

PHILIPS

Philips – Q1 2018

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Introduction

Pim Preesman

Head of Investor Relations, Royal Philips NV

Thank you, and good morning, ladies and gentlemen. Welcome to Philips' First Quarter 2018 Results Conference Call. I'm here with our CEO, Frans van Houten; and our CFO, Abhijit Bhattacharya. On today's call, Frans will take you through our strategic and financial highlights for the period. Abhijit will then provide more detail on the financial performance and market dynamics. After that, we will take your questions.

Our press release and the related information slide deck were published at 7:00 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 end of today on our website.

I would like to remind you that Philips' shareholding in Philips Lighting is currently 18% of Philips Lighting's issued share capital. The stake is presented as an investment included in 'Assets classified as held for sale' in the financial statements of Royal Philips as from the end of November 2017.

As part of a financial reporting simplification project, we have further simplified our Q1 press release by excluding the balance sheet as it's not required to be disclosed in quarter 1 and quarter 3. In our semi-annual and annual report, we will continue to present the statement, and the net debt to group equity information is provided still in the Philips' performance section of the press release.

Finally, as mentioned in the press release, adjusted EBITA is defined as income from operation excluding amortization of acquired intangible assets, impairment of goodwill and other intangible assets, restructuring charges, acquisition-related costs and other significant items. Comparable growth for sales and orders are adjusted for currency and portfolio changes.

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

Overview

Frans van Houten

CEO, Royal Philips NV

Yes. Thanks, Pim, and thank you all for joining us today. After covering some of the key results in Q1, I will talk you through some recent highlights of our journey to leadership in the exciting health technology market and how we see our future.

Let me first start with the first quarter results. We started the year well with 10% comparable order intake growth, 5% comparable sales growth and 130 basis points improvement in operational profitability.

Good traction of the new products and solutions that we introduced last year, and they contributed to 9% comparable sales growth in the Diagnosis & Treatment segment. This growth was driven by strong growth in Diagnostic Imaging, Image-Guided Therapy and, in particular, by mid-teens growth in Ultrasound. We see that in Ultrasound, our innovations in, for example, cardiovascular, but also in women's health care, are now getting very good traction.

The Personal Health businesses grew 4%, a lower growth compared to previous quarters, due to lower demand in the air purification market in China. This was due to an improvement in the weather conditions in China and government policies to improve air quality. Nevertheless, our portfolio continued to do well as we gained market share in this category. This impacted the comparable sales growth of Personal Health business by approximately 150 basis points.

The Connected Care & Health Informatics businesses were in line with last year. We continue to expect further improvement to be in the second half of the year. The increase in margins were mainly driven by growth, our productivity program and operational improvements, contributing to an adjusted EBITA margin increase of 130 basis points.

Our Connected Care & Health Informatics businesses and our Diagnosis & Treatment businesses delivered strong margin improvements, with adjusted EBITA improving by 180 and 140 basis points, respectively, versus quarter 1 2017. The Personal Health businesses further improved adjusted EBITA margin by 30 basis points.

In the quarter, we continue to make good progress with our productivity programs and took actions to further reduce our interest expense.

Let me expand on our strategic journey to leadership in health technology. As outlined at our Capital Markets Day last year, our value-creation story is built on 3 key levers on which we made further progress in the first quarter. First lever, by creating value in our core businesses by gaining market share through deeper, more comprehensive customer partnerships, innovative solutions and pursuing growth through geographical adjacencies and coverage.

On this first lever, innovation, partnerships and increased geographic coverage were important drivers of the strong sales growth of 9% and the continued momentum in order intake growth of 15% in Diagnosis & Treatment businesses. Across our markets, we continue to see strong customer interest in our innovations.

As part of our new product introductions to drive growth, in Diagnostic Imaging, we launched the Ingenia Elition, a new 3.0 Tesla MRI solution that offers superb image quality while performing exams up to 50% faster. This means that hospitals can scan significantly more patients, thus helping productivity of hospital systems.

Following the introduction of the mid-range MR Prodiva 1.5 Tesla system in the previous quarter, our offerings in Magnetic Resonance Imaging have been significantly strengthened, and this is receiving increased recognition from our customers.

We also see strong traction from the new cardiac ultrasound products, such as the new and enhanced live 3D TEE imaging capabilities to help diagnose cardiac conditions and guide minimally invasive therapies.

Also, the new women's health care ultrasound innovations like a new cutting-edge transducer 3D and 4D life-like image capabilities and Anatomical Intelligence for easier and faster exams that we introduced late 2017 for our EPIQ and Affiniti ultrasound systems, drove strong double-digit comparable order intake for this business.

Moreover, we continue to revolutionize Point-of-Care ultrasound with our Lumify app-based ultrasound solution. There are several thousands of medical professionals in a variety of medical specialties using this solution across the world, and this number is growing rapidly.

This quarter, we have further enhanced Lumify with face-to-face conversation, along with simultaneous viewing of live ultrasound images and guided probe positioning to enable remote collaboration and virtual training.

