

PHILIPS

Royal Philips First Quarter 2022 Results

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Introduction

Leandro Mazzone

Head of Investor Relations, Royal Philips

Hi everyone. Welcome to the Philips First Quarter 2022 Results Call. Our CEO, Frans van Houten, and our CFO, Abhijit Bhattacharya, will take you through our strategic and financial highlights for the period, and, after that, we will take your questions.

Our press release, the slide deck, as well as frequently asked questions on the Respiroics recall were published at 07.00 am CET this morning on our Investor Relations website. The full transcript of this call will also be made available today on the website. 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.

With that, I'll turn the call to Frans.

Business Overview

Frans van Houten

CEO, Royal Philips

Yeah. Thanks, Leandro, and thanks everyone for joining us this morning. There are three factors shaping our Q1 results and outlook today. Number one, it's the continued strong delivery of our strategy and operational performance, leading to an increased order book despite the very challenging backdrop. Two are obviously the shortages and dislocation in the supply chain, geopolitical challenges and increasing inflationary environment. And three, the huge undertaking in Philips Respiroics to do everything to deliver a solution to patients and caregivers affected as fast as we can. Patient wellbeing remains at the heart of everything that we do at Philips.

Now, let me unpack these three factors. Our strategy and portfolio continue to resonate very well with customers and consumers, and we, again, experienced solid demand for our products and solutions. Order intake grew 5% in the quarter for the Group, or 8% excluding the Sleep and Respiratory Care business, driven by strength across the Diagnosis and Treatment businesses, Hospital Patient Monitoring and Connected Care Informatics to just name a few. This further builds on the good order intake growth in recent quarters, resulting in an all-time high equipment order book for Philips – in fact, more than 30% higher than a year ago – as shown on page 27 of our presentation.

During the first quarter, we also signed 12 more long-term strategic partnerships across the world, demonstrating the trust hospital leaders have in our ability to help them enhance health outcomes, lower the cost of care, improve patient and staff experience. Also, in China we signed an agreement with Shanghai East Hospital to provide its hospitals in the Shangdong and Hainan provinces with a broad range of image – advanced imaging and critical care solutions.

Thanks to the hard work of our people, we recorded sales of €3.9 billion in the quarter in these challenging circumstances, with a 4% comparable sales decline, which exceeded our prior guidance of a high single-digit decline. Adjusted EBITA was 6.2% of sales.

I am also pleased with the 8% comparable sales growth for our Personal Health businesses, which demonstrates strong consumer demand for our propositions in this segment. We continue to face severe supply chain disruptions across our businesses, primarily related to the shortage of electronic components, increased shipping times and now, again, COVID affecting suppliers. We expect these headwinds to continue in the coming quarters. But we are taking decisive actions, with daily management to mitigate the impact.

We had already expanded the long-term orders with our suppliers and increased spot buying. Our R&D teams are adjusting product designs to diversify sourcing of components. Moreover, we are calling on suppliers and governments at senior levels to prioritise healthcare products in the supply of components. While we see some positive effects of these actions, visibility on component availability remains poor due to lack of visibility from suppliers, which makes difficult to forecast accurately.

We are concerned about the lockdowns in China, which pose additional uncertainty on the outlook for the year, both in terms of domestic sales as well as for the global supply chain. The Russia-Ukraine war, which we strongly condemn, has, so far, a small negative effect on our overall revenues for the year, and we've continued to monitor the situation closely. The current macroeconomic, geopolitical and supply chain environment also leads to mounting inflationary pressure, so we are implementing price increases and taking additional cost measures to mitigate these headwinds.

Now, let me speak about the Respiroics recall. As I said, we are deeply committed to supporting the community of patients who rely on our Sleep and Respiratory Care solutions, and the physicians and customers who are dedicated to meeting patient needs. The repair and replacement programme is underway globally and we have produced more than 2.2 million repair kits and replacement devices to date. We have increased our weekly production output more than threefold over recent months and are accelerating further despite the global supply chain challenges.

We recorded a €65 million increase in the field action provision in the quarter, which is mainly related to a higher expected volume of devices eligible for remediation and higher communication cost. Since there have been increases over the last two quarters, it is important to explain how the device registration process works. For most markets outside of the United States, the equipment is owned by our customers, the durable medical equipment providers, and hence we have fairly accurate view of the quantities to be remediated in their installed base.

In the United States, after an initial rental period, ownership of CPAP devices transfers to the patient. As a result, unless the patient registers the units it's very challenging to make an accurate estimation. It is for this reason that we have used a regression model, which looks at the existing pattern of weekly patient registrations to project the total number of units that will likely need to be remediated.

As you can see from the chart on page 33 of our presentation, around mid-February, when there was extensive communication around the recall, there was an increase in the number of

daily registrations, which has subsequently reduced. This increase of registrations led us to revise the US regression model, based on which we now anticipate an additional 300,000 units which will need to be remediated. Given the increased number of devices, we now expect to complete over 90% of the production and shipment to customers in 2022. Additionally, a further €100 million provision was recorded for potentially higher cost of execution, such as inflationary pressures, and to ensure the speed of the programme in a volatile environment as we strive to get a solution to patients as fast as possible.

I would like to reiterate that we have a strong programme management in place to ensure the field action is executed with speed. As I explained last time, we have a strong team working under the leadership of Roy Jakobs. We have strengthened management responsibility and oversight, with organisational changes made in the Sleep and Respiratory Care as well as in the Quality and Regulatory Affairs teams throughout 2021. These teams are laser-focused on resolving these legacy issues, whilst ensuring airtight procedures are in place for the future. We have also bolstered staffing and expertise around post-market surveillance, medical affairs, biocompatibility and toxicology within Philips.

