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EDITED TRANSCRIPT

PHIA.AS - Q1 2016 Koninklijke Philips NV Earnings Call

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OVERVIEW:

Co. reported 1Q16 YoverY comparable sales growth of 3%.



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PRESENTATION

Operator

Welcome to the Royal Philips first-quarter 2016 results conference call on Monday, April 25, 2016. During the introduction hosted by Mr. Frans van Houten, CEO, and Mr. Abhijit Bhattacharya, CFO, all participants will be on 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 Mr. Robin Jansen, Head of Investor Relations. Please go ahead, sir.

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

Thank you. Good morning, ladies and gentlemen. Welcome to Philips' first-quarter fiscal year 2016 results conference call. I'm here with Frans van Houten, CEO, and Abhijit Bhattacharya, CFO.

In a moment, Frans will take you through our strategic and financial highlights for the period. Abhijit will then provide more details on financial performance. After that, we will be happy to take your questions.

Our press release and the related information slide pack were published at 7:00 AM CET this morning. Both documents are now available for download from our Investor Relations website. A full transcript of this conference call will be made available by tomorrow on our Investor Relations website.

Before I turnover the call to Frans, I would like to remind you of the follow three things.

First, starting this quarter, we published our quarterly financial results under the new segment reporting structure reflecting our strategic approach in the health technology market. The new reporting structure will enhance transparency and has no impact on total Philips' financials. You can access prior period's financials under this new segment reporting structure on our IR website in the financial reporting update section.

Second, following the decision in 2014 to combine our Lumileds and Automotive Lighting businesses into a standalone company and to explore strategic options to attract capital from third-party investors, the profit and loss of these combined businesses is reported 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 combined Lumileds and Automotive businesses is reported under cash flow from discontinued operations. Therefore, all commentary that will follow in terms of sales and earnings at both the total level as well as the Lighting segment level continues to exclude the performance related to the Lumileds and Automotive Lighting businesses.

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

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

Frans van Houten - *Koninklijke Philips NV* - CEO

Thanks, Robin. In the first quarter, we booked a solid 3% comparable sales growth and a significant 14% improvement in adjusted EBITA, boosted by several successful new product launches across the portfolio that in fact drove higher volume and better product mix.

Overall performance improvement was also strongly supported by ongoing benefits from our Accelerate! program, despite challenging macroeconomic conditions in several markets. As Robin noted, we are now reporting based on six segments, four of which are part of our HealthTech portfolio, Personal Health, Diagnosis & Treatment, Connected Care & Health Informatics, and HealthTech Other. And then, of course, Lighting and Legacy Items. This reporting better reflects the future relevant portfolio logic of our Company.

This morning, I will focus my remarks on our main operating segments, Personal Health, Diagnosis & Treatment, Connected Care & Health Informatics, and of course, Lighting.

We had 5% comparable sales growth in HealthTech in Q1, and many areas of strength throughout the HealthTech portfolio.

Adjusted EBITA improved by 50 basis points, even as we continued to invest significantly in high-growth areas such as wearable patient monitoring solutions, digital pathology and health informatics, all of which are important growth areas for the future.

In Personal Health, comparable sales growth was 6% and the adjusted EBITA margin improved by 130 basis points. We drove double-digit growth in Health & Wellness, with continued double-digit growth in Oral Healthcare, which was fueled by the recent introduction of the Philips Sonicare Essence+ in Greater China, which provides consumers with the high-quality brushing experience at affordable price points.

Personal Care delivered high single-digit growth, and domestic appliances low-single-digit growth. Sleep & Respiratory Care achieved mid-single-digit growth, driven in particular by Philips' new Dream Family sleep therapy program which we launched in Europe and in the United States. This Dream Family helps to improve the sleep therapy experience for people with obstructive sleep apnea.

To date, more than 200,000 people are using the Dream Family in the United States since its introduction in the fourth quarter of 2015. We are now launching this in Japan.

In Diagnosis & Treatment, the adjusted EBITA improved by 80 basis points driven by 5% top-line growth and savings from our productivity initiatives. This was partially offset by ongoing and anticipated investments to improve our quality management systems, and by currency effects.



The production and shipment levels of the two major CT product lines in Cleveland are on track, and also the global CT production and shipment levels are by and large back on track, and the backlog has normalized.

Since last quarter, we have brought one more product line into production, and now we have one more product line that needs to be put back in production mode in Cleveland. All in all, there's still remediation work to be done in Cleveland, explaining the associated elevated remediation spend that we will incur well into the second half of the year.

As a result of all this, we expect -- we continue to expect that the improvements will contribute around EUR100 million to the adjusted EBITA in the second half of 2016, and EUR75 million in 2017.

Within the Diagnosis & Treatment segment, Image-Guided Therapy did particularly well in the first quarter with double-digit growth in orders and sales, as well as an improved adjusted EBITA margin supported, among others, by the growth in peripheral vascular diagnostics and therapy.