At the 2018 HIMSS Conference and Exhibition in Las Vegas, which is one of the largest health information and technology events globally, Philips launched the next-generation IntelliSpace Cardiovascular informatics platform. We also launched the FocusPoint, a web-based operational performance management application for our Philips' Patient Monitoring Solutions. This application aggregates processes and stores statistical and alert information, which are presented on a dashboard for optimal management of the technology.

IntelliSpace Portal, Philips' advanced data integration, visualization and analytics platform, has been named the 2018 Category Leader in the Advanced Visualization category in the 2018 Best in KLAS: Software & Services report.

I'm pleased that we further strengthened our position as a health technology leader with innovative value-added integrated solutions. Leveraging our expertise in integrated cardiology solutions, we provided the University of Ottawa Heart Institute, the largest heart center in Canada, with Patient Monitoring Solutions and Image-Guided Therapy solutions based on Azurion, the Philips' next-generation Image-Guided Therapy platform. Also, in Canada, we provided Image-Guided Therapy solutions to the Royal Victoria Regional Health Centre.

Moreover, in the quarter, we signed 8 long-term strategic partnership agreements across the United States, Europe and the Middle East. For example, in the United Kingdom, we signed an 11-year agreement with the NHS Trust in Wye Valley to transform radiology services across their sites. We will deliver our latest imaging systems as well as advanced informatics, while also providing on-site collaboration and staff training to ensure that the agreed goals will be met.

Additionally, in the Netherlands, we signed a 15-year strategic partnership with ZorgSaam Hospital, comprising imaging and Image-Guided Therapy systems, Healthcare Informatics and a range of services to advance the diagnosis and treatment of patients.

Our investments over the past few years focused on building solutions selling capabilities are paying off, and we have a very healthy pipeline of pending partnerships with customers.

Moving to our Personal Health business, we successfully launched the mid-range Philips Sonicare ProtectiveClean power toothbrush in North America. Consumers rate the product with 4.6 stars on an average scale of 1 to 5. In the next quarters, we will continue with the rollout of this launch all across the world. This will boost our competitiveness and further boost profitable growth of our Oral Healthcare business.

In Personal Care, we continued the OneBlade success story with the introduction of our latest innovation in male grooming technology, the Philips OneBlade Face + Body. This is the first product that allows men to trim, edge and shave any lengths of hair on their face and their body with just one blade. The product is now available in the United States, United Kingdom, France, and Canada and will soon be available in other markets as well.

In Sleep & Respiratory Care, high single-digit comparable sales growth was driven by double-digit growth in the patient interface or masks. In this area, we further expanded our integrated Dream Family solutions with the introduction of the DreamWear Full Face mask as part of our award-winning DreamWear platform. With this, we are addressing the largest mask segment. In Respiratory Care, we continued with strong performance led in ventilation by the award-winning Trilogy range.

Sleep apnea has a high-incident rate globally, yet there is low awareness among the impacted population. To unlock the large value creation potential for Philips, we opened Southeast Asia's first Sleep and Respiratory Education Center in Singapore to train health care professionals from across the region to better diagnose and treat sleep and respiratory disorders.

On the second lever of creating value and adjacencies through organic investments, partnerships and selective M&A, we further expanded the Digital Pathology solutions business. We signed partnership agreements with Massachusetts General Hospital and Brigham and Women's Health Hospital to advance digital pathology adoption across the United States. We also introduced an upgrade to our advanced computational pathology solution, TissueMark, which aids in identifying insufficient samples for molecular tests with accurate cellularity guidance.

Our strategic road map in Image-Guided Therapy is delivering results as evidenced by the strong order growth of the Azurion platform and continued double-digit growth in the device businesses, built on the Volcano and Spectranetics acquisitions. The growth is supported by clinical studies that are producing a growing body of clinical and health economic data. For example, the recent results of the DEFINE FLAIR trial demonstrated that an iFR-guided strategy reduces cost and improves patient comfort compared to an FFR-guided strategy, while delivering consistent cost savings and patient outcomes. The integration of Spectranetics remains on track.

In the quarter, we launched a new artificial intelligence platform for health care called HealthSuite Insights. It delivers health care specific tools and technologies to address the full process of building, maintaining, deploying and scaling AI solutions. The Insights marketplace will provide the health care industry's first ecosystem that curated AI assets from Philips, but also third parties, are readily available for license.

Artificial intelligence-based solutions have great potential to improve patient outcomes and care efficiency. However, developing and deploying AI solutions for health care use cases can be time-consuming, resource intensive and expensive. And HealthSuite Insights actually eases the logistical challenges of deploying AI solutions in research and clinical environments. It accelerates the development of analytic solutions, it reduces development and total cost of AI solutions.

Thirdly, I'd like to talk about the third value driver, which is improving margins through customer and operational excellence. Our self-help initiatives to drive EUR 1.2 billion in savings for the period 2017 to 2019 remain on track, as we delivered EUR 101 million savings during the first quarter.

The main 3 programs in procurement savings, manufacturing productivity and overhead cost reduction, all delivered on their milestones. We continue to make progress in line with the terms of the consent decree, which is primarily focused on the defibrillator manufacturing in the United States, and which included inspections by independent auditors and resumed shipments of our FRX and FR3 AEDs defibrillators to markets outside of the United States.

