

PHILIPS

Royal Philips Q1 2021 Results

Monday, 26th April 2021

Operator: Ladies and gentlemen, thank you for holding, the call will begin shortly.

Welcome to the Royal Philips First Quarter 2021 Results Conference Call on Monday, 26th April 2021. During the call hosted by Mr Frans van Houten, CEO, and Mr Abhijit Bhattacharya, CFO, all participants will be in a listen-only mode. After the introduction, there will be an opportunity to ask questions. If any participant has difficulty hearing the conference at any time, please press the star followed by the zero on your telephone for operator assistance. Please note that this call will be recorded and a replay will be available on the Investor Relations website of Royal Philips.

I will now hand the conference over to Mr Leandro Mazzone, Head of Investor Relations. Please go ahead, sir.

Important Information

Leandro Mazzone

Head of Investor Relations, Royal Philips

Good morning and welcome to Philips First Quarter 2021 Results Conference Call. Joining me today are our CEO, Frans van Houten, and our CFO, Abhijit Bhattacharya. Frans and Abhijit will take you through our strategic and financial highlights for the period and after that, we will take your questions. Our press release and the related information slide deck were published at 07.00 AM CET this morning. Both are available on our Investor Relations website. A full transcript of this call will also be made available today on the website.

Before we start, I would like to remind you of a few things. As mentioned in the press release, adjusted EBITA is defined as income from operations, excluding amortisation of acquired intangible assets, impairment of goodwill and other intangible assets, restructuring charges, acquisition-related costs and significant one-off items. Comparable growth for sales and orders are adjusted for currency and portfolio changes.

As of this quarter, the Domestic Appliances business is reported as discontinued operations. Sales and results from this business are no longer included in the results of continuing operations and relevant assets and liabilities are reported and their assets and liabilities held for sale. The restated statements of income for 2019 and 2020, reflecting these changes, are available in our Investor Relations website.

Finally, all forward-looking projections exclude the Domestic Appliances business. Over to you, Frans.

Company Overview and Strategy

Frans van Houten

CEO, Royal Philips

Hello everyone and thank you for joining us today. I hope that you and your families are keeping safe and well.

The COVID-19 pandemic is far from over and our teams remain focused on delivering against our triple duty of care, meeting customer needs, safeguarding the health and safety of our employees, and ensuring business continuity.

Despite the ongoing impact of COVID-19, our performance gained momentum with a strong 9% comparable sales growth and an adjusted EBITA margin increase of almost 400 basis points in first quarter. Diagnosis & Treatment sales grew 9%, our Connected Care businesses delivered 7% comparable sales increase and sales for Personal Health grew a very strong 17%. We are also encouraged by the strong 11% comparable order intake growth for the Diagnosis & Treatment businesses with all major markets contributing, driven by the sequential improvement of electives and hospital CAPEX and the very positive customer response to our innovative products and solutions. Comparable order intake for the Connected Care businesses decreased as anticipated, following the exceptional growth in Q1 2020, driven by the demand for hospital ventilators and patient monitors.

Looking ahead, while we continue to see uncertainty related to the impact of COVID, we see increased demand in the Diagnosis & Treatment and Personal Health businesses. We are raising our growth guidance given this momentum, and we now plan to deliver low-to-mid, single-digit comparable sales growth in 2021, compared to our earlier plan of low single-digit growth, still with an adjusted EBITA margin improvement of 60 to 80 basis points.

I would like to provide some colour on some of our initiatives to respond to the needs of today's hospital leaders across the globe as they plan for the future. In the quarter, we expanded our range of remote patient management solutions with the launch of the Medical Tablet, a portable monitoring kit designed to help clinicians remotely monitor large patient populations during emergency situations. This new offering, which is available in North America, Europe and Japan, provides remote access to patient data to improve workflows and better manage increased patient volumes.

Highlighting our strengths in smart diagnostic systems, we expanded the incisive computer tomography platform with the launch of Precise Suite, an AI-enabled solution that delivers smart radiology workflows from image acquisition to reporting, with AI-enabled image reconstruction, automated patient positioning, motion-free cardiac image capture, and real-time interventional guidance to drive precision in both speed and image quality. Precise Suite is the latest enhancement of the incisive CT platform, which already includes a newly designed patient table that accommodates bariatric patients, the tube-for-life guarantee, Philip's performance bridge process improvement services, and our dose-wise portal radiation exposure tracking solution. All of this makes the incisive CT unique in the industry.

We also further strengthened the Image-Guided Therapy portfolio with our SmartCT application for Azurion, which provides interventionists with CT-like 3D images to enhance procedural outcomes and it fits seamlessly into the existing workflows. And our ClarifEye Augmented Reality Surgical Navigation, an industry-first solution to advance minimally invasive spine operations in the hybrid operating room.

Very important, we continue to drive market share in our core businesses through deeper, more comprehensive customer partnerships. During the first quarter, we signed several new long-term strategic partnerships with hospitals in the United States, Europe and Asia, helping them achieve their clinical and operational goals. For example, we signed a five-year

agreement with the Spanish group Vithas to provide diagnostic imaging systems, combined with advanced informatics and Image-Guided Therapy solutions to enhance patient care. The agreement also includes collaboration in technological innovation projects and joint scientific research.

In Personal Health, we continue to invest in innovation and new product introductions. In the first quarter, we introduced the Lumea IPL 9000 series with SenseIQ technology for personalised hair removal, which is available through a try-and-buy subscription model in several countries.

We also produced our 100 millionth OneBlade blade just five years after OneBlade's original launch. The Philips OneBlade has disrupted shaving markets worldwide, creating a new category for shaving, trimming and edging.

In line with our plans, we signed an agreement to sell the Domestic Appliances business to global investment firm Hillhouse Capital for a total deal value of €4.4 billion. This comprises of an enterprise value of around €3.7 billion and an exclusive brand license agreement with an estimated net present value of around €0.7 billion for the first 15 year period. We expect to receive cash proceeds after tax and transaction related cost of €3 billion in the third quarter. We are very pleased that we have found a good home for this business and the transaction is expected to be completed in the third quarter subject to the customary conditions.