This is a clear demonstration of the synergetic value that Volcano brings. After its first full year as part of Philips, the projected revenue synergies are ahead of plan, and total cost savings amount to close to EUR40 million, which is substantially ahead of plan.

Comparable sales in the Connected Care & Health Informatics segment increased by 9% driven by double-digit growth in Patient Care & Monitoring Solutions, and in high single-digit growth in Health Informatics. This strong growth performance helped to improve the adjusted EBITA margin by more than 3 percentage points.

We continue to invest in organic growth opportunities as well as in partnerships that we expect will have great relevance for our existing and potential future customer base, and therefore driving future growth and profitability.

For example, we partnered with Hitachi Data Systems to introduce a next-generation Vendor-Neutral Archive System. The Philips Vendor-Neutral Archive is an open universal data management solution in which medical images, documents and potentially other clinically relevant data are archived in a standard format. It allows healthcare organizations to make many millions of images, often stored in legacy proprietary systems from multiple departments, rapidly available to virtually any clinician at any location within the hospital, no matter which information systems they use.

In less than three seconds, clinicians have a complete and integrated view of an individual patient's medical condition over time, which helps, of course, to improve patient outcomes.

The Philips data management solution is run on our HealthSuite Digital Platform, and open hybrid, on-premise and cloud-based platform that enables the next generation of connected health and clinical information technology innovations.

Now to demonstrate the strength of our pipeline of multi-year strategic partnerships, I'd like to call out another win that we forged in Q1.

We signed a 15-year, \$90 million agreement with Marin General Hospital for imaging systems based in monitoring and clinical informatics solutions. The collaboration includes technology, design and informatics to develop new patient-centric hospital bed tower and ambulatory facilities.

This partnership underscores Philips' ability to provide solutions for hospitals and health systems that are grappling with a fundamental market shift towards creating long-term patient value while also managing cost, complexity and risk.

Let's switch to Lighting now.

We reported our sixth consecutive quarter of year-on-year operational improvement on the basis of a significant 27% growth in LED sales, and improved cost productivity and product mix.

In Q1, for the first time, LED lighting accounted for 50% of overall Lighting sales. Largely as a result of our success in LED and its growing share of the overall Lighting business, we continue to expect Philips Lighting to return to positive comparable sales growth in the course of 2016.



Additionally, we would like to underline that our Home business delivered double-digit growth for the second consecutive quarter, and Professional in North America actually returned to positive growth in the quarter.

And the leading -- at the leading industry trade show called Light + Building, next to a full range of LED lamps and electronics, we showcased four of our most important connected LED lighting growth platforms for smart cities, smart retailing, smart offices, and smart homes. These growth platforms are our future. Today, I'd like to focus on one of these growth platforms, smart LED city street lighting solutions.

Of over 300 million street lights globally, actually less than 12% today are LED based, and less than 2% are connected. This offers a significant opportunity to increase the adoption of connected LED street lighting for smart cities.

For example, we recently launched a partnership with Vodafone to implement CityTouch smart street lighting systems, which will be connected wirelessly, saving energy and making maintenance so much easier and efficient.

We also introduced Philips DigiStreet, our new range of LED street lighting luminaires, which include a plug-and-play upgrade option to wirelessly connect the luminaire to the Philips CityTouch street lighting management system. With this upgrade, the street light can be monitored, controlled and managed remotely.

Typically, this provides an additional 30% energy saving on top of the 40% average saving achieved by switching to LED. Maintenance cost and time are also reduced, as real-time information on the status of each light point is relayed to the operator who can troubleshoot remotely, or schedule crews to a precise location.

Let me now provide you with an update on the separation process.

We continue to simultaneously prepare for either an IPO or a private sale of Philips Lighting. With equity market sentiment improving compared to the first couple of months of the year, an IPO increasingly appears a more likely outcome, subject of course to further market developments and other relevant circumstances.

However, we have not yet concluded on all the proposals in the private sale process, and continue to assess the attractiveness of this route compared to the IPO, both in terms of value and conditions, while taking into account the best interest of Philips and its stakeholders. As such, we expect to update the market on conclusions and next steps shortly.

I appreciate that you probably have a lot of burning questions on this topic; but I would like to state up front that we are not in a position to provide much more detail on the separation during the Q&A session beyond what I have just shared with you.

With regards to Lumileds, I can say that we are engaging with third parties that have expressed interest in Lumileds, and will provide more detail on this process when appropriate.

Our outlook for 2016 remains unchanged as we continue to expect modest comparable sales growth and to build on our operational performance improvements. We expect earnings improvements in the year to be back-end loaded, taking into account ongoing microeconomic headwinds and the phasing of costs and sales.

With that, let me now hand over the call to Abhijit to discuss our financial performance and market dynamics in more detail.

Abhijit Bhattacharya - Koninklijke Philips NV - CFO

Thank you, Frans, and good morning to all of you on the call and webcast.

In Q1 2016, we delivered 5% comparable sales growth in our HealthTech portfolio, 27% CSG in our LED lighting portfolio, and a decline in comparable sales of 20% in the conventional lighting portfolio, of which conventional lamps declined by 15%, which is in line with the industry trends.