Looking ahead, we continue to expect our markets to grow 3% to 5% on a comparable basis in 2018. We reiterate our midterm targets of 4% to 6% comparable sales growth and an average annual 100 basis points improvement in the adjusted EBITA margin.

And with that, ladies and gentlemen, I'd like to turn the call to Abhijit, who will provide more detail on financial performance and market dynamics.

Financial Overview

Abhijit Bhattacharya

CFO, Royal Philips NV

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

Let me start by providing some color on the first quarter comparable sales growth of 5%. The Diagnosis & Treatment businesses delivered a 9% comparable sales growth, with solid growth in all businesses of Diagnostic Imaging, Ultrasound and Image-Guided Therapy. We are very pleased to see the strong traction of these businesses, specifically in Ultrasound, where strong customer demand enabled us to register higher book and bill than expected in the quarter.

The Personal Health businesses delivered 4% comparable sales growth, driven by high single-digit growth in Sleep & Respiratory Care. As Frans mentioned, this includes a negative impact of 150 basis points due to lower sales in our air purification business in China.

Low single-digit growth in Health & Wellness was mostly driven by phasing and timing of campaigns and product introductions. We expect a stronger second half, driven forward by the launch of the ProtectiveClean mid-range toothbrush this year. Also in our Mother & Child Care business, we expect strong demand for our new anti-colic bottle with Air-Free vent designed to reduce feeding issues like colic, gas and reflux.

Comparable sales growth in Connected Care & Health Informatics businesses were flat year-on-year. Given the phasing of our order book, we expect improved sales growth during the second half of the year. Additionally, as per this year, we decided to split the Patient Monitoring & Solutions business into 2 focused business groups: one is named Monitoring & Analytics business, which mainly consists of Patient Monitoring; the other is Therapeutic Care business, which mainly consists of hospital ventilation and defibrillators. This will allow us to better fulfill the specific customer needs of each business.

Sales in mature geographies increased by 3% on a comparable basis, reflecting double-digit growth in other mature geographies and low single-digit growth in North America, while Western Europe remained flat year-on-year. Sales increased by 9% on a comparable basis in our growth geographies, driven by double-digit growth in Middle East and Turkey, India and Latin America.

As Frans mentioned, comparable order intake overall grew by 10%. The Diagnosis & Treatment businesses showed mid-teens growth, where North America and China markets were particularly strong, with above 20% comparable order intake growth. The Connected Care & Health Informatics group business grew low single-digit. Excluding the defibrillators business where we expected a decline, comparable order intake grew mid-single-digit.

In growth geographies, order intake on a comparable basis grew by over 20% compared to Q1 2017, mainly driven by China, Latin America and India. Comparable order intake in North America and Western Europe posted a mid-single-digit growth in the first quarter.

Let me now turn to the EBITA development for the group in the first quarter. Adjusted EBITA margin of 8.7% in the quarter was 130 basis points higher than the year before. This margin increase was driven by a strong margin improvement of 180 basis points in Connected Care & Health Informatics and 30 basis points in Personal Health, both mainly due to our productivity program and operational improvements.

In Diagnosis & Treatment, the margin improved by 140 basis points, mainly attributable to operational leverage from growth, mix improvement and the impact of productivity measures. The mix impact was mainly driven by the strong sales of Ultrasound in the first quarter.

Our productivity program delivered EUR 101 million in net savings. More specifically, the net overhead cost-reduction program delivered EUR 29 million in non-manufacturing cost, the productivity program contributed EUR 22 million to the gross margin and procurement saving, in part driven by our Design for Excellence program, delivered EUR 50 million of bill of material savings year-on-year.

In the segment Others, the adjusted EBITA amounted to a loss of EUR 37 million as guided for in the previous quarter. In the first quarter, the income tax expense decreased by EUR 35 million, driven by lower taxable income, mainly due to a gain from the sale of real estate assets in Q1 2017 and a release of tax provisions this year.

As part of the plan to reduce interest expenses and extend maturities, we started the redemption of the 3.75% notes, which are due in 2022. The bonds have an aggregate principal amount of USD 1 billion, and we expect the transaction to be completed by coming Thursday, April 26. This has resulted in a charge in the first quarter of 2018 of EUR 29 million. The resulting cash outflow in the second quarter of 2018 will be approximately EUR 840 million, excluding accrued interest.

Net income decreased by EUR 135 million compared to Q1 2017 due to lower income from discontinued operations as Philips Lighting and the combined Lumileds and Automotive businesses are no longer consolidated in our financial statements, also due to higher restructuring and acquisition-related charges and the bond redemption charges that I just talked about.

In Q1 2017, we had a gain on the sale of real estate assets, partly offset by improvements in operational performance and lower income taxes. The restructuring charges for the first quarter primarily related to actions undertaken for the rationalization of the manufacturing footprint as well as overhead cost reductions.

Operating working capital improved by 20 basis points year-on-year, driven by reduction in inventory by over 100 basis points. Operating cash inflow was EUR 92 million during the quarter.