As you know, Philips Respironics is a defendant in several class action lawsuits and individual personal injury claims. As the litigation is still in its early stages, it is too early to draw any conclusions on the ultimate outcomes. Ultimately, the science will be very important and, as you know, we are conducting a comprehensive test programme to characterise the potential risks associated with the use of the devices. We plan to provide an update on testing in the second quarter. We also reference the Canadian study, which should be reassuring for patients as it does not show any correlation between the occurrence of cancer and the use of Respironics devices, based on an epidemiological study amongst almost 7,000 users.

Building on the foundation of work already done and the material quality improvements already made over recent years, we are using this pivotal moment to reinforce the focus on patient safety across the company and to cross-check learnings from the sleep recall, where relevant, across the enterprise. We have also further stepped up scrutiny and have re-looked at past severe incidents and are reviewing all products and complaints, which has not led to the discovery of additional significant quality issues over the ones already announced earlier.

Last quarter, I mentioned that we recorded the provision in relation to two voluntary recalls in smaller business lines in the Connected Care portfolio with a well-defined scope. Both field actions are under execution in alignment with customers and regulators globally since earlier in the year.

Importantly, we continue to engage and work closely with regulators globally, including the FDA, to clarify and follow up on the inspectional findings and requests in the Form 483. Philips Respironics and certain Philips subsidiaries in the United States recently received a subpoena from the US Department of Justice to provide information related to the events leading to the Respironics recall. Receiving a request for information under these circumstances is not out of the ordinary. At this time, the subpoena is a request for information, focused on Philips Respironics, to support their investigation and we are not aware of any specific allegations. Respironics and other US subsidiaries are fully cooperating. At this point in time, there's no further information on this subject.

As Leandro mentioned, we have published Frequently Asked Questions, FAQs, on the recall to provide details and clarification on the progress. You will also find information on the topic on our presentation and the Investor Relations website. There are some areas, particularly related to litigation, where we are not able to provide further details at this time. We will share information in a transparent and timely manner as the situation evolves.

Now I would like to provide some colour on how we are supporting the needs of today's hospital leaders across the globe as they plan for the future. In the first quarter, we expanded our leading ultrasound portfolio with advanced haemodynamic measurement capabilities on our handheld ultrasound, Lumify, enabling clinicians to quantify blood flow in a wide range of point of care applications, including cardiology, obstetrics and gynaecology.

During the first quarter, we enjoyed strong growth in our Enterprise Diagnostic Informatics portfolio. Next to winning several customers for our enterprise imaging suite of solutions, we also entered into several partnerships with healthcare providers, among which in the UK and Germany, to deliver our vendor-neutral Radiology Operations Command Centre, which enables remote collaboration between technologists, radiologists and imaging operation teams across multiple sites, thereby helping to increase productivity and expand access to, for example, MR and CT-based diagnosis.

Our MR business delivered strong double-digit order intake growth once again in the quarter and continued to deliver market share gains. In fact, our team installed more than 500 helium-free Ingenia Ambition MRI systems to date, highlighting the success of our unique portfolio.

In image-guided therapy, we are successfully expanding into interventional oncology with the installation of our lung cancer diagnosis and treatment solution, called Lung Suite, in Belgium, France, Israel and in the UK. Based on Philips Azurion, this solution enhances the accuracy of biopsy procedures and provides a therapy option to immediately treat early-stage lung cancer patients. We continue to see strong traction for our image-guided therapy suite of solutions, which delivers interventional procedures, speed and efficacy.

We see strong growth of our portfolio of smart devices. For example, OmniWire, which is the world's first solid core pressure wire, which combines a workhorse design with iFR proven outcomes and iFR co-registration compatibility, making it easy to use physiology throughout the case. OmniWire is a game-changer and we see 20% to 30% uplift in our sales volumes in accounts that are already adopting this innovation.

In Personal Health we continue to invest in new products and completed the global introduction of the new Philips Shaver S9000 with SkinIQ, which is driving accelerated sales growth for the category. Moreover, our Oral Healthcare business recorded strong double-digit growth in the quarter, with very strong performance in North America and China. This is the result of the successful refresh of our entry-range and premium-range electric toothbrushes, as well as the recent launch of innovative interdental cleaning devices.

To round off, looking ahead the strong customer demand and order book, coupled with our first quarter sales performance, support our range of 3% to 5% comparable sales growth and 40 to 90 basis points adjusted EBITA margin improvement for the year, as provided in January. At the same time, it is important that we recognise the increasing risks related to the COVID-19 situation, the Russia-Ukraine war, supply chain challenges and the inflationary

pressures, which may, potentially, impact our ability to convert our strong order book to sales and achieve our margin target, if conditions deteriorate further.

Our teams, however, are fully focused on everyday execution, delivering on the customer demand and strong order book, and are addressing the supply chain risks. Moreover, we are implementing additional cost measures, as well as price increases, to mitigate the inflationary headwinds. We will, of course, provide further colour or updates, as appropriate, as the year progresses.

Our journey to leadership in health technology continues and I remain confident about our potential to grow and create value. Our customers tell us we are very relevant to them and that we have a stronger-than-ever portfolio. We are fully focused on execution and operational excellence to manage the near-term headwinds that we are facing, and to unlock higher growth and margin in the medium term. As I mentioned before, we plan to provide more colour on our medium-term performance roadmap in the summer.

Over to you, Abhijit.

Financial Performance

Abhijit Bhattacharya

CFO, Royal Philips

Thank you, Frans, and good morning everyone. Let me provide some colour on the comparable order intake growth.

The Diagnosis and Treatment order intake grew 7% in the quarter, driven by strong double-digit growth in magnetic resonance imaging and image-guided therapy, as well as a strong performance in ultrasound and Enterprise Diagnostic Imaging – Informatics.