Geographically, comparable sales growth of 3% in the first quarter was equally driven by mature and growth geographies.

HealthTech sales in growth geographies grew by 9%, and the mature geographies delivered 3% growth. Lighting sales in growth geographies declined by mid-single digit, while the mature geographies increased by 1%, all on a comparable basis.

Comparable sales growth for HealthTech in the mature markets was largely driven by mid-single-digit growth in North America and 3% comparable sales growth in Western Europe, which was partly offset by a slight decline in other mature geographies.

All segments showed positive comparable sales growth in the mature geographies, with the highest growth rates delivered by Connected Care & Health Informatics and Personal Health.

For Lighting, comparable sales growth in the mature geographies was led by mid-single-digit growth in North America, low-single-digit growth in other mature geographies, partly offset by mid-single-digit decline in Western Europe.

In the growth geographies, comparable sales for HealthTech was driven by high-single-digit growth in countries like China and India, and double-digit growth in countries like Poland, Russia, Mexico, Indonesia, Argentina and others.

Segment-wise, all segments delivered comparable sales growth in the high single to double-digit growth range in the growth geographies.

In Lighting, the mid-single-digit decline in comparable sales in growth geographies was mainly due to double-digit declines in Saudi Arabia and Brazil, and low-single-digit decline in China.

Let's have a look at order intake now.

On a currency comparable basis, order intake declined by 3% after a quarter with double-digit growth, which largely reflects the unevenness of order intake dynamics. Comparable orders declined by low-single-digit in Connected Care & Health Informatics, and by mid-single-digits in Diagnosis & Treatment.

Geographically, we reported a low-single-digit decline in comparable orders in our growth geographies, mainly as a result of China, after a very strong order intake in Q4.

In North America and other mature geographies, order intake was by and large in line with Q1 2015, while Western Europe posted a high single-digit decline on the back of, among others, strong comparables with Q1 of last year, strong order intake in Q4 of last year, as well as challenging market conditions in the NHS in the UK feeding through into significantly lower Healthcare CapEx.

In Lighting, the LED portfolio delivered another strong quarter with 27% comparable sales growth and a significant year-on-year improvement of the adjusted EBITA margin, most notably in LED lamps. Our LED-based portfolio now represents 50% of the Lighting portfolio, compared to 39% in Q1 2015.

Notwithstanding the ongoing decline in conventional lighting, we further improved the high teens adjusted EBITA margin in conventional lamps delivered in Q1 2015, which is a clear demonstration of the success of Accelerate!, and most notably, our proactive and highly successful management of our conventional manufacturing footprint.

We were also particularly pleased with the second quarter of double-digit growth in Home, and a return to positive comparable sales growth in PLS North America.

Let me now switch to EBITA development in the quarter.

Slide 33 of the presentation material that we posted on our website this morning provides an overview of the main drivers of adjusted EBITA when compared to the same period last year.

As you can see on the slide, the adjusted EBITA margin of 6.8% this quarter was 70 basis points higher than Q1 of last year, despite a stronger than anticipated negative currency translation effect of 70 basis points. This margin increase was driven by a margin improvement of 130 basis points in Personal Health, 310 basis points in Connected Care & Health Informatics, 80 basis points in Diagnosis & Treatment, and 60 basis points in Lighting.

Our underlying operational performance, therefore, contributed 130 basis points to the EBITA margin in the first quarter as our Accelerate! program continues to improve operational performance and drive efficiencies.

More specifically, in the fifth bar, you see a net contribution of EUR23 million from our overhead and End2End productivity programs, as year-on-year incremental cost savings of EUR91 million were partly offset by higher non-manufacturing cost as a result of investments in emerging business areas, higher selling expenses, and negative currency effects in the quarter.

Design for Excellence, or DfX, which is aimed at reducing cost of goods sold, delivered EUR67 million of additional bill of material savings year on year, and are on top of the normal run rate savings of EUR68 million. These cost savings more than offset the 110 basis points of wage inflation and negative price effect of 210 basis points in the quarter.

Operational improvement of 130 basis points was partly offset by a 70 basis point negative impact from adverse currency swings in a number of emerging market currencies, most notably in Latin America. The translation impact of the devaluations in just Argentina and Egypt alone impacted the adjusted EBITA margin of HealthTech by 40 basis points and Lighting by 80 basis points.

In the first quarter, the income tax expense was EUR44 million higher than the same period last year due to tax charges resulting from activities related to the separation of the Lighting business. For 2016, we continue to expect the effective tax rate to be in the low 30s.

Net financial expenses were up EUR47 million in the quarter, which was largely driven by a fair value adjustment of our stake in Corindus Vascular Robotics. Due to these two extraordinary charges, the net income in the first quarter was EUR63 million lower than in the first quarter of 2015.