In Q1, we also took important steps in our strategy to strengthen our leadership in Connected Care solutions with the completion of the acquisitions of BioTelemetry and Capsule Technologies. The combination of our leading patient monitoring solution position in the hospital, with BioTelemetry's leading cardiac diagnostics and monitoring services outside of the hospital, make us a global leader in patient care management solutions with potential for further expansion. And with Capsule, we have a unique medical device information platform that connects almost all medical devices and EMRs in hospitals through a vendor-neutral system that transforms streaming clinical data into actionable information. These acquisitions will further broaden, enrich and scale Philips patient care management solution, as well as monitoring and software as a service offering. BioTelemetry and Capsule will be accretive to sales growth and adjusted EBITA margin in 2021, and will be reported within our Connected Care Informatics business in the Connected Care segment.

On the regulatory matters, regretfully, we have identified possible risks related to the sound abatement foam used in certain sleep and respiratory care devices currently in use. And this is primarily related to the first generation DreamStation product family. We are in the process of engaging with the relevant regulatory agencies regarding this matter and initiating appropriate actions to mitigate these possible risks. Given the estimated scope of the intended precautionary actions on the installed base, we have taken a provision of €250 million. I would like to flag that our latest CPAP platform, the DreamStation 2 is not affected as it is of a different design.

Let me now update you on some changes in our management team. Earlier this quarter, we announced that Rob Cascella, currently strategic business development leader and formally in charge of our Diagnosis & Treatment segment, stepped down from the executive committee effective from 1st April, this in relation to his planned retirement from the company by the end

of this year. Rob will continue to play a role in certain strategic business development projects on a part-time basis until the end of 2021.

We also announced that Shez Partovi joined Philips executive committee, effective from 22nd March, to succeed Jeroen Tas, as Chief Innovation and Strategy Officer, effective from 1st July. Shez brings deep healthcare and informatics experience to Philips, and most recently served as the global head of business development for healthcare, life sciences and medical devices at Amazon web services. In that role, he was responsible for the business go-to-market strategy, charting the path for customer cloud transformation and the adoption of artificial intelligence and machine learning. Jeroen Tas, who joined Philips in 2011 and became Chief Innovation Strategy Officer in 2017, has made a personal decision to assume a part-time position within Philips and will focus on the continuation of several strategic business development projects until the end of 2022.

I want to thank Jeroen and Rob very much for their very valuable contributions to the transformation of Philips. Jeroen played a very important role in inspiring and executing our innovation strategy for digital health and healthcare informatics, while Rob has successfully shaped our Diagnosis & Treatment segment over the last several years, including the addition of IGT devices to our portfolio.

To round off, let me reiterate that I'm pleased with the progress that we are making on our strategic and performance roadmap. Our journey to health technology and leadership continues, and we have a clear strategy to help transform care along the health continuum, combining smart systems, devices, informatics, data and services. And I am convinced that the growth and margin profile of Philips remains very well underpinned.

And with that, I'll turn the call to Abhijit.

Financial Outlook

Abhijit Bhattacharya

CFO, Royal Philips

Thank you, Frans and thank you all for joining us today. I hope you and your families are well and safe. Let me start by providing some colour on the first quarter comparable sales of 9%. I'd like to remind you that this comparable sales growth does not include the double-digit growth of our recently acquired companies, BioTelemetry and Capsule Technologies. Our Diagnosis & Treatment businesses comparable sales growth grew 9% in the quarter. Diagnostic Imaging sales grew double digit, driven by strong installations of computed tomography and magnetic resonance. Ultrasound and Enterprise Diagnostic Informatics sales grew high single digit. Image-Guided Therapy sales saw solid sequential improvement and grew mid-single digit in the quarter, mainly driven by strong traction of our devices business as we saw good return to growth at the end of the quarter, especially in the United States.

The volume of elective procedures gradually improved during the first quarter with March tracking above pre-COVID levels. We expect that elective procedures' volumes to continue to gradually increase in the course of the year as hospitals normalise their operation, and also work through the backlog of patients.

The sales of the Connected Care business grew 7% in the first quarter driven by double-digit growth in Patient Monitoring, as we continue to successfully convert the strong order book into sales. This was partly offset by mid-single-digit decline in sleep and respiratory care on the back of a strong Q1 last year, driven by COVID-19 demand. We were also pleased to see the recovery in our Emergency Care business with another quarter of double-digit growth. This business was formerly called Therapeutic Care.

For Personal Health, we saw strong demand in the quarter with a comparable sales increase of 17%. Personal Care grew strong double digit and Oral Healthcare comparable sales increased by mid-single digit. We saw solid sequential improvement in Personal Health in China with double-digit comparable sales growth in the quarter, driven by new product introductions across the portfolio and continued momentum in North America and Europe. Consumer sales through digital channels grew double digit in Q1 and represented 43% of total sales for Personal Health. Our shift to digital and the adoption of new business models of direct to consumer resonates very well. Important to note that our online market share is higher than in the traditional offline channels.

Moving on to orders, I'm pleased to share that the Diagnosis & Treatment business comparable order intake grew double digits in Q1, driven by strong double-digit growth in Image-Guided Therapy and solid performance in Diagnostic Imaging and Ultrasound. This is due to improving market conditions, as well as the strong competitive momentum of our innovative portfolio. As a result, we saw further increase of the order book in these businesses in the quarter.

Comparable order intake in Connected Care declined 27%, as anticipated, on the back of 80% growth in Q1 2020, driven by the spike in COVID-19 generated demand last year. While we continue to expect demand for ventilators and patient monitors to normalise during the course of 2021, activity levels are expected to remain higher than in 2019 in these businesses. Also important, we continue to experience positive, competitive momentum, notably of our innovative monitoring solutions.