Connected Care order intake was in line with the first quarter of 2021, with strong growth in hospital patient monitoring and Connected Care Informatics. This was offset by a steep decline in Sleep and Respiratory Care on the back of the spike in COVID-19-generated demand in Q1 2021. Excluding Sleep and Respiratory Care, Connected Care order intake grew by 9%, and I'm very pleased that we continue to see a fundamental demand shift in adoption of our patient care management solutions and expanding market shares.

Also important to realise that activity levels remained double-digit above 2019 in the Connected Care business, with mid-single digit three-year CAGR. Group comparable sales declined 4% in the quarter, which exceeds our prior Q1 guidance of high single-digit decline. In addition to the high comparable base of Q1 2021 and the headwinds in our Sleep business, we continue to face supply chain disruptions. The impact is relevant across all modalities, but particularly strong on the higher volume and high-margin businesses like patient monitoring, ultrasound and image-guided therapy. Adjusted EBITA for the quarter was 6.2% of sales, impacted by the lower sales and higher supply cost, including extraordinarily high pricing on spot buys. This was partly offset by cost productivity measures and higher IP income.

The increasing supply chain cost and overall inflationary pressure was 250 basis points in the quarter, of which 150 basis points was wage inflation and 100 basis points was increase in

supply chain costs. We are driving additional cost measures as well as price increases across the portfolio to mitigate these headwinds.

Diagnosis and Treatment comparable sales declined 2% in the first quarter. High single-digit growth in image-guided therapy was more than offset by a decline in ultrasound and in diagnostic imaging due to supply chain shortages and on the back of strong growth in these businesses last year. The adjusted EBITA margin decreased to 5.9% in the quarter in Diagnosis and Treatment, mainly due to lower sales and supply chain costs.

The comparable sales for the Connected Care business declined by 21% in the first quarter, driven mainly by the substantial decline in the Sleep and Respiratory Care business on the back of the recall and by supply chain headwinds in patient monitoring. The adjusted EBITA margin amounted to 0.4%, mainly due to lower sales.

Personal Health comparable sales grew a strong 8% in the first quarter on the back of 17% growth last year, driven by double-digit growth in Oral Healthcare. Underlying consumer demand for our strong portfolio remains very solid. The adjusted EBITA margin increased to 15.3% in Personal Health in the quarter, mainly driven by growth, partly offset by supply chain costs.

We continue to focus on driving productivity initiatives that delivered gross margin savings of €97 million in the first quarter. After deducting the impact of cost increases related to freight cost and spot purchases, net savings amounted to €8 million in the quarter. As Frans mentioned, we are driving additional cost measures of between €150 to €200 million for the year, in response to the mounting inflationary headwinds. We are tightening the belt with tactically – with tactical discretionary cost savings, as well as acceleration of structural productivity programmes and further procurement and indirect spend management.

Adjusting items were higher than guidance in the quarter, mainly due to €165 million provisions related to the recall that Frans mentioned earlier, as well as restructuring and portfolio alignment actions of around €85 million, resulting from the overall quality remediation efforts in Sleep and Respiratory Care. We decided, for example, to cease manufacturing of hospital respiratory care products in the Carlsbad facility in the US, and we'll consolidate those activities under the broader Respironics footprint. Free cash outflow of €402 million in the quarter due to increased working capital resulting from higher inventories, as well as higher income tax paid.

On capital allocation, we renewed our €1 billion revolving credit facility with an interest rate linked to the company's year-on-year ESG performance improvement. The revolving facility matures in 2027 and substitutes the previous facility, which had a maturity date in 2024.

Let me provide some guidance for the segment 'Other.' We had an adjusted EBITA loss of around €80 million in this segment in 2022, which is €20 million better than our previous guidance due to higher license income and cost productivity measures. At EBITA level, we expect a net cost of around €140 million for the full year 2022. For Q2, we expect a net cost of around €30 million at the adjusted EBITA level and around €50 million at the EBITA level. We currently expect an effective tax rate in the high teens for 2022, lower than our mid-term guidance of 24% to 26%, mainly due to lower income and one-off tax gains.

To conclude, I'd like to take you through how we expect the year to progress in a little more detail. We exceeded our sales plan for the first quarter around – and are on track to achieve the mid-single digit sales decline that we communicated in January for the first half of 2022, on the back of 9% growth in the first half of 2021. We continue to expect a strong recovery in the second half of the year, supported by customer demand and our strong order book.

At the same time, we see very challenging external environment and increased uncertainty related to the COVID-19 situation in China, the Russia-Ukraine war, ongoing supply chain challenges and higher inflationary pressures, as mentioned by Frans. We are actively monitoring the situation, and our teams are working very hard on delivering on our order book and mitigating the impact of the headwinds. Our focus is continuing with the good progress on the repair and replace programme, mitigating the global headwinds and remaining laser-focused on our strategic improvement targets so that we can realise the growth and profitability that – supported by our record order book.

With that, Frans and I will take your questions. Thank you.

Q&A

Operator: Thank you, sir. If any participant 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. We will now take our first question from Hassan Al-Wakeel from Barclays. Please go ahead.

Hassan Al-Wakeel (Barclays): Thank you for taking my questions, I have two please. Firstly, a broader question around guidance to start. It would be helpful if you can discuss how some of your underlying assumptions have changed, if at all, since initially guiding the market, given, arguably, stronger demand than the top line but margin weak – weakness owing to supply chain pressures and inflation. Do you expect supply chain issues to persist for longer? And how do you think about the margin target range and whether the lower end of this range is more realistic in your view?

Secondly, could you please talk about the hospital CAPEX environment as investor concerns here increase, with hospitals facing rising OPEX costs, and whether you're seeing any impact here at all? Thank you.