The return on invested capital, which is calculated on a five-quarter MAT basis, was 6.9%. Excluding the total one-off charges of EUR345 million related to the pension liability de-risking in the US and UK in Q4 2015, the ROIC was 9.9%, which is about 1 percentage point above our WACC.

Inventories as a percentage of sales declined 260 basis points to 14.7% year on year. Excluding the negative currency translation effects, inventory as a percentage of sales were down 50 basis points year on year, driven by all operational segments.

Free cash flow for the quarter amounted to an inflow of EUR43 million. Excluding an outflow of EUR172 million as part of our pension liability de-risking initiatives in the US that we announced in Q4 2014 and partly had to fund in Q1, and separation costs of EUR48 million.

By the end of the fourth quarter, we completed 82% of our three-year EUR1.5 billion share buyback program which we started in October 2013.

Looking ahead, we remain in general concerned about ongoing macroeconomic headwinds and geopolitical uncertainty in a number of regions around the world; and in particular, Latin America, parts of Middle East, China and Russia.

In the US, we expect the healthcare market to show a flat to low-single-digit growth in 2016 following a strong year in 2015. For 2016, we expect a relatively strong economy and growth in procedure volume to be partly offset by continued reimbursement reductions. Capital spending for hospitals is expected to be flat in 2016.

The European healthcare market, coming off a slight growth in 2015, is expected to see flat to low-single-digit growth in 2016. We continue to see an uptick across Europe in multi-year solution-oriented deals, although cuts to public spending budgets have offset this growth driver.

In China, headwinds related to government anti-corruption measures, centralized tendering and price erosion, continued the overall slowdown across the healthcare market in 2015. We expect the Chinese healthcare market to stabilize in 2016 and grow modestly.

Overall, and similar to 2015, we estimate the global healthcare market to be in the low-single-digit range for 2016.

In Lighting, the global market is expected to grow in the low to mid- single-digit range. The outlook for the overall US lighting market remains positive. The US construction market is forecast to grow by 9% in 2016, of which non-residential construction is forecast to grow by 5% in 2016.

The Western European construction market is expected to see a continued recovery as year-on-year growth is forecast to increase by close to 3%, driven by a slight pickup in non-residential and residential construction spending. Nevertheless, overall sentiments and market expectations in Europe remain quite uncertain and vulnerable, so we remain cautious.

The Chinese residential construction market remains weak, but short signs of improvement in the first quarter of 2016. While during 2015 floor space of construction started for residential buildings declined by 15%, it showed a growth of 10% in the first two months of this year.

Let me briefly summarize our financial performance in the first quarter before opening the line for questions.

Our HealthTech portfolio delivered 5% comparable sales growth; and the LED-based portfolio in Lighting, which now constitutes 50% of total Lighting sales, grew comparable sales by 27%.; and our improvement programs continued to drive operational performance across the segments in Q1.

The separation of the Lighting business remains well on track as we continue to simultaneously prepare for either an IPO or a private sale. Now that we have substantially progressed with the separation process, we expect separation costs for the full year of 2016 to be in the range of EUR200 million to EUR225 million. These costs represent the vast majority of what we expect to report in legacy items for the full year.

For HealthTech Other, we expect royalty income to decrease by approximately EUR60 million in the first half of 2016, of which about one-half occurred in Q1 and the other half is expected to occur in Q2 due to the expiration of patents.

In addition, we expect to incur approximately EUR50 million of restructuring cost and other incidental items in HealthTech Other in 2016, which will be slightly offset by cost savings.

As a result, we continue to expect a net cost of EUR80 million to EUR100 million at EBITA level in 2016. This expectation is in line with the 2016 guidance we gave for the former IG&S during the Q4 earnings call.

I would also like to remind you that in Q1, the profitability of our Sleep & Respiratory Care business within Personal Health was negatively impacted by about 100 basis points, as anticipated, due to the change in the US reimbursement for home ventilation which we were able to partly offset by a strong performance of the recently introduced Dream Family sleep therapy program. We expect this negative headwind from the change in reimbursement to have a similar impact in Q2.

For the full year 2016, our outlook remains unchanged, as we continue to expect earnings improvement to be back-ended loaded, taking into account ongoing macroeconomic headwinds and the phasing of costs and sales.

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). Max Yates, Credit Suisse.

Max Yates - Credit Suisse - Analyst

My first question would just be around the IPO and the potential timeframe. Could you just give us a bit of guidance on if we were to progress via that route what the timeframe would be; when we should expect the IPO to be launched?

Frans van Houten - Koninklijke Philips NV - CEO

Good morning, Max. This is Frans. What we flagged in the release this morning is that we plan to take a decision shortly, meaning that at this time, we are still evaluating both tracks with the various bids on the study and the IPO preparation in full swing. As we then take a decision shortly, then thereafter, things could go fairly fast.

Max Yates - Credit Suisse - Analyst

Okay. Thank you. And just one follow-up would be, obviously, in the press around the bidding, GO Scale Capital have been rumored to be involved in the bidding process again. Given you now have a fairly detailed understanding of the CFIUS process, is there any work you can do initially to try and understand their position on any bid from GO Scale for that business? And have you actually been in contact with CFIUS so far?