Let me now turn to the profitability development in the first quarter. Adjusted EBITA for the group increased by 390 basis points to €362 million, which is 9.5% of sales. In Diagnosis & Treatment, our adjusted EBITA increased 230 basis points to 8.7% of sales. Connected Care delivered an adjusted EBITA margin of 12.8% of sales compared to 9.8% in the first quarter of 2020. In Personal Health adjusted EBITA was 14.3%, up from 7.3% last year. The improvement across our business segments was mainly driven by sales growth and results of our productivity programmes.

At the same time, we continue to execute on the planned higher investments in advertising in Personal Health. Adjusted EBITA for the group was also impacted by positive currency impacts of 40 basis points in the first quarter.

We continue to focus on driving productivity and are executing initiatives that will deliver cumulative net savings of €2 billion by 2025. These initiatives delivered €97 million savings in the first quarter. More specifically, €44 million through procurement programmes, €33 million supply chain productivity and €20 million overhead cost reduction. Restructuring acquisition-related and other charges include a €41 million gain due to the release of a contingent consideration liability related to EPD. Revisions to the financial forecast due to the

maturity of the technology resulted in a decrease in the fair value of the respective contingent consideration liability.

At the same time, we recognised an impairment loss of €55 million in amortisation of acquired intangible. The net impact, therefore, of the impairment is €14 million. The charges also include the €250 million provision related to the intended precautionary quality actions that Frans mentioned before. This amount is our best estimate at this point in time. Financial income and expenses were an expense of €6 million compared to €19 million in Q1 2020. This decrease is mainly due to the increase in value of our minority participations. Net income was in line with Q1 2020 with higher earnings and an increase in net income from discontinued operations, offset by the provision related to quality.

The adjusted diluted EPS from continuing operations doubled from €0.14 in Q1 2020 to €0.28 in Q1 2021. Free cash flow was an inflow of €169 million to a €15 million outflow in Q1 2020 due to strong working capital performance and lower capital expenditures.

Let me provide some guidance for certain areas of our business. In the segment Other, we continue to expect an adjusted EBITA loss of around €120 million, and an EBITA loss of around €240 million for the full year 2021. This includes €80-100 million of cost related to the separation of Domestic Appliances in 2021. For Q2, we expect a net cost of around €35 million at the adjusted EBITA level, and around €70 million at the EBITA level.

In line with our previous guidance, restructuring charges are expected to be 70 to 80 basis points. Acquisition-related costs are expected to be around 70 basis points in 2021. This is lower than our prior guidance of 100 basis points due to the positive one-off impact from the release of the contingent consideration liability for our EPD business that I explained earlier. We continue to expect one-time EUMDR and consent decree costs and related costs of around €40 million in the year.

Financial income and expenses are expected to be a net cost of around €140 million in 2021. This is lower than our prior guidance of €180 million, largely due to the increase in the value of our minority participation in the first quarter and assumes no one-off gains or losses in the rest of the year. Our midterm guidance of 24-26% effective tax rate, excluding incidentals, remains valid, while for 2021, we currently expect that to be around 22% due to one-off effects.

On the topic of share buybacks, I would like to remind you that our €1.5 billion programme for capital reduction purposes that was announced in January 2019 will be completed during the course of 2021.

To conclude, let me reiterate what we stated at the start of the year. Given the comparison base of 2020, we expect overall relative performance to be stronger in the first half of 2021, as has been confirmed by the Q1 performance. Further, as mentioned by Frans, we see an increased demand in the Diagnosis & Treatment and Personal Health businesses, and now plan to deliver low-to-mid single-digit comparable sales growth for the group in 2021, compared to the earlier plan of low single digit growth. We continue to expect a decline of Connected Care sales in the high single to low double-digit range as previously guided. We also expect an adjusted EBITA margin improvement of 60 to 80 basis points for the group.

With that, I'm happy to take your questions, along with Frans. Thank you.

Operator: Thank you, sir. If any participants would like to ask a question, please press the star followed by the one on your telephone. If you wish to cancel this request, please press the star followed by the two. Please limit yourself to one question with a maximum of one follow-up. This will give more people the opportunity to ask questions. If you're using speaker equipment today, please lift the handset before making your selection. There will be a short pause while participants register for questions.

The first question comes from Veronika Dubajova from Goldman Sachs. Please state your question.

Veronika Dubajova (Goldman Sachs): Hi, good morning Frans, Abhijit. And thanks for taking my questions. Two please, and both related to the guidance for the full year. First one is just on revenues and trying to parse out where that incremental confidence is coming from in terms of the low to mid-single-digit organic sales growth versus what you had guided for previously. Can you maybe talk through what are some of the moving parts where you've become incrementally more confident? Is it PA, is it D&T? Is it a specific region? Is it a specific business line? If you can just shed some light into that, that would be really helpful.

And then my second question, I appreciate you don't guide for EPS but obviously this year, there's quite a lot of moving parts. We have the dilution from Domestic Appliances, from the disposal. You have some contribution coming in from acquisitions. And just curious if you can level set for us, Abhijit, how we should think about EPS development in 2021. And I guess looking beyond 2021, if you can comment on some of your midterm expectations on EPS growth and how we should level set those off the new base, that would be very helpful. Thanks guys.

Frans van Houten: Yeah. Hi, Veronica. Great to hear you. And I sympathise with your question on EPS. Abhijit will try to answer it as best as we can, given the circumstances. But indeed, let me start on the revenue traction. So if I take you back to the Capital Markets Day guidance, right, wherever we said D&T and Personal Health should grow in the 5-6% bracket while Connected Care, given the difficult compare, will first have a year of a negative and then in 2022 also be in that frame. Okay? So that's the framing of it.

Now, obviously as we said in the call, Connected Care stays with the same guidance of approximately high single-digit, low double-digit decline year on year, which then implies that all the upside comes from Diagnosis & Treatment and Personal Health, both of which will grow ahead of the 5-6% range this year. You see strong order momentum in Diagnosis & Treatment, with the order growth of 11%. The 11% order growth in Q1 is driven across the world basically; China high single-digit, North America double-digit growth in orders. I think very pleasing and perhaps also a precursor of what can happen when COVID becomes more under control and Europe, a very solid around 6% order growth, right? So – and much driven by IGT, which of course was weak last year. Customers holding back on orders, also postponing shipments. And now that comes back with a vengeance as there's a backlog in patients, elective procedures are stacked up.