Return on invested capital, which is calculated on a 5-quarter MAT basis, was 11.3%, which is 3.6% above our WACC. ROIC decreased by 0.6% versus the previous quarter, mainly due to the impact of acquisitions.

During the first quarter, we completed a further EUR 350 million of the EUR 1.5 billion share buyback program, which we announced on June 28, 2017, and planned to complete within 2 years.

Let me now provide you with an update on the U.S. health care market and our outlook for Western European and China health care markets. The first quarter saw North American health care customers continue to focus on priorities around the quadruple aim that is lower costs while delivering better outcomes with improved patient and employee experience.

There appears to be a positive momentum around value-based care based on the priorities of new leadership at the Department of Health and Human Services. This underscores the importance of our strategic priority to bring value-based solutions to the market. Overall, we continue to expect U.S. health care market growth to be in the low single digits, while we closely monitor further developments.

In Western Europe, we expect modest growth, low single-digit health care market growth. And in China, we expect high single-digit growth for 2018.

Let me now provide some additional guidance for 2018 for certain areas of our business. In the segment Others, we expect a net cost of approximately EUR 55 million in the second quarter and continue to expect approximately EUR 165 million for the full year 2018, both at the EBITA level. Included in these numbers are EUR 5 million restructuring costs and other incidental items in the second quarter and approximately EUR 50 million for the full year. On an adjusted EBITA level, we continue to expect full year costs at EUR 115 million, which is an improvement of EUR 42 million versus last year.

Restructuring charges for the 2017 to 2019 period are still expected to be 80 basis points on an average with a decrease thereafter. Overall, restructuring for 2018 is expected to be approximately 90 basis points. Acquisition-related costs are expected to be approximately 40 basis points.

As a consequence of the consent decree, mainly related to our defibrillator business, we continue to anticipate an EBITA impact of approximately EUR 60 million in 2018, of which approximately EUR 20 million in the second quarter of 2018.

During the first quarter, we provided you with guidance for the expected FX translation, combined with the consolidation and deconsolidation impact on sales in Q1 and the full year 2018. We will continue to do this twice a quarter, once immediately after this analyst call and once during the last week of the quarter. Both these updates will be available on our IR website.

In summary, we are pleased with the good start of the year in terms of order intake, sales growth and profitability improvement. For the full year 2018, we are confident that we will deliver on our midterm targets of 4% to 6% comparable sales growth, an average annual 100 basis points improvement in adjusted EBITA margin and a free cash flow between EUR 1 billion to EUR 1.5 billion.

With that, we'll now open the line for your questions. Thank you.

Q&A

Operator: (Operator Instructions) we will now take our first question from Mark Troman from Bank of America.

Mark Troman (Bank of America): Just a question, please, on order patterns. I mean, D&T clearly very strong with 15% or so order growth, but noticeably different from CCHI. So I guess, the first question on the D&T is what visibility do you have that you can keep at a very healthy rate in terms of Ultrasound, Imaging and Image-Guided? And then on CCHI, I guess I'm trying to understand, it obviously seems a little bit disappointing on the growth, is that an operational issue? I know you mentioned some changes about splitting some of the Monitoring and the Therapeutic Care, et cetera, but what do you need to do better in CCHI?

Frans van Houten: Mark, this is Frans. Well, let's dive in. The Diagnosis & Treatment order growth come on the back of many innovations that we brought to market in the second half of 2017 and we continue to do new product introductions also in Q1, for example, these new MR systems that can scan patients at half the time. We think we are taking market share. I'm not promising you the 10% will continue exactly, but we certainly are confident that our innovations have good traction. And CC&HI, let's peel the onion there. First of all, I need to ask you to take into consideration the impact of the defibrillator business. If we exclude the defib business, actually the order growth in the quarter was about mid-single digit, right, not as strong as D&T but certainly demonstrating an ongoing interest in our innovation. What further needs to be said is that many of the innovations around connected care, telehealth, population health have a strong interest. And we see

a funnel of hospitals and IDNs that are very keen on it, but decisions are slow in coming. So we have not lost deals, but we do see that customers are taking their time to make these important decisions. And finally, also in effect, is that we continue to see a shift from so-called capital deals to subscription-based deals where you get the revenue in as a trickle, all right, an annual subscription base. But we also have the habit of only booking orders within, let's say, allowing for a time window of order recognition of about 12 to 18 months, all right, so we are not booking then the full horizon of these orders. So maybe altogether, a somewhat complex answer to underline that I remain confident. And CC&HI is actually one of those businesses where, in January, we said the year will be back-end loaded. And in fact, that is also what will happen.

Mark Troman: Okay. That's super clear. And just one follow-up, just on the cash flow maybe for Abhijit. Working capital looked pretty heavily, and I know there's obviously some areas of strong growth. How much of that can you get back during the year? Or will it just depend on the growth rate?

Abhijit Bhattacharya: Yes, we will get back most of it, Mark, because the cash flow is basically the difference in the working capital position between end of the year and end of Q1. So end of the year typically, we end very low. Year-on-year end of Q1, actually, working capital is down 20 basis points, inventory down more than 100 basis points. So it basically reflects the buildup of working capital from the end of Q4 to the end of Q1. But again, as we go through the year, we will make that up.