Frans van Houten: Yeah, thanks. Fully understand the questions, Hassan. So let's first talk a bit more about guidance. You're right to point out that with the ongoing strong order intake we actually see further underpinning of our growth potential, so that is good news. And the growth range of 3% to 5%, of course, reflects, in a way, contingency from the high end to the low end, right, and if everything would go well the strong order book would definitely allow us to perform a very strong growth.

The – if you look at the first quarter, thanks to hard work we were able to mitigate a lot of supply chain challenges, but not all, all right? If we would have been able to mitigate everything, the sales could have been even higher in the first quarter. So, you know, in a way it is day-by-day, week-by-week working the issues. We have a strong, sustaining

engineering team in India that is also able to redesign parts and find ultimate suppliers, and all of that helps to overcome supply chain challenges.

So if I look back at the guidance that we gave in January then we are on the right path with regards to revenue. And although I do expect that supply chain issues will persist longer – I think I was a bit more hopeful in January – we should not discount our ability to find solutions. It's just that the volatility is quite significant.

As Abhijit and I were discussing ahead of this call, we also thought that it would be valuable for you to know that we expect to deliver higher volumes in the second half-year versus the first half-year, right? In other words, our normal seasonality, where we expect higher volumes in the second half-year, we expect to be able to deliver that and deliver a stronger second half of the year.

Now, I realise that your question was actually also pointing to margin. Now, you know that in our business we are operating with high margin but also high fixed-cost businesses, and, therefore, volume is a key driver towards profitability. And this certainly applies to us and the second half of the year is always a higher profitability than the first half. The range that we guided for is doable, especially also because we have taken additional measures to increase prices. On Personal Health this is already starting to come through, and we will take further measures in the second quarter.

On our recurring revenue base in healthcare, we have implemented indexation some years ago and therefore we are able to pass on some of the higher cost. Of course, that leaves the order book, especially on the tender business, where last year's – where it's still partly last year's prices. For more book and bill business, like ultrasound, we are able to pass on prices, increased prices, already now. Moreover, we have taken additional cost measures because we are very cognisant of the inflationary pressures, as also mentioned in the introductory speech. So driving an additional €150 to €200 million will also help us offset that higher inflation that we mentioned. So we are – and we aim to communicate that clearly while we see volatility and risks. We also radiate the possibility – the possibilities and we stick with our guidance as we've given in January.

Now, then on the second part, hospital CAPEX. We continue to see strong demand, but I see that there is a high priority from the C-suite of all the hospitals and that is staff productivity. As staff costs go through the roof, especially in the United States, more than ever every decision to invest needs to drive efficiency of the hospital system and reduce the dependence on OpEx or staffing. Now, here comes in the Philips strategy around care pathway optimisation, clinical decision support, you know, higher throughput time; the whole story around quadruple aim resonates completely with the hospitals. The fact that, for example, with our MRIs or – that even the upgrades to the installed base we can half the scan time; that means better staff productivity.

So we see that there is CAPEX available with hospitals for the right innovations, and, of course, I'm implying here that we have those right innovations. We also see hospitals building more ambulatory surgical centres, right, focused on helping patients in an ambulatory setting, with shorter hospital stays or even day interventions. So there's definitely orders to be gotten, and at this time I'm not – we are not reducing our confidence in the market resilience.

Hassan Al-Wakeel: That's very helpful, Frans, thank you. If I could just follow up on the top line. Can you talk about how installations are trending and whether you're seeing any improvement here globally? Presumably, maybe a worsening situation in China?

Frans van Houten: Yeah. We definitely see a worsening situation in China where – at least in the cities where there's a lockdown; you know, we've seen a slowdown. Now, we hope that Shanghai will come out of the lockdown in the course of May, and then we can still do a lot in the remaining part of the quarter. But, globally, installations are going well. The only thing that affects installations are incomplete supply chain deliveries, where, I must say, customers are very understanding and are really trying to lean in in accepting installations, and thereby also helping us to realise our revenue.

Hassan Al-Wakeel: Perfect, thank you.

Frans van Houten: You're welcome.

Operator: We will now take our next question from Veronika Dubajova from Goldman Sachs. Please go ahead.

Veronika Dubajova (Goldman Sachs): Hi Frans, hi Abhijit, hope you can hear me okay. Two questions from me. I think, Frans, you mentioned this in your prepared remarks and it's obviously also in the press release this morning, saying that you expect to achieve the guidance if there is no further deterioration in the current conditions. And I just was hoping you could clarify this a little bit for us, and does this mean if, you know, we see the current cost pressures and inflation pressures persist through the remainder of the year you can still make the guidance, but if they get worse you can't? Or is your expectation that they must improve, and if they don't improve then you don't make the guidance? Just a little bit of clarity around this. I mean I think we all appreciate the world has changed a lot since you gave this guide in early Jan, but I think we're struggling to reconcile that a little bit.

And then my second question is just on the DOJ request, and I appreciate there is not a lot you can say here. But just what are your expectations, I guess, maybe more broadly for further action from the regulatory agencies in the US? I'm thinking warning letter, consent decree and potential fines. You know, what are your assumptions, your expectations, and when do you expect to have more clarity on all of those things? Thanks.

Frans van Houten: Yeah. Hi Veronika. Where to start? The – on the guidance. The volatility affects the parts' availability, that's our number one priority. And while that volatility persists we have also shown in Q1 an ability to overcome some of those headwinds, and I remain confident that we can convert enough of our order book to be in that bandwidth of the 3% to 5% comparable sales growth. Of course, if all goes well we will be at the high end of that because the order book is so significant that it could achieve that. So, in a way, the 3% to 5% represents already a contingency on revenue that I feel good about.