Frans van Houten - Koninklijke Philips NV - CEO

Yes. I had my share of the CFIUS process last year. I can say that. I've been to Washington. But in my understanding, it's a process that you can only do after you actually register a request with a specific transaction and, therefore, it's very difficult to have an anticipatory assessment done. And, yes, it's not easy to assess these kinds of things.

And maybe if I expand then on the question. Obviously, we will take various factors into account when deciding; value being one, deal certainty being one. And, of course, also expect what it means to the various stakeholders and do we provide a good home for Lighting. So, therefore, it's not a purely binary valuation, and we are in the middle of that process as we speak and hope to conclude that shortly.

Max Yates - Credit Suisse - Analyst

Sure. Just one final one would be on the Personal Health margin this quarter. If I try and back out what the old Consumer business did in the quarter, it looks like it did around a 14% margin. And obviously, when I look at seasonality of this business, the second half is normally stronger in the Consumer business than the first half.

Is there anything --? Am I firstly right with that Consumer margin? And is there anything particularly in the first quarter that means that's unusually strong and we shouldn't see margin progression in that business through the rest of the year?

Abhijit Bhattacharya - Koninklijke Philips NV - CFO

This is Abhijit. No. I think you are right. The margin progression through the year is, of course, second-half loaded because we have stronger growth in the second half. The first quarter was partially impacted, as we said, with the Sleep & Respiratory business because it had a dip compared to last year with the reimbursement cuts.

If you remember, the reimbursement cuts started in Q3. So Q2 would be the last quarter where we will suffer, let's say, on a comparable basis, but then in the second half, margins should pick up. So I think that that's how you should look at it.

Max Yates - *Credit Suisse - Analyst*

Okay. But is the assumption that the Consumer business did a 14% margin in Q1? Is that correct?

Abhijit Bhattacharya - *Koninklijke Philips NV - CFO*

No. I think -- we are now reporting as Personal Health the whole portfolio, and then I wouldn't like to go back to former reporting and what it meant because we have given all the comparables a few weeks back at the end of March.

So I think you have good trends to compare with. Otherwise, we are forever caught up in this discussion of what it was as per the old structure and new structure, and as we try to simplify things in Philips, I think this goes against that drive.

Max Yates - *Credit Suisse - Analyst*

Sure. I understand. Thank you very much.

Operator

Ben Uglow, Morgan Stanley.

Ben Uglow - *Morgan Stanley - Analyst*

So my first question is I'd like to know how to think about the margin in Diagnosis & Treatment just conceptually. When I look at the margin for the first quarter, and obviously I understand that it's a low quarter and that we still may have some remediation impact, 2% feels quite low. And what I'm trying to figure out is what over time -- I'm not necessarily saying in the next six months, but what --? Over time, where should that division sit in terms of its profitability?

And if I think about the old Healthcare targets, which admittedly we're now going back to 2015, divisionally we were considering 16% to 17% reported EBITA, should Diagnosis & Treatment be in line with the old divisional targets, above or below? And is there anything in particular in the businesses, for example, a big difference between Ultrasound and the Advanced Imaging, what would make that division be above or below the old margin targets? So that was question number 1.

Question number 2 very briefly. Patient Monitoring had a very strong quarter; was growing at 9%. Is that a catch-up effect? Is there a base effect? Or could you just explain the sales growth there, please?

Frans van Houten - *Koninklijke Philips NV - CEO*

All right. Ben, let me start, and then Abhijit will help me to provide more color where necessary.

You refer to the guidance on Healthcare. In fact, we gave directional guidance on all of HealthTech by saying it should be in the mid to high-teens EBITA in the longer term; and, obviously, we stick to that overall goal.



The old Healthcare guidance, of course, also excluded the IG&S charges -- I'm referring to Ben's reference to old Healthcare target that excluded it -- whereas my mid to high-teens includes that IG&S charge. So that is where we need to go.

And then, the three segments, in fact all, should be able to achieve that target, and at this time, I don't see the need to indicate which one will be above and below the average.

The Diagnosis & Treatment portfolio has a strong set of product categories where Ultrasound and Image-Guided Therapy would be above average within that portfolio and the old Imaging modality is slightly below that average. But D&T overall should be in line with the stated objective for HealthTech.

We start the year -- of course, it's a seasonal business so the first quarter would be low. We still have elevated cost levels related to the quality & regulatory efforts that we have throughout this segment, and gradually we will improve this business.

Abhijit, do you want to add anything to this?

Abhijit Bhattacharya - Koninklijke Philips NV - CFO

No. I think that's a fair -- other than the -- the only thing, Ben, you will see that the seasonality, particularly in Q4, is extreme for this business. So it's a bit, let's say, abnormal compared to even normally seasonal businesses, and therefore you see Q1 coming in, let's say, pretty low.