Operator: The next question comes from Ian Douglas from UBS.

Ian Douglas-Pennant (UBS): Yes, it's Ian Douglas-Pennant at UBS. So first on toothbrushes. This weakness looks like a trend. I mean, looking back in my data, you've grown double-digit pretty much every year since 2010 until last year. Is this something -- a new -- or what gives you confidence this is something a new product can fix rather than just a structural change in the market? And on your guidance -- second question on your guidance for this year. You said last quarter that you think revenue growth will be H2 weighted. Given the strong growth we've seen so far this year and given the strong order book that you have at the moment, would you like to reevaluate that commentary or restate that commentary?

Frans van Houten: Yes. Ian, this is Frans. Well, we don't see a structural change in toothbrushes. And we are currently launching new products, and therefore, we are expecting a stronger second quarter and second half. Now what does play into the overall global equation is that as the base in China becomes bigger, the relative growth contribution changes. We continue to see very strong growth in China. But we saw -- originally coming from a very low base, we saw 50%, 60% growth. And of course, that growth rate is now, as the business becomes so big, that growth rate is becoming more -- coming down a bit. Now having said that, we are opening up new markets. We are investing in Brazil, which is also a country with a large population with strong interest in dental hygiene. We think that for years to come, oral care will be a very strong category. There's only -- there's not that many players, of course, who our competitors are, but we think we will continue to grow strong. On the second question on guidance, I think I already referred to it a bit when Mark asked his question. In CC&HI, you actually see this play out, expectation for a back-end loaded year in fact comes through. On D&T, a strong quarter. What particularly played into the quarter was the interest in Ultrasound, the strong double-digit orders and revenue. Now Ultrasound is a category where the cycle time to go from order to revenue can be relatively short, in fact even weeks. And when we gave that guidance in January, that was not, let's say, fully clear yet. And we got quite some orders late in the first quarter that also made it into revenue. And therefore, D&T got an extra boost in the quarter, all right? Now that doesn't mean that it will exactly play out in the same way in the second quarter, although as to my earlier statement, the innovations are strong and we see good interest.

Ian Douglas-Pennant: Just a quick one, if I can sneak it in, for Abhijit. You didn't -- or excuse me if I missed it, but you didn't comment on the impact of currency on margins for this quarter. Could you give us any data? Or is that because it was negligible?

Abhijit Bhattacharya: Yes, it was negligible, Ian. So we've mentioned earlier how we have balanced our footprint and also changed our hedging actions. So unless there is really a short-term big swing in emerging market currencies, we should be able to manage that within a negligible bandwidth.

Operator: The next question comes from Veronika Dubajova from Goldman Sachs.

Veronika Dubajova (Goldman Sachs): My first one is on the revenue growth outlook for the remainder of the year. Given that you've come in at 5% or the order book is [inaudible]. Wonder if you could comment on your confidence in your ability to achieve the upper half of the 4% to 6% range? And at what point in time might we see you narrow that 4% to 6% as we move through the year? And then my second question is on buybacks, Abhijit. Clearly, with the further sell-down in lighting, do you see scope or desire for increasing the buyback amount this year beyond the EUR 1.5 billion under the 2-year program?

Abhijit Bhattacharya: Yes, I can maybe take both, Veronika. Regarding the growth, we have given a 4% to 6% growth outlook over a longer period of time, right? And within that, last year we were at 4%. We have started this year well at 5%. We are not going to narrow the guidance for a specific year or a quarter. This is a range we've given for a longer period, and we will stick to that. The growth in the order book, which on a last 12-month basis, gives us a 7%. Order intake growth gives us confidence to be within the 4% to 6% range. Regarding the buybacks, we have said we would do the EUR 1.5 billion over a 2-year period, so we are not planning to increase that at this point of time, Veronika.

Veronika Dubajova: And I guess -- I mean, your degree of confidence in your ability to grow in the upper half, do you think -- given where the first quarter is and given the order pattern that you saw in the first quarter, are you more confident in your ability to accelerate growth this year?

Frans van Houten: Well, last year, we had an average of 4% growth. That was at the bottom of the bandwidth. Now we had a good start of the year and a healthy order growth. So it's definitely our ambition to get well into the 4% to 6% bandwidth.

Operator: The next question is from Michael Jungling from Morgan Stanley.

Michael Jungling (Morgan Stanley): I have 2 questions in relation to the Diagnostic & Treatment business. First question is, if I look at the organic order book growth, can you provide a bit more color what it means specifically for Diagnostic Imaging? Are we talking here about double-digit growth, meaning in the teens? Or did the Diagnostic Imaging business actually deliver something more in the 20% range? And question number 2 is also on Diagnostic Imaging. Can you comment on specifically the order demand and sales demand for your CT business?

Frans van Houten: Yes, Michael. DI actually delivered a low-teens order growth in the quarter, and we saw strength across the various modalities for MR, CT and X-ray. We launched -- we renewed almost 70% of the product range, and it's our belief that we are currently regaining market share across the world on these products.

