Esnou - *Exane BNP Paribas - Analyst*

Okay, thank you.

Operator

Simon Toennesen, Credit Suisse.

Simon Toennesen - *Credit Suisse - Analyst*

Yes, good morning, gentlemen, just two questions. The first one is just on these market headwinds that you've obviously talked about a few times now for fiscal 2014. Could you just provide a bit more color on that, has pricing worsened in any of your markets and has that impacted and is that part of the market headwinds that you're talking about?

And then secondly just on healthcare, you commented about reported EBITA earlier and I just want to clarify, in healthcare given the FX impact we know about for the first half, the volume impact now, do you think you'll still be able to generate the kind of 70 basis point of margin improvement underlying in healthcare that the market is looking for for this year, whether that's achievable?

And then secondly just on growth, imaging systems had, which is roughly 30% of your healthcare sales, was declining double-digit now in Q1, What are your expectations for imaging in the second quarter? Thank you.

Frans van Houten - *Koninklijke Philips NV - CEO*

Yes, let me start with the market headwinds. We see that many of these emerging economies have impact from their currency devaluation making import of healthcare equipment more expensive and uncertainty is reigning. This means that some projects are either postponed -- we do not see specifically that it is causing additional price erosion, on price erosion we continue to see the regular 3% to 4% on a moving annual total basis, so we don't see significant uptick of price erosion. Of course, we adjust our prices when currency headwinds hit us wherever possible so it is more a demand and volume impact than a pricing impact.

Then on the healthcare outlook, I think we have already said that we will not be able to get a year-on-year improvement in 2014, whereas we continued to be fully committed to the 2016 targets for all three sectors.

Imaging is within healthcare affected most whereas patient care and clinical informatics and home healthcare actually performed pretty well. So it is the imaging systems business that is a little bit under pressure here and where some orders have been postponed given the temporary suspension of manufacturing in Cleveland.

We expect that to come back in the second half of the year, which makes us pretty backend-loaded, but we remain optimistic about our strategic positioning of the business. Several of the new product introductions that we announced at the RSNA in Chicago last year such as the Spectral CT and the PET/CT, those are products that still need to come to the market and which are now a little bit delayed due to the Cleveland situation. But those products continue to be great innovations that the market is waiting for.

Then there was one last point on the EBITA for healthcare that Ron will cover.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Yes, you asked, can you generate 70 basis points underlying margin improvement in this year? So what I think we're trying to express here and what we said earlier is that healthcare will not improve on a reported basis for this year and on the 70 basis points having said that I can't really give a clear answer on that.



I want to say one thing about Q2 for China using this moment, so that is that bear in mind that last year, in Q2 2103, we had a 41% order intake growth in China and 20% sales growth, so that will be a difficult compare.

Simon Toennesen - *Credit Suisse - Analyst*

Thank you very much.

Operator

Frederic Stahl, UBS.

Frederic Stahl - *UBS - Analyst*

Hi, good morning, guys, it's Frederic here from UBS. I just want to clarify if I understood the message on healthcare correctly. You mentioned the gross margins are coming down and that it's demand driven largely. Is it then because of geographies, that your geographic mix is weaker, with the weakness across the emerging markets? Is that the driver or is it the fact that you have a lower load in your factories? That's the first question.

Frans van Houten - *Koninklijke Philips NV - CEO*

Okay, thanks, because I realize there is still uncertainty or unclarity about it. I responded to the previous question, is it price erosion or demand in emerging markets, and I said it's more demand in emerging markets than price. Overall for healthcare, the gross margin is coming down due to currencies. The currency effect on healthcare is significant and that's the biggest driver there and not so much, let's say, price erosion or orders.

We see, as we said in the earlier question, a mixed picture across geographies, some markets a strong order intake growth, other markets there are negative. This lumpiness and volatility I think will be with us for the year but strategically we feel that we are very well-positioned to grow the business. So it is a period that we need to see come through. Also because of Cleveland some customers are holding orders for the second half of the year before they want to place them.

When I look at the pipeline of big opportunities and big hospital deals actually I can be optimistic, so that's the message that I want to leave you with.

Frederic Stahl - *UBS - Analyst*

Very good, that's clear. Can I finish off with two housekeeping, or one housekeeping question just on your, the tax rate if obviously quite low in the quarter, if you can give us a steer on where you expect it to be for the full year? Then the same thing with interest cost, it was a bit below what I had expected, if this is a good level to assume for the coming quarters.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Yes, this is Ron. So last year there were more non-tax deductible expenses so that derives part of the compare. Also we had some uncertain tax provision release in some of the geographies which are things that typically come in sometimes lumpy and also driven by statute of limitations expiration. That basically explains the lower tax rate.