Ben Uglow - Morgan Stanley - Analyst

Okay. So just on that point, Abhijit, the reminder that we get, the EUR100 million improvement from Cleveland in the second half of 2016, what we're effectively saying is by the second half of 2016, all of those effects should be out of the way and we should be thinking about the margins in line or at least on track for what the HealthTech guidance has been.

Abhijit Bhattacharya - Koninklijke Philips NV - CFO

Yes. So what we have said is that the second half of the year will see most of the benefit of the EUR100 million of the Cleveland year on year, so that should also push up margins in the second half. That will give you a stronger year-on-year improvement than you will see in the first half of the year.

Although Q1 improvement was still good and we got hit by both currency by quite a heavy extent in Diagnosis & Treatment alone by about 70 basis points, but I think for the second half would be that improvements, as well as the lower quality cost and then a few things that we are doing with our manufacturing footprint, in the medium term we should be able to get the margins up.

Ben Uglow - Morgan Stanley - Analyst

Okay. Thank you.

Abhijit Bhattacharya - Koninklijke Philips NV - CFO

Coming to your question on Patient Monitoring, I think the answer is something in between. So we had, of course, good pickup in Patient Monitoring. Part of that was catch up, or weaker comparables. If you see Q1 last year, we had a decline. So, therefore, I think the 10% growth is not something that you would look to extrapolate for the rest of the year, but we are pretty happy with how we've managed to catch up in this business in this quarter.



Ben Uglow - *Morgan Stanley - Analyst*

That's helpful. Thank you.

Operator

David Vos, Barclays.

David Vos - *Barclays - Analyst*

I also had a more general question on the Connected Care & Healthcare Informatics business. It's very similar to Ben's question really. Margin improvement has been pretty good there, from 0.8% to almost 4%. but it's still also a little bit lower than what you reported in Q1 2014. So I was just wondering if you could help us understand where your ambitions lie there.

And maybe as a second leg to that question, if you could frame your ambitions in the context of what we see your competitors in the healthcare informatics space do. And I'm thinking for example about Cerner where you see EBITA margins north of 30%, which is quite a long way north of where Philips is at the moment. That would be very helpful.

Thank you very much.

Frans van Houten - *Koninklijke Philips NV - CEO*

Well, David, the ambition for Connected Care & Health Informatics is the same order of magnitude as I've explained for HealthTech, so the mid to high teens. And I don't make a distinction between the three reporting segments.

Now what you need to realize is that in Connected Care & Health Informatics there are sizeable investments, step-ups in R&D versus the first quarter in 2015; for example, investments in extending patient monitoring towards wearables as well as investments in health informatics, among which our HealthSuite Digital Platform and the extension and build-out of our consulting activities around healthcare transformatory services.

So overall, it is a segment that is heavily weighed down by those investments, which of course will pay off over time; and then we --. And by the way, the high growth that you see in that segment, of course, also reflects the fact that we are making investments.

Then your point on peers, let's say in the medium term we look to this mid to high teens EBITA. That doesn't mean that there are not businesses that would be above average, and certainly, I can have a -- we can look at Cerner and other companies' profitability margin, but at this time, we will strive to get to the mid to high teens.

David Vos - *Barclays - Analyst*

Okay. Thank you for very much. That's it for me.

Operator

Peter Olofsen, Kepler Cheuvreux.



Peter Olofsen - *Kepler Cheuvreux - Analyst*

First two questions on Lighting, please. So on the overhead and support functions within Lighting, now we have some of the former IG&S costs having been allocated there, do you think the cost structure is appropriate for the size of this business? Or do you see room for meaningful reduction in overhead and support costs in coming years?

And then on the Lamps side, conventional lamps, could you remind us what you expect to spend annually on the footprint adjustments in conventional lamps?

And then my final question relates to working capital. I think both Connected Care & Health Informatics, as well as Lighting, showed pretty nice improvements. You think these improvements are sustainable?

Frans van Houten - *Koninklijke Philips NV - CEO*

Okay. Thank you, Peter. We have done the separation and it gives us the insight that we can further simplify over time. The overhead support functions can be expected to have further productivity enhancements over the next one to two years. In any case, as part of the plan for improving the Lighting profitability, we expect to be able to make significant productivity enhancements in the business as we strive for steady profit enhancement year on year.

The Lamps footprint reduction will be answered by Abhijit.

Abhijit Bhattacharya - *Koninklijke Philips NV - CFO*

Yes. I think we have said so far that conventional footprint was about 1.5% to 2% of sales. So you could say for this year roughly between EUR90 million to EUR100 million would be the range (for Manufacturing footprint reduction restructuring).

Regarding your question on the working capital, that clearly we believe is sustainable and we have some runway there to go as well. So clearly, we are working on that. You see now that for the second quarter, you see our inventory levels also coming down, and that is something we will continue to drive in the coming quarters.

Peter Olofsen - *Kepler Cheuvreux - Analyst*

Okay. Thank you.

Operator

Phil Wilson, Redburn.