Now, that's then also maybe a nice bridge to talk about the consumables. We have seen a very nice uptick in the course of Q1, and you can really track how COVID gets under control. In the United States, March was very strong on elective procedures, and we, of course, compare not only to 2020, but also to 2019. And on the consumption of our catheters, we

are well ahead of 2019 on a run rate basis, right? And that bodes for a very nice growth step-up over 2019 in IGT devices, right?

So make a long story short, good start in Diagnosis & Treatment, strong order book, strong order intake. We are looking at momentum there in Q2. Of course, the second half of the year, the comparison already becomes a little bit more difficult, but still overall growth ahead of the 5-6% on revenue.

Then let me do a similar, albeit slightly shorter story around Personal Health. If we are honest – and, of course, 2020 was not a great year for Personal Health, even though the second half year was much stronger than the first half year. So we are having a very positive comparison year-on-year, 17% growth in Q1. We are also looking at a very strong growth in Q2, while the second half of the year will be much more moderated given the year-on-year comparison.

The driver of growth, from a geographical perspective, we see China double digit. We see Europe performing very strong, amazingly strong. North America in the high single digits. So, strengths across the globe as consumers rally to buy our new innovations in Oral Care, in Personal Care, in Beauty. So good traction there. As you know, that we have also stepped up A&P, advertising and promotion, because in a digital world that becomes more important. And at the same time, we have taken cost out of what is called other fixed selling expenses. So you could say we have changed the mix of Selex to drive more consumer preference. And we think that that is working and it bodes well for the future.

So I think that gives you colour on revenue. And maybe in the meantime, I can look to Abhijit for your EPS.

Abhijit Bhattacharya: Yeah. So, hi Veronika, if you look at last year, we estimate that DA had probably about €0.24 contribution to our EPS. If you look for this year with now our increased sales guidance, we will compensate most of that. Maybe about €0.17-0.18 of that will get compensated with the group growth of the company itself and the adjusted EBITA growth. Important to understand that we will have a lower share count. So we will complete the buyback this year, so that will also add to the EPS. And then, finally, I guided for a lower tax rate this year; that also contributes positively. So with this, we will actually be able to offset the dilution of EPS with last year. And then of course we have BioTel and Capsule, which are doing well and they will probably even result in slight incremental EPS this year for the group compared to last year.

So last year, if I include DA and this year, if I exclude DA, our EPS will still go up. And then if you, let's say, look forward, of course, that will go up in the range that we have guided for improved earnings, as well as slightly lower restructuring costs. So I think on a good trajectory there.

Frans van Houten: All right, did this answer your question, Veronica?

Veronika Dubajova: That was very helpful, thanks guys.

Operator: The next question comes from Hassan Al-Wakeel from Barclays. Please state your question.

Hassan Al-Wakeel (Barclays): Thank you. I have a couple, please. So, firstly, on the DreamStation 1, could you talk about some of the issues that have been reported by users

and whether any of these have been significant? And what does the current provision account for as it relates to the €3-4 million installed base? And whether you expect any short-term impact on sales because of these issues.

And then if I can ask a second question on the broader performance of the sleep business, where are diagnosis rates relative to pre-COVID levels, and do you think you're gaining share here? Thank you.

Frans van Houten: Yeah. Hi, good morning Hassan. The issue with the DreamStation 1 family and related products come out of our post-market surveillance, where we have picked up reports from users that lead us to do this warning. The occurrence rate is very, very low and in the last year, it got accelerated because of what we have discovered, the use of unauthorised detergents in cleaning the machine. In the US there's quite a lot of locations that have started to use Ozone to disinfect the machine. And in fact, that has an impact on the foam used in the machine which makes it degrade. Globally, we have seen some occurrence of that phenomena in high humidity, high temperature environments. As I said, the occurrence rate is very, very low, 0.03% of the top of my head. Nevertheless being responsible and proactive, we don't want to have this happen and we are going to repair the machines in the field, for which we have taken the provision.

Now, the installed base is very high given that Philips is the market leader in sleep apnoea CPAP devices. And there's several millions out there, a couple of millions out there, and that relates then to the magnitude of the provision. I hope that that scopes that a bit. It is early stage because we wanted to go out immediately and we are, also in parallel then, engaging the regulatory agencies with whom we have to detail out the field safety notice as is customary practice. I want to emphasise this is coming out of our own post-market surveillance actions.

Now then, you ask, does it have impact on sales? The good thing is that we have launched DreamStation 2. That product is also already authorised in the United States, and is of a different design and is not affected by this component. Other countries, that product is not yet authorised and therefore we were still manufacturing and shipping the Dream series 1. We have, out of precautionary measures, put a temporary stop to the production of those units. Therefore, in relation to your question, can it impact sales on the short term? Yes, it can on a limited basis, because in the United States, which is our biggest market and the majority of the demand, we have the Dream series 2 to ship. We are planning to outsource most of the field action to show that we can do it fast and the collaborate third-party capacity, thereby avoiding hindrance to our own manufacturing line.

Then on your related question, how is the sleep market developing? We still see relatively low levels of sleep lab visits. So consumers are not yet back to sleep labs and therefore the new diagnosis is still at a lower level than what it used to be. It's about 80% of pre-COVID times. We expect this to go up later in the year, as normality in life resumes, especially in those countries where vaccination degrees are high.

Then, finally, I want to assure everybody on the call is that we will compensate for the slowness in the sleep and respiratory care business. We still see good demand for a hospital respiration and oxygen concentrators and across Connected Care, we also see strong traction on Patient Monitoring. So, this is also why we kept the guidance on Connected Care the same

as we flagged to you before; i.e. high single-digit to low double-digit decline year on year, given the peak of last year.

Let me pause there Hassan and see whether I've captured your questions.