Now, we do flag the risks out there. Frankly speaking, I don't know what China is going to do, right, and I would love to meet somebody who can exactly predict what will happen in China and what will the consequences be on the global supply chain. We don't know. I mean the – clearly, the harbour in Shanghai needs to reopen, otherwise the whole world will suffer from that. So we have not taken that into further account, other than that I can repeat to you that our revenue plan has quite some redundancies in the plan.

Now, then I think you're also asking for the margin side. I already indicated that realising the growth is quite fundamental to profit expansion. Raising prices and tightening the belt on cost in our view can offset the inflationary pressures that we are facing today, right, and I think Abhijit mentioned around 2.5%.

Abhijit Bhattacharya: Yeah.

Frans van Houten: That is in the numbers. That is what we are counting on. We don't see, at this time, further deterioration on that, so we will work with the 2.5% assumption. And with the price rises and cost tightening offset that, while then the volume and mix will help us on the profit expansion.

That's your first question, Veronika? Then –

Veronika Dubajova: Yes, thank you. I – I'll have a follow-up, but I'll let you answer the DOJ one first.

Frans van Houten: Yeah. On the DOJ I can be shorter because at this time it's a subpoena for information, right, and that means they are preparing an investigation and we just have to accept that. As we said in the introductory speech, that is not uncommon for a situation of this magnitude. What to expect from the regulatory agencies? We are in close collaboration and contact with them. Like us, they feel the pressure from the patients and they are very focused on working with us to achieve the remediation as fast as possible. That is what the conversations are about; let's say that's priority number one in all our conversations.

Secondly, there is keen interest in the testing that's going on and what we expect to share in the second quarter. At this time, there is nothing to be concluded, what I would point to. You asked me about, you know, could there be a warning letter? I don't exclude anything, but the measures that we have taken voluntarily are of such a significance that it has gotten the attention of the FDA and they appreciate those measures; ranging from closing the site in Carlsbad, to retiring some of the older product ranges, to a slate of activities to re-look at patient signals from the field, and, of course, we are sharing all those findings with them. So we are doing a lot and I think that will help very much on how the agency will judge us. So it's work in progress.

Veronika Dubajova: Understood, understood. And so just circling back to your first – to my first question, perhaps[?]. Is it fair to say that the revenues remain the single biggest variable, and, I guess, if you can get to 3% you can show some margin improvement year-on-year? Again, assuming there is no further step-up in cost inflation.

Frans van Houten: Yes. And, Abhijit, you – so you're immediately nodding, so why don't you answer it.

Abhijit Bhattacharya: No, I think it's how you explained, Frans. I think the biggest risk that we have is on the top line. If we get the top line for our businesses, as, actually, Frans mentioned, you know, once we cross the breakeven point then the drop-through to the bottom line is pretty strong, and we are struggling in the – mainly, our high-margin businesses, so, you know, in image-guided therapy, patient monitoring, ultrasound. Once these go above a certain threshold the profitability goes very high, and that's the biggest risk.

Frans van Houten: Yeah. But we did tell you that we expect higher volumes in the second half versus the first half, despite the supply chain challenges.

Veronika Dubajova: Understood, okay. Thanks guys. I'll go back into the queue.

Frans van Houten: Thanks.

Operator: We will now take our next question from David Adlington from J.P. Morgan. Please go ahead.

David Adlington (J.P. Morgan): Morning gents. Thanks for the questions today. Just on Personal Health, I just wondered if you saw any stocking in the quarter ahead of the price increases and if you're able to quantify that? And within that 7.7% growth number, just wondered how much was volume versus price that's contributed to that? Thank you.

Frans van Houten: Let me be straight up. On stocking, we have not seen any stocking happening. In fact, there is good sell out and good consumer traction. Then I'll look at my team with regards to volume versus price.

Abhijit Bhattacharya: I think it's largely volume. So the price agreements were made in February, so by the time you supply it in March with the new pricing. So I think largely volume, David, that's how you should look at it, a very small part in price.

David Adlington: Great, thank you.

Operator: We will now take our next question from Julien Dormois from BNP Paribas. Please go ahead.

Julien Dormois (BNP Paribas): Hi, good morning Frans, good morning Abhijit. Thanks for taking my questions. The first one relates to the growth assumptions that you have for the full year but dissected by division. I think you provided some after the full year numbers. At the time, if I remember well you reflected high single-digit growth in D&T, low single-digit decline in CC and mid-single-digit growth in PH. Does that still hold true looking at the – after the Q1 numbers? So that would be the first question.

And the second question is more specific on D&T, because you started, unfortunately, with a decline in that business and the comps are getting tougher in Q2 and Q3, particularly in IGT. So just curious to understand why – what we may see in this division to get to the full year number?

Frans van Houten: Yeah. I – hi Julien – I think on the first question those growth assumptions stay largely the same.

Abhijit Bhattacharya: Yeah. I think, maybe – so we've said mid-single-digit for Connected Care and high single for D&T. I think that remains, so –

Julien Dormois: PH, you mean?

Abhijit Bhattacharya: Yeah. But also for D&T we had said high single digit. And for PH we had said –

Julien Dormois: Mid.

Abhijit Bhattacharya: – mid-single-digit, so we will be there or slightly higher, but Connected Care will be a mid-single-digit decline.

Frans van Houten: Take the second one.

Abhijit Bhattacharya: Yeah. So then on the D&T, you know, Julien, we are held back, really, on supply chain. So the order book is – and you talk about IGT, but the order book in IGT continues to grow. So despite the tough comps, if we are able to get the supplies of critical components that we are looking for the second half of the year will be strong, with good growth.

Julien Dormois: Okay, thank you.