In financing costs, as you know over long term finance we do the reviews on what that's supposed to look like but as of now the net present value of alternatives is not compelling so the interest cost for the ongoing debt portfolio remains the same. There was some investments in associates results that we have counted, of course, in the financial line that helped offset cost a little bit.



On the tax outlook it remains around 30%, over 30% for the year.

Frederic Stahl - UBS - Analyst

Very good, thank you.

Ron Wirahadiraksa - Koninklijke Philips NV - CFO

Thanks.

Operator

Daniel Cunliffe, Nomura.

Daniel Cunliffe - Nomura - Analyst

Thank you. Just in terms of lighting first of all. I've seen the over 10% decline in conventional lighting. Now I guess should that continue the zero growth that you reported this quarter may well continue through the balance of 2014. That obviously makes the 2014/2016 growth targets a little bit more challenging without stronger recovery elsewhere. So I guess if you could just speak to that in terms of where would you expect a recovery or is it that the conventional decline that was, my calculation was well over 10% this quarter, is expected to be less aggressive on the downside. That's my first question, thanks.

Frans van Houten - Koninklijke Philips NV - CEO

We do expect the conventional lighting to continue to decline but perhaps not in the same strength, or let's say the same level of decline as in the first quarter which was a little bit higher also driven by the China market demand and thereby aggregating it. We are confident about the ability to offset conventional business by LED business; we see a very good reception of the innovations that we have brought out. I think we have a stronger than ever product portfolio for all major segments of outdoor office, city beautification and home lighting. So that will carry eventually the future and we remain committed to our 2016 targets for lighting and for the other sectors of course.

Daniel Cunliffe - Nomura - Analyst

So you don't see the well over 10% decline that we saw this quarter continuing. Is that driven by, I don't know, an improving China? You said that that was a big negative this quarter. I'm trying to understand what could be the kicker to improve conventional pressure here?

Frans van Houten - Koninklijke Philips NV - CEO

So I said that 10% is a bit steep and we do not expect that on average in all the quarters and I said that other businesses will compensate for the decline of conventional lamps business.

Daniel Cunliffe - Nomura - Analyst

Okay, maybe just one quick follow-up, you said EUR250m of gross savings, I think I noted EUR22m in Q1, that's a step up at around just over EUR75m per quarter for the remaining nine months. Why the step up there? Is that just down to timing or is there anything that we should be aware of?



Frans van Houten - *Koninklijke Philips NV - CEO*

No, so as we always say, we'll do our best to try to reduce overhead costs as fast as possible, last year we came in at EUR1.066b, that was EUR66m ahead. We had originally planned for EUR250m and we make it a habit that if we do better we still look how to stay with the original target and possible do more. So that's how you should see this.

Daniel Cunliffe - *Nomura - Analyst*

Okay, thank you very much.

Frans van Houten - *Koninklijke Philips NV - CEO*

Yes.

Operator

Philip Wilson, Redburn.

Philip Wilson - *Redburn - Analyst*

Yes, morning, everyone. I just want to go back on the non-LED actually and that 10% decline. You talked about China, can you say what the other regional drivers were in that non-LED business? And can you also talk about what the product drivers were, so splitting between CFL, halogen, incandescent, HID, which of those is deteriorating faster?

I do want to go back to the outlook for that non-LED for 2014. In the past you've talked about a single-digit decline for the full year, are you now saying perhaps it's going to be a bit worse, in the mid-single-digit? That's the first question.

Then my follow-up question would just be on the gross margins versus sales expenses. Your gross margins are actually up in the quarter but sales expenses were up 120 basis points year on year and that looks to me like a record level. What was the driver of the increase in sales expenses; was there some exception in there? And what should we see as a sustainable level of sales expenses as a percentage of sales over the next year or so?

Frans van Houten - *Koninklijke Philips NV - CEO*

Great questions in a lot of detail, I'm not sure that we can give full satisfaction on all your detailed questions. I'd love to of course. Drivers for conventional decline, it is mainly at this moment in emerging markets that we see headwinds. That also correlates to my earlier comment that the 10% seems a bit steep in the first quarter and for the future quarters we think it can be a little bit less. The golden tail of conventional lamps will be with us for many years to come, it is under pressure but it doesn't go away.