Hassan Al-Wakeel: Yeah, you have, that's very helpful. Thank you.

Frans van Houten: You're welcome.

Operator: The next question comes from Patrick Wood from Bank of America. Please state your question.

Patrick Wood (Bank of America): Morning, thank you very much. I'll just ask my two upfront if I can. The first, I think you gave a little bit of colour, but a little bit more would be great, was within Connected Care and the Patient Monitoring business. Just giving us a sense of how much traction we're starting to see in the general ward, and so outside of the ICU. Obviously, that's a long-term driver there but I'm just curious as to what you're seeing and how the outlook is looking.

And then as the second question, thank you Frans, you touched on this earlier. IGT devices, obviously good data out of the ILLUMINATE trial, but more short term, I'm just curious, if the devices were up double digit in Q1, the hardware must've been pretty weak still. Can you help us understand why we've seen such a dramatic acceleration in the core Diagnostic Imaging business, but then on the more procedure-focused side of things, it seems the recovery curve has been quite a bit slower, albeit it sounds like the order book's going better. But just help us understand why one has just leapfrogged so fast versus the other one, that that'd be really helpful. Thank you.

Frans van Houten: Yeah, absolutely. Let me start with Connected Care and Patient Monitoring. Yes, we see patient monitoring coming more and more outside of the ICU. And let me just also explain that most COVID wards in the hospitals are not ICU wards, right? So many patients that have moderate COVID never make it into, let's say, the proper ICU and are in COVID wards; COVID wards that we have equipped with monitoring as well as with ventilators. We also see a general trend towards remote supervision, using command centre technology, where you can overlook – or your central stations, if you like, where you can overlook cohorts of patients with a higher patient-to-staff ratio.

Finally, we're seeing hospitals standardise on an enterprise level to one vendor as it integrates with their informatics network. And there's a general feeling that hospital informatics are too fragmented, too much patchwork, and standardisation is the name of the game. And finally, hospitals and providers are gearing up for the out-of-hospital monitoring and want to leverage a uniform, strong architecture across their enterprise. This plays very much into our hands because we are a market leader and we are then often the party on which hospitals are standardising. And that's strengthened by our innovations in command centres and eICU. And now with the extension with Capsule, being able to integrate data from other sources, and BioTelemetry expanding monitoring outside of the hospital, the portfolio becomes pretty comprehensive for such an enterprise play.

So I think it bodes well for the future and I would express my expectation that monitoring at large is going to grow at a higher pace versus 2019, structurally.

Yeah, then your IGT question, I mentioned that the – sorry, Patrick, I mentioned that the electives are up, but that is a phenomenon late in the quarter, right? So January, we were still behind 2019. February, we started to become breakeven on 2019. And then in March, we soared ahead, right? That also means that IGT devices as such is not yet showing this massive impact on the revenue cycle of Q1, but it's rather good news for Q2 and beyond. That then also suggests that the revenue in Q1 was in fact supported by IGT systems installations, and the order intake in the quarter was also very much driven by IGT systems.

Patrick Wood: Very clear. Thanks guys.

Operator: The next question comes from Michael Jungling from Morgan Stanley. Please state your question.

Michael Jungling (Morgan Stanley): Thank you. And good morning, I have two questions. Firstly, when it comes to the 2021 guidance upgrade, if you had a further chance to raise organic sales growth because of, let's call it pent-up demand, would you consider in the next round some upside to the EBIT margin, which currently seems to be set in stone at around 60 to 80 basis points?

And then question number two is on the DreamStation 1 provision. Can you comment on what will physically happen on the ground? Do all sleep apnoea machines have to be returned to Philips for repair and/or inspection? What happens is patients need the sleep apnoea machine? Will you provide a replacement?

And thirdly, if we look at the provision, it's around €71 for the 3.5 million machines, or if the incident rate is 0.03%, it's 1,050 machines with the provision of 238,000. So it's a wide range. Which one is it? How are you providing for this? Can you give more colour on what the math is behind this? Thank you.

Frans van Houten: Right. Well, Michael, your first question is, of course, very hypothetical, that if we were to further increase guidance, what would we do? So, with your permission, I'm not going to speculate on that. The reason why we keep the guidance the 60-80 basis points at this time is that we do see some higher freight cost, we see a tight semiconductor market. So the intake costs, we want to be a bit careful there. We don't want to get ahead of our skis here on margin. And for now, we see this as very good underpinning and also potentially with these few mix effects. You'll recall, of course, that last year Patient Monitoring had a very strong impact on the mix, it is very profitable product. And if you now have a slightly different mix, then that has an influence.

So we just want to be cautious on not getting ahead of ourselves on margin.

Then on your further inquiry on the DreamStation, so, indeed, occurrence rate very low. However, the intended precautionary measures will expand to the entire base of the DreamStation 1 related family whether or not symptoms are there. Now, that's the cautionary approach that we take. If the discussion with regulators lead us to a different conclusion, then that can change. But at this time, we think that this is the most – the best course of action. We have calculated this on the basis of an expected time of intervention in the field per unit, times the amount of units, and leveraging, as I said before, also our DMEs and others.

I want to assure everybody on the call that the device is safe to be continued to use to the best of our knowledge at this time. Of course, this will also be discussed with the regulator, but our own expectation is that users can continue to use it. And then, as we repair the units, they either get a replacement unit or they get their own unit back, that still needs to be determined. So I don't want to be completely precise about that.

Michael, does that answer your question?

Michael Jungling: It does a bit, maybe a brief follow-up. You mentioned that people are using Ozone, which is against the FDA regulations or against your user manual. Why is it your problem then if someone wants to use a cleaning agent that is not even permitted? Why are you taking responsibility for that in those provisions?

Frans van Houten: Well, patient safety is always our concern and we have - be very clear to say, first comes the patient. We don't want to debate culpability at this time or who's done it because that doesn't help the patient. And so if there is something to be said about what is the root cause and why did people choose a certain way of cleaning the device, that can be an endless debate. At this time, that should not be the debate. We should just deal with the issue. And then later on, we can sort out better how this cleaning came about.

