

FINAL TRANSCRIPT

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PHGFF.PK - Q2 2009 Royal Philips Electronics Earnings Presentation

Event Date/Time: Jul. 13. 2009 / 8:00AM GMT



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PRESENTATION

Operator

Welcome to the Royal Philips Electronics second quarter results 2009 conference call on Monday July 13, 2009. During the introduction, hosted by Mr. Pierre-Jean Sivignon, CFO, all participants will be in a listen-only mode. After the introduction, there will be an opportunity to ask questions. (Operator Instructions). Please note that this call will be recorded and is available by webcast on the website of Royal Philips Electronics.

I will now hand the conference over to Mr. Sivignon. Please go ahead, sir.

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Thank you. Ladies and gentlemen, let me first welcome you to this conference call. In view of the current economic climate, let me start by looking outside to developments in the markets our businesses are in.

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Let me start with Healthcare. As you are all aware, there is pressure on Healthcare spend from the weak economy and, particularly, in the USA, from more difficult financing conditions and ongoing regulatory uncertainty.

During the second quarter, we saw little change here. There is some limited evidence that hospital financing is becoming a touch easier, but very little concrete progress in the American regulatory and reimbursement environments. As a result, customers continue to remain cautious about making new capital investments. Demand outside the USA is showing some signs of improvement.

In Lighting, the main commercial constructions market remain depressed, although there are some very early positive signals here and there from some leading indicators, such as new housing starts, and the demand for architects' services in the USA.

In Automotive, car sales increased in almost all key markets, mostly due to purchase incentives, including car scrapping incentives. It's, however, still too early to conclude on the sustainable benefit of these actions for automotive production in the medium term.

Let me now turn to consumer demand. Here, we noted a slight uptick in several consumer confidence indicators, albeit from a low starting point. On the other hand, unemployment continued to increase, and is expected to further increase in most major economies, and so it remains difficult to predict a recovery point in consumer spending.

Let me now turn to Philips' results for the quarter which, of course, very much reflect the developments in our key markets. Group sales fell by 19% on a comparable basis, resulting in an EBITDA margin, excluding incidentals, of 3.7%. The equivalent EBITDA margin for Q1 this year was just above break even.

Net income, supported by the gain on the sale of our stake in Pace, was a profit of EUR45 million. On cash, I was extremely pleased with our ongoing ability to successfully manage both working capital and CapEx, which resulted in a EUR250 million free cash inflow in the quarter. This meant that, even after our EUR634 million dividend payment, our cash balance remained at a robust EUR3.6 billion at the end of June.

With that, let me now take a closer look at the performance of each of our businesses during the second quarter. At Healthcare, currency comparable Equipment order intake fell by 9% compared to Q2 last year. This compares to a 17% order drop in Q1 this year.

In the USA, Equipment orders were down around 28%, a similar level to last quarter, while orders outside the USA improved considerably, growing by 6% in the quarter.

While nominal sales at Healthcare continued to grow, comparable sales fell by 5%, broadly in line with our expectations. Sales in mature markets fell by 7%, partially offset by encouraging high, single digit growth in emerging markets. At a business level, higher sales at Customer Services were more than offset by lower sales in the other businesses.

The EBITDA margin at Healthcare was 8.4% in the quarter compared to 10.4% in Q2 last year. Excluding incidentals, this 8.4% would have been 9.7%. The year-on-year profitability decline of 2% was due to the lower volume, some negative price and currency impact, partially offset by cost savings.

We saw lower profitability at Imaging Systems, Clinical Care and Healthcare Informatics. The EBITDA at Customer Services and Home Healthcare Solutions remains strong. Going forward, we will step up efforts to reduce the fixed cost base of this sector.

At Consumer Lifestyles, sales were a touch under EUR1 billion below the level of Q2 '08, a comparable decline of 30%. I would like to again stress here that the fall in absolute sales value is a result of both proactive portfolio pruning on our part, as well as weaker consumer demand. Geographically, the sales decline was broadly similar in both mature and emerging markets.

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On the business axis, sharply lower sales at Television and Audio & Video Multimedia were partially offset by a comparatively resilient sales performance at the former DAP businesses which, together, declined by 6% in the quarter.

Despite the significant drop in top line, the reported EBITDA for the quarter was around break even, underscoring enormous progress made in Consumer Lifestyle in recent years to improve the leverage of the sector. EBITDA profitability, excluding incidentals, was 2.5% of sales, well ahead of Q1 this year, and broadly in line with the second quarter of '08.