With regard to SellEx we, of course, need to see here also a mix effect, so let me hasten to say that SellEx should come down but it should come down more for lamps and less for professional systems and services and luminaires. In professional lighting systems and solutions we actually operate a direct go-to-market model for part of the sales and as we take on more complex projects in fact the SellEx part is relatively higher.

So as we change the mix of our lighting division you see opposing poses, lower SellEx for lamps and relatively higher SellEx for professional lighting solutions and consultancy and services as we engage with these multiyear deals with municipality and large automated systems integrated projects. Therefore, a sustainable level needs to be seen as an average between the two drivers, it will come down overall and we have not specifically guided for the percentage.



Philip Wilson - Redburn - Analyst

And also, sorry, that specifically related to the Group rather than lighting. So are you saying that sales expenses for the Group will also come down from the level we saw in this quarter?

Frans van Houten - Koninklijke Philips NV - CEO

I misunderstood, sorry, I thought you were talking about lighting.

Ron Wirahadiraksa - Koninklijke Philips NV - CFO

So let me talk about the SellEx in the Group, so on page 21 of the press release actually if you look at the difference there it's about 70 basis points, so maybe you can explain the 120 but if I look at the 70 then we have some efficiency from Accelerate, we have lower leverage in the healthcare sales, in CL we have some more A&P and there was a little currency in there, that explains the difference in there.

Philip Wilson - Redburn - Analyst

Thank you.

Operator

Hans Slob, Rabobank.

Hans Slob - Rabo Securities - Analyst

Yes, good morning, gentlemen, a question on the Ohio Cleveland factory. When do you expect that you can restart the production and when you do expect that the plant will be running at full capacity? Will you be able to deliver in the make-or-break Q4?

Frans van Houten - Koninklijke Philips NV - CEO

Okay, thank you, Hans. The Ohio Cleveland factory will resume production in a gradual manner, expectedly late Q2, early Q3, and then gradually ramp up towards to the fourth quarter to capacity. I'd like to point out that besides Cleveland we also have other facilities in the world, of course, that serve the imaging systems business.

Hans Slob - Rabo Securities - Analyst

So for the fourth quarter you expect to be able to run at a normal capacity in Cleveland again.

Frans van Houten - Koninklijke Philips NV - CEO

Yes, we expect for imaging systems that we will see a strong finish of the year although it is backend loaded obviously.

Hans Slob - Rabo Securities - Analyst

Okay, many thanks.



Frans van Houten - *Koninklijke Philips NV - CEO*

You're welcome.

Operator

Timm Schulze-Melander, JPMorgan.

Timm Schulze-Melander - *JPMorgan - Analyst*

Good morning, gentlemen, thank you very much for taking my question. I just had one really and that's just wrapping up on this healthcare. The EUR60m to EUR70m seems a pretty benign impact to me given the duration of the fix, the modality that's being impacted, the gradual sort of ramp of production and the fact that this is now, looks to be broadening, the initiative seems to be broadening in scope. So the question is, could you give the market some generic detail of what the issue is and what the fix is that would help to explain that?

And then how should the market, or how should we, assess the risk that the impact may be more than this EUR60m or EUR70m which seems to be predominantly forgone earnings. Thank you.

Frans van Houten - *Koninklijke Philips NV - CEO*

Thanks. The EUR60m to EUR70m impact is the direct correlated margin impact from Cleveland, effects on related business we don't count under this header. The amount has stayed the same so we have not really changed it. We have only said that the offsetting measures cannot be attributed to Cleveland but rather are needed for general market and currency pressures.

We are working very hard to keep the impact in this range. You used the word benign, I've not looked at it in that way, I find it pretty terrible actually, so we're working hard to fix it. I think currently we are on schedule to so do but of course in the second quarter still a lot of work has to be done.

Timm Schulze-Melander - *JPMorgan - Analyst*

Thank you.

Operator

William Mackie, Berenberg Bank.

William Mackie - *Berenberg Bank - Analyst*

Yes, thank you for the question and good morning, gentlemen. If I could come back to healthcare please first in relation particularly to imaging equipment. If I take your comments on PCCI and home healthcare and service it suggests on the revenue level that the underlying decline for imaging was around 14% or so. Now Cleveland, maybe you could throw some light on it, but I think in the quantum of what we've discussed is probably 4% or 5% suggesting there's about a 10% decline in the underlying imaging business. Could you throw a little bit more color on the regions of the world where you're seeing that and is that something that is temporary? I know we've talked about a stronger pickup in the end of the year linked to Cleveland, perhaps there are other factors as well that can help us recover the underlying decline. So that's the first question on healthcare.