I mean, if we look around the world, then there's use of Ozone is typically a US issue. And then within the US it is related to certain regions where certain companies have been very active in marketing that message. But that's all, let's say, 20/20 hindsight. The FDA observed this and also put out a safety notice to say, don't use ozone for CPAP machines. Nevertheless, we cannot control that. But we don't want to focus on culpability questions. Our prime concern is let's take this small risk out of the market and deal with it proactively.

Michael Jungling: Great. Thank you. Very clear. Thank you.

Operator: The next question comes from Lisa Clive from Bernstein. Please state your question.

Lisa Clive (Bernstein): Hi, thanks very much. Just two questions on Patient Monitoring. So, first of all, you discussed a little bit the potential to move into the general ward. Number one, what is the technology limitation here? Is it the reliability of wireless sensors and I guess, are sensors - are wireless sensors good enough to be accurate enough, have connectivity that's very consistent, etc.? Or are we still a little bit early in that stage?

Number two, as those wireless sensors get better, then that opens up the home market. But a question more on the pricing model in the home because, obviously, the actual hardware would come into competition potentially with all sorts of gadgets from the likes of Apple, Fitbit, etc. So, if we think about how - the value across your patient monitoring business, what proportion today is the hardware itself versus the software and the broader connectivity? And as this market develops, so there's actually more in the home, how will that look? Thanks.

Frans van Houten: Yeah. Hi, Lisa. Great questions. On your first one with regards to adoption, I would actually say that technology is not a limitation at all, right? This is all about hospitals having to change their ways of working. If you put monitoring in a general ward where then you also need to organise for somebody to oversee the central station, where you can look at a whole cohort of patients, patients that are using a wireless device, they can

wander around. So that also means do you want to track where the patient is or not? Technically all of that is possible, we have solutions for that, but actually hospitals can only adopt this once they change their ways of working.

Now, I mentioned earlier that COVID has been an accelerator for the use of monitoring in general wards or COVID wards. As hospitals were struggling with a shortage of staff, then having monitors aided by a central station could actually help take care of more patients with less staff, right? So I think providers have gotten a good insight and boost of how changing ways of working is actually a good thing for patients and for productivity. So no technological limitations. We have everything available.

Similarly with the home, technology is there. I would not jump straight to consumer devices, as you mentioned. Actually, the data coming out of those devices is causing doctors to despair because they get a lot of people coming in, 'Look at my data,' kind of thing. Which then bridges already to, what is your operating model behind the technology so that you can actually handle large cohorts of patients with data coming in, whereby AI in the cloud stratifies the patients as to who needs what and why, and directed to the responsible in the care team that is appropriate to the severity of an incident, right? Because this is a whole new world of how do you organise care.

And that may be is then the final bridge to hardware, software and services ratio, because the services will play an increasing role in handling remote patient monitoring, whereby the device becomes a smaller proportion of the value and the software and the services become the bigger proportion of the value.

I'm over-asked to give you a number in this call, unless my friends here at the table can help me out quickly. But I don't want to guesstimate the number that I... We take that separately, Lisa, and then in future call, we will be able to share that with the whole community.

Lisa Clive: Okay, thanks. And then one just very quick follow-up question. I think I read somewhere recently that the FDA is thinking about trying to regulate these consumer health-related devices. Are you aware of what they're thinking here? And I guess, obviously, the likes of Apple and Google, etc., have enough money that if they want to get involved in medical devices, they certainly can hire the regulatory people to do so. But what do you think are the barriers to entry for big players like that coming into the monitoring market?

Frans van Houten: Well, I mean, these devices are already regulated, right? If you put the heart rate risen monitor in a watch, then that's already a class II device, so that is regulated. From my story, you also heard that people are worried about what happens with the data, how does it disrupt the healthcare market, who can have access to the data? How safe is it? So it's a new world out there that indeed deserves to be further scrutinised from a regulatory perspective. Also, interoperability is a big factor. And what are patients taking away from the data, because it worries them unnecessarily sometimes. And also, that is something the FDA is concerned about, right? So I would say this is not used as a technological barrier. It's much more the overall ecosystem that needs to be looked at.

Lisa Clive: Great. Thanks very much for that.

Operator: The next question comes from David Adlington from JP Morgan. Please state your question.

David Adlington (JP Morgan): Hey guys, thanks for the questions. So two please, just to follow up on the field repairs, the €2.15 billion provision, is that provision purely for the field repairs or is there some mitigation cooked into that? And just to make sure, has there been any litigation started or any patients injured?

And secondly quite good start on the free cash flow front. Abhijit, just wondered if you have any thoughts in terms of free cash flow for the year, please.

Frans van Houten: Sure. David, let me say that the amount is related to the field action. I've already flagged that any slowness in the business near-term is absorbed within the business and compensated elsewhere, and therefore not expected to further impact. This is very early stage so we are acting on the fact that we've got a few reports out of the field, out of our post-market surveillance and our own test. We are taking proactive action here even though the earlier question around Ozone and that's not us, that's somebody else, doesn't matter, we are taking proactive action. There are no litigations here at this time. Moreover, I can say that we have not seen reports of severe user harm, right? We have seen some reports of irritation, but not severe patient harm. And, moreover, it's still, to our knowledge, safe to use the machines while we are going about preparing and executing on this field action.

Then maybe Abhijit...

Abhijit Bhattacharya: Yeah, on the cash flow, yeah, I think it's a good start to the year. Like I mentioned, our working capital management has been better. Overdue receivables have come down quite substantially, so that's, let's say, good operating. With that, our net income or our profit increase for the year was also good. We were helped a little bit also by the calendars. So that will be a bit lower in Q2, but I think overall for the year, we are in line with what we had guided for. It will be a tad lower depending on how much is the cash out for the repair actions that we have to take on the DreamStation issue, but for the rest I think we are glad with the way we have started the year.

David Adlington: Great. Thanks guys.