Abhijit Bhattacharya: Yeah. So you will also see growth coming back in Q2, but second half will be also very strong.

Operator: We will now take our next question from Graham Doyle from UBS. Please go ahead.

Graham Doyle (UBS): Morning. Thanks for taking my call – my questions. Just on the recall, you haven't talked about it so much today. And I just noticed on slide 33 you talk about a spike in registrations in February. And it's kind of interesting, because you obviously then published a statement in regards to an FDA update on 10th March, where they were asking you to communicate more effectively with patients. So is there a risk that maybe that starts to tick through and we get another spike at some point soon? And can you, kind of, square that for me just in terms of the communication with the FDA coming after you've seen this spike?

And then, lastly, just a follow up to that, which is you talk about 90% of production for these devices being complete by the end of this year, which sort of implies that there'll be further production in the recall in 2023. Does that mean we should assume there'll be some point in 2023 when you are not selling systems commercially? Thanks. That – just those questions, please.

Frans van Houten: Yeah. Hi Graham. The – it's true that the intensified communication in – around February led to more patients registering, but immediately afterwards there was, again, a reduction of the weekly rate. So the spike up was not very significant.

Now, to be on the safe side, when you imagine an asymptotic, kind of, regression model that keeps, let's say, reducing, as is shown in the slide, when you – yeah, when you raise that curve a little bit it already adds up to a higher assumption on numbers. So let me be clear, at this time those 300,000 additional patients have not materialised yet, but it is – it's the consequence of using a regression model and with the slightly higher registrations in the first quarter, it means that that you lift the whole tail, right? But the characteristics of that curve are firmly confirmed, right? I mean that sounds a bit funny, firmly confirmed, but I mean solidly confirmed, right? So we see the decline continuing on a week-by-week basis, right? That also gives us belief that there's not going to be a radical, different inside as time progresses; in fact, the model becomes more accurate as time progresses.

The – and so the €65 million additional is only in part for the extra volume. In part, it is for the fact that we decided to keep a higher level of patient communication out there into next year, which we then provided for.

The current view on production and deliveries, because this is not only about production but also the delivery into the field, is that we will exceed 90% by the end of 2022. And I add the word delivery because, you know, before it reaches the patient it takes time, right? That also

implies that we will be earlier done in the internal factory than the last unit arriving in the field with the patient, right? So there is some fluidity there. I think we said also that we expect, depending on the geography, to finish either by the end of this year or in early Q1 next year. That would also imply that around that time commercial activities can resume, right, and also there there can be some variation by country, because if we are done in a certain country then we can also start preparing for the resumption of sales.

Look, there is no hard signs about an exact week or date, but we are pretty confident that we are progressing very well with the recall, and yeah, please allow us some weeks back and forth because, you know, it's a huge volume. But we are proud of the fact, how we have ramped up, and we see further ramping up during the year.

Now, we have taken an additional €100 million as a sort of contingency to deal with unforeseens, such as suppliers wanting expediting charges or whatever, other measures we need to take to keep the speed up, right, and we didn't want to, yeah, come back time and again with surprises there. And, therefore, with this decision to reserve €100 million we feel that we are, yeah, well provided for.

Graham Doyle: Maybe just a quick follow-up. In terms of the, sort of, go or no-go decision about when you can start selling commercially, obviously depending on geography, how much certainty do you need to have and how do you have certainty that you have reached all the patients that require the machine to be replaced or repaired?

Frans van Houten: I think it starts first with a moral obligation to treat patients first, and, therefore, we want to get very far, let's say, in delivering against the registered patients. And maybe that's where the core of your question is, could somebody register even next year? Yes. And then we will deal with it, right? But if there is a late registrant it will not make a huge impact.

So we see that that moral gate relates to having done the registered patients and, yeah, then given logistical consequences it needs to be somewhere in the high 90s, by which time we feel that we have fulfilled on that obligation and that resuming commercial activities is justified, and, as I said, that's somewhere end of the year, early next year with the current looks of it.

Graham Doyle: Okay, that's very clear. Thanks a lot for taking my questions.

Frans van Houten: You're welcome.

Operator: We will now take our next question from Delphine Le Louët from Société Générale. Please go ahead.

Delphine Le Louët (Société Générale): Yes. Hi, good morning everybody. Thank you for taking my question. I got two. I was wondering, regarding the price hikes that you're going to pass on across the year, what sort of a flexibility do you have on a divisional basis, can you be more specific? If we stick with this 2% to 3% figure that you gave, do you see far more flexibility into the PS division than into the CC, for instance, or D&T?

Second question deals with the cost saving – additional cost saving programme you're putting in place. Can you clarify which division is going to be the most impacted by this €150 to €200 million envelope? Thank you.

Abhijit Bhattacharya: Yeah, let me take this. In terms of flexibility, I presume you mean elasticity?

Delphine Le Louët: Yeah.

Abhijit Bhattacharya: So I think we have the ability to increase prices across, because, you know, the inflation is so widespread, it is happening everywhere, so it's not that we have particular businesses where we cannot raise prices. The only thing you need to understand is the impact of the price increase differs in timing. So, as Frans mentioned earlier, you know, in Personal Health you see the impact in the P&L earlier, whereas in, let's say, the longer order book businesses you first have to get through the order book that has been taken at pre-price increase prices, and then the new orders will kick in. So it's a timing issue, but we don't have a problem in terms of increasing prices anywhere. The other thing is even for the health system businesses in the service and services businesses, we have the ability to raise prices at reasonably short notice and that is what we are currently in the process of doing.

Delphine Le Louët: Okay.

Abhijit Bhattacharya: Regarding the additional cost savings, they actually happen across the enterprise, so it happens in Group cost, it happens in respective businesses, so there is not one particular business which there will be a spike. So you will see that across all businesses, just like inflation is hitting the businesses across the board.