Michael Jungling: Okay. And then specifically in relation to CT, how would you describe the demand for the products following some refreshments in the portfolio? Specifically, the order book growth in CT, is that a very high number right now, sort of 20%, 30%, 40%, given low comps?

Frans van Houten: Well, we don't specifically split out CT. I just said that the low teens order growth in DI. And actually, over the last 12 months, a very similar pattern is that we are sustainably growing Diagnostic Imaging. And then I mentioned that is across the 3 modality clusters of CT, x-ray and MR.

Michael Jungling: Okay. And finally, just the driving demand for CT. Are you having to use more pricing to get back into the market? Or would you say that pricing for your products is as expected?

Frans van Houten: Pricing is as expected. And let's not forget, we introduced some very high-end products like that digital PET/CT and the dual energy IQon Spectral CT. Both have higher price points than, let's say, normal systems and actually raised the average of revenue per system for us. Also, in MR, we have launched 2 new products. The 3.0T Tesla can scan a patient in half the time. It comes also with a camera system in-bore with artificial intelligence that can guide a first-time right image acquisition. So what -- the reason I expand a bit on this is that we feel that we have come out of the, let's say, the issues around Diagnostic Imaging strongly with a slate of attractively featured products. And customers are gaining confidence to do business with us, leading to market share gains. If you look at the last 12 months order growth, off the top of my head, at high single-digit even around 10%. So that is just testimony to that strategy working.

Operator: Our next question is from Yi-Dan Wang from Deutsche Bank.

Yi-Dan Wang: A couple of questions. So for Ultrasound, would you be able to give us some color on how much of the mid-teens growth in revenues, comparable growth in revenues, and also the order intake is coming from the new segments versus the businesses that you were already strong in? And if you could, what is the share that you have in the new segment versus existing segments? And then the second question is for air purification, can you give us some sense of what the size of that business is? So based on your comments, it seems that, that is a structural trend in China. So with that, should we take a haircut to the Personal Health business growth over the medium to long term? And then finally, Abhijit, on the financials, you've done some refinancing at -- and so there are still some -- quite a bit of outstanding debt with very high interest rates of 6% to 7%. Do you have scope to refinance these? And if so, what sort of timeline are we looking at?

Frans van Houten: Let's start with the air purification and refinancing questions by Abhijit, and then I will take the Ultrasound question when we find the data.

Abhijit Bhattacharya: Yes. So I think for air purification, the business is about a couple of hundred million euros a year. It's a fast growing business. Normally, this year, the trend has been reversed a little bit in the first quarter. So I don't think you should look at it as a long-term trend because this is a business which grows well. It is largely dependent on Q4 and Q1 and swings with the weather conditions in the bigger markets. But I would not say it is a structural. If you look the year before last year, also, we had a similar situation and then it gets -- it changes year-on-year. So I would not look at it as such a major issue in the medium term, okay? So that is one. Second is on the debt. We have the more expensive ones. We've cleaned up as much as is possible. You will see what is left is only small tranches, and those are with certain, let's say, lenders who don't want to buy back because, of course, they are happy with our credit performance as well as with the interest that they get. So the value creation, having to buy those out, doesn't work out. So we are doing the 3.75% paper now, and with that, we get more than, yes, 20 million plus in terms of value creation every year. So that's why we do that.

Frans van Houten: All right. So let's come back to Ultrasound. I don't have all the numbers in front of me, so let me just give you a general color. Globally, Philips is the #2 in ultrasound, we are the #1 in cardiovascular and we are a relatively smaller player in OB/GYN, right? And we sustain our leadership in cardio. Order growth there is also good in the low teens in the first quarter. But in OB/GYN, in women's health, their order growth

was around 30%, right, and double what it was before thanks to the new product introductions that are gaining traction. So I think that just underlines the point that we are gaining market share in this important adjacency.

Operator: The next question comes from Scott Bardo from Berenberg.

Scott Bardo (Berenberg): The first question, please, just related to the Personal Health division. And I note you had pretty strong sleep apnea performance this quarter. Can you give us an update as to the launch of the Full Face mask in that segment, whether that contributed to growth at all or if that's due to fall out in the remaining quarters of the year? Also, whilst on this division, if you could just possibly share some dynamics of the Electric Razor business, which I understand has had some relatively pedestrian growth. Just wonder if that market changed in any extent? So that's the first question, please. And second one just on Diagnosis & Treatment. Obviously, encouraging to see some good life in that division. Given the significant margin strides already so far, is it fair assume that we see a margin expansion well north of 100 basis points this year for the division? If you could comment a little bit on that point.

Frans van Houten: Yes, Scott. Let me start with the Diagnosis & Treatment, and then pass it to Abhijit for the Personal Health questions. D&T actually has to deliver above 100 basis points. We have promised in Diagnostic Imaging 150 to 200 basis points, which is necessary to get there in DI to the low teens and for D&T, as a whole, to the mid-teens, right? So yes, that rate of expansion is going to be above the average of Philips. And we are arguably, for Personal Health, it can be a little bit below that average. Now let's come back to your first question and give a bit of color on the PH business.