The second on lighting, going to professional luminaires North America. Listening earlier you talk of a recovery in the third quarter, could you quantify what you mean? Is the North American luminaires business profitable yet? Are we talking about a recovery being a return to profit and growth? Or just at least to provide some more understanding of how you see a recovery from Q3.

And the last thing is a housekeeping, looking at the IG&S business, it seems underlying royalty IP was somewhat higher, offset by your provisioning against environmental charges. Is there any adjustment to the full year guidance that you've previously given on the IG&S expense? Thank you.

Frans van Houten - Koninklijke Philips NV - CEO

Right, great questions, so let me start by imaging systems. Your assessment of the decline is on the high side, so actually the imaging systems order intake growth was more, a little bit more, so a mid-single-digit decline and that includes Cleveland. Nevertheless, imaging systems is affected by negative market pressures, in North America, we talked about it already, we see hospitals giving preference to IT projects over buying big iron.

We have seen some timing issues in China where the first quarter, maybe even the first half year are relatively weak, Ron mentioned that on a comparable basis last year we had a very strong second quarter and that may not replicate itself this second quarter.

In Europe we actually have seen some positives in some countries. I've mentioned the Southern European countries where, due to some pent-up demand and the economy improving, we have seen some customers coming back to us. But it is a very mixed picture, with some countries a strong double-digit growth and some other countries in double-digit negative.

Maybe also interesting to point out is the Middle East and Turkey region and Africa region that for us also showed strong double-digit growth in imaging systems, and India did well as well.

So overall globally a mixed picture, some macro trends in the near term that have negative downward pressure, and then we have all these great new products coming out in the second half of the year where we expect stronger traction as well. So we are not structurally negative at all about imaging systems it is just that 2014 is a tough year but we remain optimistic about healthcare and imaging systems in particular.

Now then with regard to PLS North America, we have always said that for PLS our goal is to be in double-digit EBITA and that goal applies to professional lighting solutions everywhere in the world, also in North America. It will take us time to fix that. The Genlyte acquisition was integrated too late, now we have new management on board, we started last year with a complete overhaul of brand consolidation, manufacturing site reduction, R&D upgrades, the go-to-market channel is being changed. It is taking us much longer than we originally anticipated but it doesn't change our perspective on the profitability opportunity that we have in this business.

When we win big projects like the Washington parking garage lighting with a recurring revenue model, these are just examples of what we can and should do. Coming back to profitability will take us some time, we expect a much stronger second half of the year and then in 2015 we need to further repair the profitability to what we called these entitlement levels that I referred to earlier.

Ron Wirahadiraksa - Koninklijke Philips NV - CFO

On your point on IG&S, we remain the same guidance that we had, EUR380m for the full year, there is no change.

William Mackie - Berenberg Bank - Analyst

Great, thank you very much.



Operator

Andrew Carter, RBC.

Andrew Carter - RBC - Analyst

Good morning, it's Andrew from RBC. I wondered if it was possible to sort of take a step back a little bit. If you go back, it was only two months ago that you gave the guidance for 2014 and if I think back over the last couple of years your guidance has tended to be somewhat conservative. So I wondered actually, what's actually changed in the last couple of months that has made you look at things a little bit more differently?

And the second question was just in terms of whether you'd consider putting together a EBITA bridge that investors and the market could look at? It just strikes me that quite a lot of the other companies do this, there are many, many moving parts in terms of Philips at the moment, in terms of cost savings and currencies and it might just make things a little bit easier for us to understand what's going on.

Frans van Houten - Koninklijke Philips NV - CEO

Thanks, Andrew. We spoke first to all of you in January and we signaled that we expected not an easy year ahead. Over the last three months of the first quarter we have seen that currency impacts are more severe than originally anticipated and that market weakness has increased, for example the situation in Russia. So this had led us to become more prudent on the overall outlook for 2014 and changing it to the description of it's a challenging year where we continue to expect year-on-year improvements in lighting and lifestyle, but we cannot say that for healthcare given the things that we need to do there.

On the EBITA bridge I'll refer to Ron.

Ron Wirahadiraksa - Koninklijke Philips NV - CFO

Yes, so you said give us an EBITA bridge so that we know what's going on. I think we've tried to help, maybe not literally presented in a bridge but the EUR110m that we -- you can incur from the 1.8% is a good lead in.

We also did say that we have been able to offset part of that with a gross margin improvement if you don't look at ForEx mainly because of procurement savings, some volume, a little bit of mix, but mostly procurement savings. And there is some miscellaneous but that's not a very big part.