Delphine Le Louët: Thank you.

Operator: We will now take our next question from James Vane-Tempest from Jefferies. Please, go ahead.

James Vane-Tempest (Jefferies): Hi. Thanks for taking my questions. I have two if I can, please. Firstly, just on the existing contracts. Can you remind us how many of them have an indexation clause, so you can pass on some of those higher costs versus those where you need to, perhaps, absorb some of the higher inflation? And, I guess, although you have a strong order book, are you seeing any signs installations are getting delayed due to hospitals' own higher costs, especially labour?

Second question is if I can just follow up on the €150 to €200 million savings and the timings for those. Just curious, is this muscle of the business that these savings were not identified earlier, and can you give us some examples of potential tactical discretionary savings, which I think is how you refer to them? Also, without those my maths implies margins would otherwise be going down this year, so I'm just, you know, curious of the timing and phasing of those through the year as well. Thank you.

Frans van Houten: Yeah. Let me first take the first question, James, and then Abhijit can talk about the second one. Most of our service contracts have indexation clauses and therefore prices can be adjusted on a regular basis, and, as Abhijit said just a bit before, we are working on implementing those price raises.

On the equipment business, much[?] go through tendering tenders, and therefore it takes a whole order sequence cycle before the new prices are in. I think that paints the picture, and I think Abhijit said, look, there is usually then a significant time lag on equipment before you see the new prices come through.

For book and bill business, such as ultrasound and some other shorter cycle healthcare system businesses, we can be almost immediate, right? So as we take – as we currently take orders, it is going to be against higher prices. So three buckets. Services, fairly immediate, book and bill business, fairly immediate, and then the large tender-driven businesses, diagnostic imaging and IGT, it takes a longer time.

I think I covered that. Abhijit?

Abhijit Bhattacharya: Yeah. I think in terms of cost saving, the plan is to get the savings this year, right, so it's still in the remaining three-quarters. If you look at the discretionary or tactical savings we've talked of, be it in travel, be it in exhibitions or shows that we conduct, it's also looking at our temporary labour force to see where we can flex it. We also have factories which are idle for a certain amount of time because of the lack of parts availability, so we have programmes running there. So it's a multitude of actions that we take. But to your concern on timing, the amount that we talked about, the €150 to €200 is a mitigation that we are expecting within this year.

Frans van Houten: Yeah. And then I realise I have not answered your question on, you know, our customers delaying orders. Customers also struggle with access to parts and materials from supply chain, and if they have a renovation project in their hospital we have seen some delays in room readiness, but that's much more logistical constraint than a desire to delay. In fact, I see no desire to delay; hospitals want the additional capacity, they want the increased productivity. And I did also say they have understanding for when we come with a delay, and we are, therefore, not being bombarded with requests for penalties and so on. So there's, I think, a good coexistence there.

James Vane-Tempest: Thank you.

Operator: We will take our next question from Kate Kalashnikova from Citi. Please go ahead.

Kate Kalashnikova (Citi): Hello Frans, Abhijit, Kate Kalashnikova from Citi here. I've got two questions. So, firstly, looking at the comparable order intake growth chart in the presentation, North America order intake looks like it decelerated on what was an easy comp in Q1. What gives you confidence that there is no deterioration in demand, and by that I mean hospital CAPEX trend in the US?

And then, secondly, in a typical year 70% of order book is converted to sales in the next 12 months. What is your current expectation, given ongoing supply chain challenges? How much of the current order book do you expect to convert to sales in the next 12 months? Thank you.

Abhijit Bhattacharya: Yeah. In terms of the order book development in North America, if you look the overall order growth is low single digit, but if you look at Precision Diagnosis, for example, we have double-digit order intake growth. It's only in Connected Care where, let's say, we have – so, overall, for Diagnosis and Treatment IGT was a little bit lower compared to last year because we had, if you remember last year, an 82% order intake growth last year in Q1, so there the comparables are tough. So we don't see, really, a decline. And in Connected Care, of course, in the hospital respiratory business you see a decline, but in

patient monitoring we continue to see robust growth, so that's how you should look at it. We don't see any kind of slowdown or re-prioritisation in North America.

Frans van Houten: Conversion?

Abhijit Bhattacharya: In terms of conversion, I think, you know, again it's a question of availability. So the longer order book will lengthen the conversation time a little bit. I don't have a precise number, Kate, so maybe I need to come back to you, but it will be a touch lower than we have traditionally seen, simply because the order book is so big and the supplies are constraining us. So it will be a slightly longer period before we can convert all of that into sales.

Kate Kalashnikova: Okay, understood. Thank you. And thanks to North America CAPEX power?

Abhijit Bhattacharya: Yeah. And we continue to see good momentum in Q2 in North America as well.

Kate Kalashnikova: Great, thanks.

Operator: We will now take our next question from Sezgi Oezener from HSBC. Please go ahead.

Sezgi Oezener (HSBC): Hi, hi Abhijit, hi Frans. Thanks for taking my questions. I have two, please. First of all, the restructuring plans that you've mentioned, you specifically mentioned that you're going to cease production of hospital respiration products in one plant, but my question is how do you expect these restructuring plans to evolve? Does it only concern hospital respiratory products or more, and do you expect any revenue consequences from that?

And my second question relates – is more general, relates to your overall quality checks. You mentioned that you have conducted extensive quality checks in the Connected Care segment and the results from new – some new areas erupted where you wanted to take precautions. Do you – how do you see the risk of an issue coming out from other segments, such as D&T, adding to this, or did your programme – quality check programme also cover D&T areas, as well as all areas that you're active in?