Abhijit Bhattacharya: Thanks, David.

Operator: Next question comes from Scott Bardo from Berenberg. Please state your question.

Scott Bardo (Berenberg): Yeah, thanks very much for taking the questions. Two please, the first one just on the field action and provision again. I just wondered Frans if you kindly confirm that the issues detected were not informed by any FDA inspection, warning letter or 483 form. And furthermore, is it your working assumption that those sorts of warnings or observations that manufacturing plants will not unfold as a result of this?

The second question, please, just relates to Oral Care. And I know that you had a mid-single-digit growth this quarter. I would have thought that that business would have performed better given that the rest of the business has been rebounding. The comp was, I think, high single-digit negative last year, and you're in quite a meaningful product launch cycle. So I wonder if you can confirm is there any softness in the end market demand or anything we should be aware of for that particular business. Thanks.

Frans van Houten: Yeah. Hi Scott. I can confirm that the field action originate out of the user reports and tests that we did ourselves and that there is no regulatory origin in that. The Pittsburgh or Marysville, that Maryville's close to Pittsburgh, is where the business unit is and the factory is, has a good record with regards to prior inspections. And other than that, I cannot anticipate what will be future discussions. But I feel that we are taking appropriate proactive action fully in line with our quality management system.

And Abhijit will answer the second question.

Abhijit Bhattacharya: Yeah, I think overall, Oral Healthcare demand was good. China recovery, as we had said last time for Oral Healthcare, will start from Q2. So, actually we're gearing up for a much stronger Q2 in Oral Healthcare, but for the rest of the world, it was strong. So it was more that China recovery and the launches in China have taken place at the end of Q1, so from Q2 onwards, you see a better momentum, Scott.

Scott Bardo: That's very helpful. Thanks. And if I can, just one quick non-related follow-up, also for Abhijit please. And again, congratulations on the disposal of Domestic Appliances. I think previously, Abhijit, you'd highlighted an expectation of some ongoing royalties as a result of this separation. Now that you've concluded the deal, can you just highlight how those royalties will flow through, what sort of magnitude one should expect? Thank you.

Abhijit Bhattacharya: Typically we cannot disclose separate royalty agreements with each of our partners. So, but I think the way you should look at it is for this year, we will compensate for the standard cost. And then from next year, it will be a bit of an add-on, but it's part of the overall guidance. So I think that's how you should look at it for now.

Scott Bardo: Okay. Thanks very much, indeed.

Operator: The next question comes from Julian Dormois from Exane BNP Paribas. Please state your question.

Julian Dormois (Exane BNP Paribas): Good morning Frans, good morning Abhijit, thanks for squeezing me in. I'm left with two questions. The first one relates to the order book which was at 11% in D&T overall. You mentioned strong double-digit growth in IGT. So I was just wondering whether you could shed more light on the actual growth in your order intake for imaging specifically. And that's obviously in the context of maybe some slowdown that we saw in CAPEX spending from listed hospital groups in the US and also all the discussions around stimulus money for Europe. So just curious to get more colour on that side, please.

And the second question, it relates to M&A once you get the cash for DA, the leverage will be back to a relatively low level. So how should we think about your appetite for more deals in the short term, or are you happy first in the next few months to digest the recent acquisitions and the divestment from the DA?

Frans van Houten: Yeah, hi Julian. Let me unpack a bit the Diagnosis & Treatment order book. Of course, last year we already saw strong traction on Computer Tomography in Diagnostic Imaging. Right? So the compare for precision diagnosis is a bit tougher than the compare for IGT. Okay? So, the 11% is strong double digit for IGT, driven by, first of all, North America, then Europe and China, more or less, ex equal, also with mid-single-digit growth. And then precision diagnosis, given that last year, we saw a lot of Computer

Tomography orders, this year, the mid-to-high single-digit order growth in PD is driven, first of all, by China, then by basically Europe and other markets. Notably North America is still quite modest on precision diagnosis, also because last year we saw there's quite some good performance.

Then, yeah, Abhijit just gives me two data points that order growth last year on CT and general x-ray was over 30%. So that just gives it a little bit of colour on that difficult compare with only MRI being softer last year. And now if you look at the mix, MRI is actually the star, together with cardiovascular ultrasound again, which is very logical because with the resumption of elective procedures, the interest to spend money on cardiovascular equipment is back, which is also a positive.

So I think that explains the nature of the order book. So I'm happy to see the China is really performing well. With all the discussions, of course, always about local competition, Philips is holding its ground very well.

Then, the DA cash, yeah, let me not go over that. Look, you could, of course, argue that much of the cash we have just spent on BioTelemetry and Capsule -but you kindly reminded us about the balance sheet and the state of it, which will be great. Let's just say that it puts us in a comfortable position with the ability to do a further bolt-on. We don't have to, because Abhijit went to great lengths to discuss our organic growth opportunity. Our normal guidance for next year, 5-6% across the board in all segments. Moreover, on top of that, you get the contribution of BioTelemetry and Capsule, which are both growing above the average of Philips, so that's also good news. We are not in a hurry to spend our cash. We are quite comfortable to keep the balance sheet then for a while with leverage in the guided range.

Julian Dormois: Thank you very much.

Frans van Houten: You're welcome.

Operator: Next question comes from Falko Friedrichs from Deutsche bank. Please state your question.

Falko Friedrichs (Deutsche Bank): Thank you very much. Two quick questions, please. Firstly, on this ongoing semiconductor supply shortage, could you share some colour on how this could impact your business throughout the year, and to what extent that is baked into the guidance you gave us today?

And then secondly, out of interest, with regard to Connected Care, what are you still seeing in terms of demand for hospital ventilators? Especially in light of the rising hospital admissions, again, in several countries across the world.

Frans van Houten: Yeah. Hi Falko. The semiconductor market is certainly a concern to us. We have near-term demand well organised, yet we are seeing, of course, an increase of revenue. Therefore, we are increasing our own plans and put more requirements on the semi industry in terms of supplies. So far, we have been able to handle that well with the exception of the fibrillation, where we saw already some tightness in Q1 and in Q2. Other than that, for now, we are navigating this scarcity situation and we hope that we can continue to do that. We are not baking in big constraints going forward.