Phil Wilson - *Redburn Partners - Analyst*

I'll do one at a time, if that's okay. Firstly, just looking at your guidance for the 11% adjusted EBITA margin which you appear to have stuck to, that looks quite a challenge given the first quarter. To what extent do you need a macro base, second-half growth recovery to achieve this versus your internal measures of savings and Cleveland coming back?

Frans van Houten - *Koninklijke Philips NV - CEO*

Yes. Hi, Phil, Frans here. Well, we have said it is going to be around the 11%. So, of course, that has a bandwidth around it. We believe that there is a lot of self-help improvement possible. We've already talked on Ben's question on Diagnostic & Treatment being quite back-end loaded. So we will continue to make improvements through the year, and indeed, we have still quite a journey to make.

Phil Wilson - *Redburn Partners - Analyst*

Okay. Thank you. On slide 46, you talk about how you expect the overall US healthcare market to grow, but it looks like you actually expect that diagnosis and treatment market, so the imaging market, to decline low single digit in 2016, which is different to what other peers I think are saying for the imaging market. Can you talk about what the drivers are behind a potential decline in the US imaging market in 2016?

Abhijit Bhattacharya - *Koninklijke Philips NV - CFO*

Yes. I think overall we've said that we expect procedures to grow, but with cuts in reimbursement it could be flat to slight growth in the market. You see that for Patient Care & Monitoring and Health Informatics we see a bit of growth, and that could be marginally offset with reimbursement cuts in the diagnosis and treatment area.

But it's a very minimal decline; you could say more flattish than anything. And that's based on the current projections we have.

Phil Wilson - *Redburn Partners - Analyst*

Okay. Thank you. And then finally, I see, as you said, Professional Lighting in North America returned to growth. Can you give some help on what the margin currently is for PLS North America and where you think that can settle?

Frans van Houten - *Koninklijke Philips NV - CEO*

No, Phil. We are not detailing out the margin in North America, but it is safe to assume that as we are back to growth, also our margins are improving.

Phil Wilson - *Redburn Partners - Analyst*

Is it profitable?

Frans van Houten - *Koninklijke Philips NV - CEO*

We are not detailing out the margin there.

Phil Wilson - *Redburn Partners - Analyst*

Okay. Thank you very much.

Operator

Andrew Carter, RBC.

Andrew Carter - *RBC Capital Markets - Analyst*

I wonder if you could just help us understand a little bit what's going on in terms of the quarterly order intake at HealthTech. So I was looking at page 44, and I apologize if I missed something in the prepared comments there.

But I was wondering. I guess in particular North America and Western Europe do seem to have been flat to down having been on a much improving trajectory over the last couple of quarters. Could you give us a bit of a feel as to what's going on there; whether any of it relates to comp effects? And also I guess in terms of how important the different quarters are as we go through the year in terms of building up the order backlog as you go into the following year.

Frans van Houten - *Koninklijke Philips NV - CEO*

Sure. First of all, there's always unevenness in the orders, especially as we go to the larger contracts. Right? Having said that, in North America, we grew orders mid-single digit. Do you want to --?

Abhijit Bhattacharya - *Koninklijke Philips NV - CFO*

Yes. In Q4 last year, we actually had very strong order intake in North America, very strong double-digit. And as Frans mentioned it is uneven. So for Q1, it was largely flat, but that's something we expected in line with what we call sometimes lumpy or uneven.

But if you look at the rolling 12-month order intake, you see that for North America we are in pretty good territory, because if you look at the 12-month rolling, you then don't get caught up in the quarter-by-quarter fluctuations; and, therefore, our recovery in North America is pretty good.

Similarly for Europe, as we called out in -- when I was giving you the details, we had a very strong Q1 last year, so the comparables are tough. But we had an even stronger Q4 which, of course, therefore meant that the backlog of orders coming in in the first quarter this year was a little bit lower.

Regarding this year, we are actually pretty happy with our order book and commitments that we have, which is why we have guided that the second half of the year would be stronger than the first half in terms of profitability as well because we see our order book coverage for the second half as pretty okay at this stage.

Andrew Carter - *RBC Capital Markets - Analyst*

Thank you. Can I just do a follow on just on Lumileds, please? I guess over the last several quarters, the performance there -- which obviously we can only see a little bit of -- but it does look as though the performance there has been somewhat disappointing. Has the --? Have you had to have a step-up in restructuring measures and footprint measures and stuff in Lumileds? And if that's the case, how long is that going to take to execute on?

Frans van Houten - *Koninklijke Philips NV - CEO*

Yes. That's good analytics, Andrew.

Indeed, the Lumileds performance had been under pressure over a couple of quarters. We expect it to go up in the second half of this year. We make that statement on the basis of a good order book for the Lumileds products. We also have taken measures to improve the cost productivity, and these measures typically take an effect in about six months, again underpinning an improved second half of the year profitability.

So we believe that we will come through this period. It's a good business. We have great design-ins with various mobile platforms for flash applications; and also, of course, for general illumination applications. So overall, I expect a good future for Lumileds.