Frans van Houten: Yeah. Hi. The restructuring and cost measures go across Philips. Specifically, we, indeed, called out the closure of the Carlsbad site, but we have, also, other measures where we are seeing opportunities to accelerate savings. Think about high-wage versus low-wage transitions, reduction of complexity, reducing the long tail of projects and SKUs, etc. There is no direct revenue impact from these measures because they are already included in our plans, right? So for your modelling there is no new news, other than that we try to accelerate cost savings and measures.

Now, on your second question, the expansive re-look at post-market surveillance data that I spoke about in January applies to the whole company and not just only to Connected Care. And, broadly speaking, we have made good progress with that re-look to our post-market surveillance data and severe incidents and we have not found new issues coming out. In January, we already flagged the quality issues in Connected Care that, by now, you have seen the field safety notices for, among which the defibrillator and the V60, right? And so that's

basically the follow-up on what we already referred to and took provision for in the Q4 results.

Yeah, that, I think, covers your question. Did I miss anything, Sezgi?

Sezgi Oezener: No, you didn't miss anything. Just as a follow-up then, is it safe to conclude that these – the three[?] look at quality actually covers the whole of D&T as well and you haven't actually come out any incidents worthy of mentioning?

Frans van Houten: That's correct.

Sezgi Oezener: Okay, good to hear. Thank you.

Operator: We will now take our next question from Falko Friedrichs from Deutsche Bank. Please go ahead.

Falko Friedrichs (Deutsche Bank): Thank you. Good morning everyone. I also have two questions, please. Firstly, how good is your visibility into actually getting those comprehensive test results of the recalled devices in Q2 of this year, which you guided? Are there any fixed contractual agreements that those labs have to and are actually on track to deliver these results in Q2, or how are the agreements in this instance?

And then my second question is going back to the DOJ request. It – to me it sounds a bit as if they're essentially requesting that you simply submit some paperwork for now. But are you able to share with us how much time you have been given to provide all of that information, so that we might be able to develop some kind of an understanding for the begin of a potential investigation? Thank you.

Frans van Houten: Yeah. Good morning Falko. The – you know there are many tests underway, since last year, and sometimes tests result in more tests as you have to go deeper. There are no compulsory timelines on these tests because we need to give it the time that the experts require, and these are external test houses, external experts that will not let them be chased, so to speak; I mean we need to give it the time it takes. It's our expectation that we are going to be able to deliver those test results in the second quarter, but, you know, when you have thousands and thousands of data points from – coming out of these tests, it's all about the interpretation of the test results by an expert panel, right? Now, all of that is planned out, all of it is expected to come through in the second quarter, but you can see in the way I answer it that we are highly dependent on those external expert panels and test houses, right? So we are confident with the current plan, but it is not an iron-clad guarantee because I can only publish the results when those expert panels have drawn their conclusions.

Yeah. Then, on the DOJ, look, I'm only able to share that there is a subpoena for information related to an investigation by the DOJ, and I cannot predict anything else, and I'm also – yeah, I'm unable to predict how this will go. I'm sorry. I understand why you want to know, but there's nothing more I can share today.

Falko Friedrichs: Okay, thank you.

Operator: We will now take our next question from Max Yates from Credit Suisse. Please go ahead.

Max Yates (Credit Suisse): Thank you. Just my first question is on cash flow. So I just wanted to understand, given the current environment do you think you will have to hold structurally more inventories going forward given, kind of, what looks like ongoing disruption to supply chains, and, I guess, how does that view on working capital and inventory differ to when you previously talked about free cash flow guidance? And as an extension of that, could just help us with, of the provisions that you've taken for the product recall, which I think is about €890 million, how much cash has actually come out of that and how much is still to come over the next few quarters? Thank you.

Abhijit Bhattacharya: Yeah. So, you know, at this present moment we are probably at the peak of holding our inventory. It's at an all-time high, primarily because we are holding unbalanced inventory, right? So we have, let's say, 98% of the parts available, and then for 2% you can't complete it and therefore you cannot ship. So I think our inventories will come down, but there is not a – let's say, I don't expect us to hold structurally significantly higher inventory that will affect our cash flow guidance in the outer years, when we are back to normal running.

Now, on the second point in terms of the cash utilisation, let's say last year we used about €175 million in terms of cash, and this year we will spend about another €650 million or so cash. So the incremental over last year will be about – close to €500 million or so.

Max Yates: Okay, thank you. And maybe just my second question would be, I think at the time, kind of, when the issues around the product recall first started, you highlighted this being about a €1.1 billion business, around – sort of, two-thirds of it was the systems, a third of it was the masks. I just wanted to understand – that obviously you're not selling the systems externally, but in terms of the mask sales how have those been affected through the last 12, or through, I guess, the last nine months, 12 months since this issue arose? Are you – I think you previously said 30% to 40% were linked to new machines. Obviously, maybe those aren't being sold, but I guess the replacement masks business, I'd be keen to understand how that's been affected through this period.

Abhijit Bhattacharya: Actually, we've done pretty well there. So like you said, you know, about 30% to 40% was going with new systems, so that has declined, but the overall decline is far less than that. So we are just about, kind of, double-digit decline, so – in the overall mask business. So, actually, our sales force, since we are not selling the complete machine is entirely focused on the mask business and they have done, actually, a pretty remarkable job to keep the decline down to just about 10% or so.

Max Yates: Understood. Thank you very much.

Operator: Thank you. Mr van Houten and Mr Bhattacharya, that was the last question. Please continue.

Frans van Houten: All right. Then I appreciate everybody's attendance and thank you very much for your questions. Rest assured, we remain laser-focused on the execution of our plan. Despite the challenging environments we are full of confidence about the opportunities ahead. Thank you very much.