So I would say that ForEx has hit us particularly hard, of course we're pleased with the top line growth, that means less operating leverage, it also means with the currency combined that in the sectors where we had growth, like lifestyle, that operating leverage was eaten up by ForEx. But the gross margin has actually expanded by 30 basis points and if you look at the comparable with last year and that 30 basis points clearly reflects the offset that we have been able to make at the gross margin part, although the amount is lower because we have made the improvements faster than the sales declined, so then you get somewhat of a good effect in the gross margin.

So rest also assured that, and we've also given that to you, the overhead cost reduction remains on track, we've just said that we will strive for EUR250m and thereby taking the original target back, so that's an additional EUR66m in the overhead expenses.

As you know, we don't guide in a quantitative way for the year. We have our mid-term 2016 targets on which we remain undeterred and very confident we'll be able to reach them, and Frans has given you in the beginning of the call a lot of leads on how and why that is going to happen, particularly in terms of the growth opportunities in lighting and in healthcare that there are.

When we were earlier asked on professional luminaires, professional lighting solutions North America, is it profitable? No, it's not and we intend to make that better in the second half so there'll still be a drag for the full year.



So I hope with this we've given you good leads on what actually is going on, we try to be as transparent as we can on the quarter.

Andrew Carter - RBC - Analyst

Thank you.

Operator

Ben Uglow, Morgan Stanley.

Ben Uglow - Morgan Stanley - Analyst

Oh, thanks for letting me on, I just had a very simple question. The Cleveland facility, roughly how big is that as a percentage of your production in imaging systems? Obviously we know Suzhou is very good but I wanted to get a feeling for how much of your overall production comes from Cleveland?

And then a second question is just on the mix effects in the emerging markets. Was there any significant adverse mix impact in the first quarter in China healthcare? I.e. the fact, I'm presuming obviously that China healthcare revenues were down as well as orders, did that have any significant effect on your Group margin or your divisional margin for healthcare.

Frans van Houten - Koninklijke Philips NV - CEO

Hi, Ben.

Ben Uglow - Morgan Stanley - Analyst

Hi there.

Frans van Houten - Koninklijke Philips NV - CEO

Cleveland is a significant factory for healthcare, we don't detail out the production value but if it gives you any indication we have thousands of employees in Cleveland so it is a big facility. Moreover, it produces critical products like CT, PET/CT and some of the new innovations that we announced at the RSNA out of there.

Ben Uglow - Morgan Stanley - Analyst

That's right. Is it the only one in the States producing Spectral CT and all that type of stuff?

Frans van Houten - Koninklijke Philips NV - CEO

We do have other production facilities that can also produce CT such as Haifa and Suzhou but we are keen to make sure that a quality system is in good order and some of these new orders first come out in Cleveland.

There are some customers that place multi-modality deals also hold back because they would like to see Cleveland come back up before they continue, so there is some peripheral impact beyond the direct impact from Cleveland. Nevertheless, we feel that we're on track in remediating

the root causes, I remind you it's a voluntary suspension of manufacturing. It is not a mandated one. The whole team is putting all their energy behind it and we are on track.

With regard to your second question, no, we don't really see a significant adverse mix in China. I've spoken about timing issues and an overall somewhat more subdued market due to the general economy there but, of course, strategically China remains important. The government has said healthcare remains a strategic imperative for them and therefore I think it's a matter of timing and the second half year undoubtedly will be better than the first half year.

Ben Uglow - *Morgan Stanley - Analyst*

That's great. Thank you very much.

Frans van Houten - *Koninklijke Philips NV - CEO*

Thank you very much. Well, that concludes this call, lots of detail on the EBITA bridge and near term headwinds, sorry about that but I want to leave you with an important message. We are on a journey of transforming Philips, we are a different Philips than before, we manage the business much more granular than before and we are about halfway on our marathon now. So we have some hiccups on the road that we need to deal with. We are dealing with it in the same granular and persistent way that you know us for. 2014 will therefore be challenging.

However it doesn't change at all what we outlined for you at the Capital Markets Day in September. We see 300 basis points to 400 basis points of improvement down the pipe and we believe that strategically we are very well positioned given our businesses addressing the megatrends in the world on healthcare, energy efficient lighting and consumer wellbeing.

So if you please keep that in mind because we feel very excited about it and this quarter and the next quarter will not let us down on our determination to deliver that unlocked potential that Philips has.

And with that, thank you very much for your attention and we hope to meet you soon.

Operator

This concludes the Royal Philips first quarter results 2014 conference call on Tuesday April 22, 2014. Thank you for participating. You may now disconnect.

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