Operator

Graham Phillips, Jefferies.

Graham Phillips - Jefferies - Analyst

My question is around Cleveland. You spoke about the EUR100 million improvement last year, and I think in the end it was a slight decline. You're now saying EUR100 million improvement in the second half. Why did we slip last year? What more has to be done to get this improvement from just a little over two months' time?

Frans van Houten - Koninklijke Philips NV - CEO

Graham, we started out by remediating Cleveland factory itself in 2014 and 2015. And then we have extended the efforts to include our supplier base. And supporting our suppliers with the right measures is, you could say, a handholding effort that takes a considerable investment. And we are partly also transitioning the supplier base towards alternative suppliers.

So all of that has proven to be quite a bit of a project. We do see light at the end of the tunnel. We are very pleased with how the manufacturing is going. Production levels are back to normal. We have just introduced another product line that was still outstanding. There is now only one small product line to go. We have started to ship our IQon Spectral CT to several countries.

So all in all, I'd say we are having the situation well in hand, albeit with cost levels that are higher than originally planned. But I'm intent to do this well, and so a bit extra cost is an acceptable price to pay. And then we expected the second half of the year to show stronger bottom-line results.

Graham Phillips - Jefferies - Analyst

Okay. Thank you. And the one follow up is around the like in IPO. Have you looked at the cost alternatives between IPO or an asset sale to the firm? And if you did go for an IPO, what would the proceeds likely be used for afterwards?

Frans van Houten - Koninklijke Philips NV - CEO

Yes. We have looked at all the various options and at this time are comparing a private sale versus an IPO. The proceeds will be used -- well, first of all, the proceeds need to come in and if there's an IPO, of course, they come in in a phased manner.

The proceeds will be likely used in a blended form partly to pay off existing debt, for example, the debt that we used for Volcano acquisition; partly for additional pension liability reduction that we've already communicated before that we would still do later this year. Partly, we have a share buyback program to finish this year. And then, we will also consider M&A activities to boost the portfolio that we have in HealthTech.

So that's the update that I can give you today.

Graham Phillips - Jefferies - Analyst

And you prefer that rather than a simple spin and putting perhaps more debt into that business because you actually want the cash for these other proceeds?

Frans van Houten - *Koninklijke Philips NV - CEO*

Yes. That's right. Correct.

Graham Phillips - *Jefferies - Analyst*

Okay. Thank you.

Operator

Ian Douglas, UBS.

Ian Douglas - *UBS - Analyst*

Most of my questions have been answered already. I just had one last one on your working capital. All of the lines there declined materially this quarter. Is there some change of scope that we should be aware of, or are you --? Is this is a focus reducing working capital at the moment? And if so, how far could that go?

Thank you.

Frans van Houten - *Koninklijke Philips NV - CEO*

I can give a compliment to my CFO, Abhijit, who has certainly made working capital a focus area, and I'll let him speak to how much further we can improve.

Abhijit Bhattacharya - *Koninklijke Philips NV - CFO*

Thank you, Frans. But you know, this is -- we had a fair amount of cash locked in this. We've been working for the last couple of quarters to see a tangible improvement. You see that across the board. And that's not only in inventories but also in our receivables and overdues.

So we believe there is still some room to [grow]. At this stage, I'm not specifically guiding how much, but clearly, there is still some more improvement which is possible for the rest of the year, and we are driving that hard every day.

Ian Douglas - *UBS - Analyst*

And then, obviously, a lot of that has been offset by decline in payables year over year. Is that just an accident of timing? Should we expect to increase that back again?

Abhijit Bhattacharya - *Koninklijke Philips NV - CFO*

Yes. The payables is directly a factor of what we are doing in terms of contracts that we have to pay, but partly, the lower payables is also due to the payment of the CRT fines as well as certain pension payments. So these are not, let's say, current trade payables which are going down. In fact, our DPO, as we call it, days payable outstanding, is creeping up slightly to the levels which we want it to be.

Ian Douglas - UBS - Analyst

Great. So cash flow should be pretty good in the second half as well then by the sounds of it. Thanks very much.

Abhijit Bhattacharya - Koninklijke Philips NV - CFO

Yes. We had a pretty decent cash flow last year and we are looking to build on that this year as well.

Ian Douglas - UBS - Analyst

Thank you.

Operator

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

Frans van Houten - Koninklijke Philips NV - CEO

All right. Well, thank you, everybody. Let me give one elucidation, because you may have noticed that there were less -- fewer questions than usual, and in fact, a couple of good attendees were not speaking up. And that is a reflection of the fact that a number of the analysts that cover Philips have currently suspended their active coverage as the institutions that they work for are involved in the preparation for a potential IPO. So at least that is how I explain it. Time will tell exactly, of course.

But thanks very much for attending, everybody. It was a pleasure, and have a great day.

Operator

This concludes the Royal Philips first-quarter 2016 results conference call on Monday, April 25, 2016. Thank you for participating. You may now disconnect.

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