Then on the vent demand, of course last year we had the peak. We're still seeing pockets of demand across the world and we are doing whatever we can to help with those critical care

requirements. For example, in India, where we have been able to alleviate some of the most pressing needs, both for ventilators as well as for oxygen concentrators, where even with Abhijit's personal intervention, several flights out of the US with cargo, take over 10,000 concentrators into India to help remediate the most pressing shortages over there.

Nevertheless, if you add it all up then, all hospital ventilation this year is much lower than last year. And that's just maths; cannot be avoided.

For monitors, you heard us with a much more positive story because we expect demand for monitoring to go wider and even outside of the home. And therefore it's much more a trend, whereas ventilation was more of a one-time peak.

Falko Friedrichs: Okay. Thank you.

Frans van Houten: You're welcome.

Operator: The next question comes from Sezgi Oezener from HSBC. Please state your question.

Sezgi Oezener (HSBC): Hi. Thanks very much for taking my questions and thanks for all the information. Just one question. Given that most of the productivity savings programmes have delivered a lot of results since 2017 and given the tightness in the market, not only semi-conductor market but also a lot of the supplier types you've seen recently, how much further scope do you see for further productivity gains within 2021 and beyond?

Frans van Houten: Yeah. Sezgi, let me first welcome you to this call. Great to have you as an analyst for HSBC following Philips, so I really appreciate that. Abhijit, this first question, something for you.

Abhijit Bhattacharya: Yeah, I think we guided for €2 billion 2024 – 2025, sorry. So at this stage we continue to track to that programme. Typically we have done a little bit more, but I think that is par for the course over the next five years. But at this point in time, we report on net productivity, right? So, therefore, whatever price increases come, we have to offset that. So, we will not increase that guidance, but we constantly work to look at bigger opportunities to compensate for newer headwinds that come up, like the ones you mentioned. But right now we want to deliver on the €2 billion programme that we had set out last year.

Sezgi Oezener: All right. And just as a small follow-up, can you comment or, like, guide about the increased R&D expenses that we've seen this quarter? I mean, should we assume a correction in the rest of the year and what kind of trajectory?

Abhijit Bhattacharya: I think the R&D increase in the quarter may have to do with the impairment that we have taken. So, let us come back to you. There is no significant increase in the overall R&D spend for the year, so maybe I will give you the adjusted number for the restructuring, and then we should be okay. We are on a good trajectory there.

Sezgi Oezener: All right. Thanks very much.

Operator: The next question comes from Daniel Wendorff from Commerzbank. Please state your question.

Daniel Wendorff (Commerzbank): Yes, good morning. And thanks for taking my questions. The first one is a follow-up really on Diagnostic Imaging. How would you see the underlying market develop there, including the Corona related effect, the positives you

highlighted from last year and also this year? So, the underlying market development would be of interest to me.

And then a more big-picture question. If you look at your product offering now, inpatient monitoring, outpatient, inpatient, including all the related products you have on offer there, how do you see the competitive environment develop? I would assume that this is rather limited in most important regions in the world. Any more colour you could provide would be helpful. Thank you.

Frans van Houten: Yeah. Hi, Daniel, Diagnostic Imaging market globally we would classify as low-to-mid single digit with more strengths in China, and low single digit in mature markets like US and Europe. Installed base is pretty old so there is a need for renewal. Regardless actually of the CAPEX situations, hospitals has been postponing this for a while and there's real need to make step-ups. China's strengths relate also to government interventions towards diagnostic centres. With the influx of monetary support in the Biden administration and in Europe towards hospitals, we can actually expect some acceleration in the DI market space with more room for CAPEX than maybe was previously assumed. So I see a slight positive trend emerging, even though on the question of – I think it was Julian, to give more colour on the order of book, I think I said that on Diagnostic Imaging, the US was still the lowest of all the regions. But I see a general trend that is moving in a positive direction.

And we'll see, we'll certainly update you again in Q2 and July if that trend is continuing. For now, as you know, we have updated our growth guidance for Philips and much of that is also driven by Diagnosis & Treatment and therefore by DI also.

Yeah, on the Patient Monitoring offering, we pride ourselves in being the market leader and having also the widest approach, and a platform approach, whereby we think it's all about the data and processing the data and turning that into actionable insights, as opposed to just offering a box. And I think we have taken some distance from competition in that context. I don't claim that we are the only one, but the more complex these systems become, in fact, the better it is for us, right? So we take a solutions approach to monitoring. We've also started to offer monitoring as a service, thereby moving away from a discreet CAPEX and call-for-tender situation towards a more continuous upgrading approach to hospitals. Time will tell how fast that goes, but the initial reception is very positive.

Operator: Due to time, the last question is a follow-up from Michael Jungling from Morgan Stanley. Please state your question.

Michael Jungling: Thank you for this. I have a question on Ultrasound. If there was a sizable Ultrasound business up for sale, would you be interested to further expand your market-leading business and does your current market share actually allow this? Thank you.

Frans van Houten: I love hypothetical questions, Michael. As you know, our strengths foremost is in cardiovascular ultrasound and there we are number one. In other areas, such as general or point-of-care ultrasound, we are much lower. So if opportunities would arise, potentially we would look at it but we do have to worry around antitrust approvals. So it would not be a slam dunk.

Michael Jungling: Okay, great. Thank you.

Frans van Houten: You're welcome. All right, back to you Leandro.

Leandro Mazzoni: Well, thank you. I think that concludes the call. That was the last question.

Frans van Houten: Okay. Well, I appreciate it very much everybody dealing in. We are slated for a good future, with increasing momentum makes us very happy, and we will keep you posted as we go. Thanks.

Operator: This concludes the Royal Philips First Quarter 2021 Results Conference Call on Monday, 26th April 2021. Thank you for participating. You may now disconnect.

[END OF TRANSCRIPT]