Abhijit Bhattacharya: Yes, on the first one on the new DreamWear Full Face mask, we just launched it in Q1, so customer reception has been actually very, very good. The volumes have been low in Q1, so the double-digit growth of the mask range is not really impacted big time by the Full Face mask of DreamWear, but that hopefully will drive good growth in the coming quarters because that is the biggest segment of mask, the Full Face. And we now use the same technology that we use in the DreamWear series, so we are pretty confident that, that is going to work out for the remaining part of the year. Regarding the shaving business, yes, there has been, let's say, a software shaving business overall. But grooming has been very, very strong. So the growth in OneBlade continues to be very strong, both because of the geographic expansion but also because of more applications that we do, as Frans mentioned in his speech, with the full body groomer, et cetera. That is really driving top line as well as change in our distribution since we now go into the shaving aisle in the supermarkets, and that has to drive further growth. So within, let's say, shaving and grooming, shaving, a bit soft because you see more and more men with facial hair styling. But that of course, gives the positive impact on the grooming business, which is doing extremely well.

Scott Bardo: Just one follow-up, please. I think after your Q1 update, you announced the closure of Cleveland and the transfer of production from that facility. Can you give us a little bit of an update as to how that's going, when you expect the full manufacturing to be in terms of your facilities and when you see a positive margin impact, if you like, from the closure of that facility?

Frans van Houten: Yes. Well, let me first underline that Cleveland will continue as a location for research and development as well as for service and training, and it will also remain a headquarter for the CT and AMI business units. The production had already reduced in Cleveland. As over the last 2 years, we had been making progress in ramping up the factories in Haifa and in Suzhou. That process will be completed in the second half of this year. In parallel, but not specifically related to this location, we will continue to expand margins in Diagnostic Imaging. And in relation to the earlier question this conference call, DI has a plan to improve margins between 150 and 200 basis points annually in order to get to a decent return profile.

Operator: The next question comes from David Adlington from JPMorgan.

David Adlington (JPMorgan): You were fairly vocal at the start of this year, and when we saw you just voiced in terms of growth and margins being second half weighted this year. But obviously, Q1 has really come in a bit better than anticipated. I just wondered how we should be thinking about progression through Q2 and the rest of the year. And it sounds like these statements still stand, but really just wanted to get your feeling for why Q1 have come in better than maybe than originally expected.

Frans van Houten: Yes, I remember that I said that, thanks for rubbing it in David, definitely something that came through stronger was the Ultrasound business, a business that has relatively short cycle between orders and revenue recognition. So that was very pleasing to see. I think Ultrasound has the opportunity to continue to perform well without promising the same order growth as we have seen in Q1. But it's great to see that Diagnosis & Treatment overall is having traction with its innovations. Now CCHI actually -- I mean, there it followed the guidance, right? I mean, we started the year a bit slow and we need to catch up in the second half year. I would say that is really a second half of the year game and not just a second quarter game. So altogether, yes, maybe we are a little bit ahead of the guidance that we gave in January. And then PH, where we had the headwind from the air purification market in China where we actually gained market share but the market was down, there, of course, also we have to catch up and over deliver to compensate for the 4% growth in Q1.

Operator: The next question comes from Max Yates from Crédit Suisse.

Max Yates (Credit Suisse): Just one question from me. I just wanted to understand a little bit about Spectranetics and the integration there. I think when you sort of bought the business, you gave some quite sort of bullish messages around where the margin could get to. I think you were saying it's a double-digit in 2018, and also around the growth there. So I just wanted to check how the business was evolving under your ownership and how the integration had gone so far.

Frans van Houten: Yes, Max. The integration of Spectranetics is going well. We continue to see double-digit growth. And I can also confirm that we expect double-digit margins in the second half of this year.

Max Yates: And so, in which case, I think, then you talked about 30% margins inside the [inaudible] business. So I mean, everything is sort of on track with those original midterm targets that you gave as well, I take it?

Frans van Houten: Yes, that number is specifically related to the Spectranetics business. Overall, we gave guidance on our device business. We said if IGT will grow to 3 billion by 2020, then 1 billion of that is going to be devices. And overall, the profitability of IGT needs to be close to 20%. And also, the device business will then, at that time, be in the high teens. And beyond 2020, we expect them to continue to improve margins to the high 20s.

Operator: The next question comes from Julien Dormois from Exane.

Julien Dormois (Exane BNP Paribas): I have just one question on the CC&HI business. Again, sorry to push you on that. But as you just said, so you expect an improvement in organic growth in that business in H2. I'm just curious because you're going to face much tougher comps on that business. And I was just wondering where the improvement would come from. Is that purely from the defibrillator manufacturing issue coming to an end? Or is it coming from an order book?

Abhijit Bhattacharya: Yes, I think it's across the board, Julian. So if you look in the monitoring business, which is the big part also, there, we continue to expect growth in the second half. Growth has been a bit soft in the

first quarter in monitoring, but we have a large market share there, well above the 40%. So, if we grow small, the market is also kind of growing small. The Healthcare Informatics order intake was good. So therefore, we expect that business to pick up. So it's not just related to defibs. Overall, I think with the order book that we have, we expect to get stronger growth in the second half. And given the high-margin content of these businesses, then, of course, you start getting higher earnings out of it as well.

Julien Dormois: Okay, very clear. And if I may just follow up on that. Regarding the defibrillator issue, have you provided any timeline in order to get rid of the consent decree? Is there any indication of time?

Frans van Houten: Yes, Julian, a consent decree is a multiyear affair. So that will not go away quickly. What we did speak about earlier was that the injunction on sales within North America for the defibs, that we aim to get that lifted in the second half of the year. And there, we believe, we continue to be on track.

Operator: Our next question comes from Ed Ridley-Day from Redburn.

Edward Ridley-Day (Redburn): If I could follow up on the strong growth in IGT. It's just -- breaking that back, it would appear that your angiography business, Azurion, and your last legacy angio business has grown substantially stronger. Is that right? With high single-digit or even low double-digit for the angio business, could you give us some more color on that? And also, on Spectranetics, could you comment a little on the impact of the U.S. reimbursement cut for drug-coated balloons, which has been implemented in January, and how that affects the business or not? And indeed, relative to say it's the growth of Stellarex or the uptick of Stellarex in Europe?

Frans van Houten: Yes. Ed, you're right, the Azurion and the angio business are growing strongly. So I can confirm that. Then the uptick of Spectranetics is on track. The reimbursement cut, or actually it was the lack of prolongation of an uplift on the reimbursement that was a disappointment. Across the industry, so not just Philips alone, but across the industry, we are working on creating the insight that a drug-coated balloon should have a higher reimbursement than a nondrug-coated balloon. And we believe that, that is certainly a realistic effort to make. That would happen at the earliest in the next budget year, so this year, we need to live with it. Nevertheless, we don't see it slow down the adoption of Stellarex as such. It does have a slight impact on the profitability of it, but in the bigger scheme of things, like we had in the earlier question, I can confirm that the Spectranetics integration and business case, i.e. value creation case, are on track.

Edward Ridley-Day: That's helpful, and can you give us any color on the rate of growth of Stellarex in Europe?

Frans van Houten: I don't have the geographical split out of growth of Stellarex. Overall, Spectranetics is growing a strong double-digit, and therefore, in line with our expectation.

Operator: Our next question comes from Wim Gille from ABN AMRO Bank.

Wim Gille: During the comment, you mentioned that the growth in CC&HI was also impacted by a shift from CapEx-related revenues to OpEx-related revenues, or in other words, shifting boxes to more subscription-based revenues. Can you give us an indication on where you are in the transition for the overall business? Are we just at the start or at the end? Is subscription the majority of the revenues, yes or no? So please some guidance on that one.

Frans van Houten: It's still early stages to see these shifts in business models. Remember that at the Capital Markets Day, we reported that we were at 28% of total revenue in recurring revenues, and then that turns into 30% currently. So the proportion of recurring revenues is gradually rising. But as our overall business is also growing, it's a steep -- it's a chase, right, to make sure that, that proportionally goes up. Maybe I'll give it

from a different angle, many of these larger-scale strategic partnerships that we announced, the 8 LSPs that we won in Q1, also have a strong degree of working revenues to it. So there's definitely market interest to it. And within CCHI, we will feel this more profoundly because the business lends itself to these subscription models better than some other businesses. And other than that we have not specifically detailed it out in the sense of impact.

Operator: Our final question comes from Yi-Dan Wang from Deutsche Bank.

Yi-Dan Wang: I just have a couple of quick questions on your working capital that has continued to improve. And just wondering whether you will be able to close the gap between yourself and your closest competitor. And if so, what kind of time frame we should be looking at? And then also, CapEx. Do you have a CapEx number for the year? And how we should think about that going forward, too, will be helpful.

Abhijit Bhattacharya: Yi-Dan, the second part of your question when you said closed the gap with your close peers, because from a working capital perspective, at least if I look at the numbers, we seem to be pretty much ahead of the pack. So yes, we will still continue to drive it down. If you look for the last 13 quarters, every quarter we have brought it down. So of course, as you go longer into the journey, the reductions become more difficult. But we still have a plan to bring it down during the course of the year. Regarding the CapEx number, not really too much different from the pattern of the earlier year. We will be between the -- close to the EUR 800 million, and that is not just CapEx, but that includes then capitalization of R&D as well. So if you look at the CapEx in terms of plant and machinery, that's roughly about half that of the amount.

Yi-Dan Wang: Okay. Great. Maybe we'll take the working capital question off-line, because I seem to have different numbers with yours. But, anyway.

Abhijit Bhattacharya: Okay. No problem.

Operator: Thank you. Mr. Van Houten and Mr. Bhattacharya, there are no further questions, please continue.

Frans van Houten: Okay, then we will round off this session. Thank you very much for attending. Good start to the year, a lot of good news on innovations and customer tractions, and we will continue to chip away and making progress every quarter.

Thanks very much. Have a great day.

Operator: This concludes the Royal Philips First Quarter 2018 Results Conference Call on Monday, the 23rd of April 2018. Thank you for participating. You may now disconnect.