Television reported an improvement of EBITDA, despite a sales drop of over 50% in nominal terms, from a loss of EUR117 million to a loss of EUR99 million. This loss was compensated by equivalent profit in the rest of the businesses, notably Shaving & Beauty, and Health & Wellness.

At Lighting, the sales level during the quarter very much reflects the market developments I alluded to earlier in the call. Comparable sales were down by 18%, just slightly better than the 19% decline we saw in the first quarter. At the business level, we saw a further decline in the comp sales at Professional Luminaires, while sales at all other businesses, although still negative, were better than Q1.

Looking across geographies, emerging markets performed somewhat better than mature markets. The root causes for the lower EBITDA at Lighting are broadly the same as we reported in the first quarter, lower volumes, some adverse products mix and, thirdly, additional fixed cost under-coverage as production levels were further adapted to manage inventory.

EBITDA profitability, excluding restructuring and acquisition related charges did, however, show solid sequential improvement from 1.8% in the first quarter to 4.2% in the second one, helped by the increasing impact of fixed cost savings. As you saw, we nevertheless announced additional measures to be taken in the third quarter to further increase the leverage in this sector.

At Innovation in Emerging Businesses, EBITDA was lower than Q2 last year as a result of restructuring charges and lower income from intellectual property. Given the increasing maturity and alignment of our incubator activities with the business sectors, we have decided to charge this cost directly to the three sectors as of Q3 this year. Moreover, the remaining INEB activities will be reported together with the existing Group Management & Services reporting segment.

This means that from Q3 onward this year, Philips will be further simplified from five to four reporting segments. We will make available the restated historical financials on the investor relation website in the course of September.

The EBITDA at Group Management & Services was significantly better than Q2 of '08, due mainly to the favorable impact of EUR57 million in insurance recoveries, and EUR33 million in legal settlements. In Q2 last year, we had a EUR39 million gain from a real estate transaction. However, excluding these incidental gains, the underlying cost of GM&S also fell, driven by an improved corporate cost structure.

So much for the P&L; let me now move to cash flow. As I mentioned already, we again successfully managed our cash this quarter. Free cash flow improved from an outflow of EUR5 million in Q2 '08 to an inflow of EUR251 million this quarter, due to tighter working capital management, and a 20% plus cut in gross capital expenditures.

Our inventory balance ended the quarter below both Q2 last year and Q1 this year. This other main cash movements in the quarter were the payment of the annual dividend, EUR634 million, and a EUR76 million cash inflow from the sale of our stakes in Pace. These movements, combined with the free cash inflow, resulted in a net drop in our cash balance from EUR4 billion at the end of Q1 to EUR3.6 billion at the end of June.

Let me turn now to net income. We reported a net profit in Q2 of EUR45 million. This is the combined effect of a more or less break even EBIT after tax supported by the gain on the sale of Pace shares, and a positive revaluation of the value of our stake in TPV.



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Ladies and gentlemen, let me now wrap up with the following remarks. The external environment in which Philips operates remains tough, and has impacted all our businesses in the quarter. We are concentrating on the things we can best control, namely cost and cash. These efforts are clearly paying off, as we can see from the 3.6% improvement in underlying profitability in the quarter, and the free cash inflow of EUR250 million.

We continue to progress our strategic agenda through the further sale of stakes, and the acquisition of businesses we feel complement our portfolio. Looking ahead, I can only repeat what we said in the outlook of the press release. We see some signals in some markets that the fall in demand is bottoming out.

However, we remain cautious, and so we will continue our relentless focus on the things we can most influence. We are pleased with the progress made in our cost reduction efforts, and expect the lower cost level to increasingly support EBITDA during the remainder of the year. Consequently, we expect our comparative performance in the second half of 2009 to be better than in the first and second quarter of 2009.

With that, let me now open the line to your questions.

QUESTIONS AND ANSWERS

Operator

Thank you, sir. (Operator Instructions). Would you please limit yourself to one question, with a maximum of one follow-up. This will give more people the opportunity to ask questions. (Operator Instructions). There will be a short pause whilst participants register for a question.

And the first question today comes from Michael Jungling from Bank of America. Please state your question, sir.

Michael Jungling - Bank of America - Analyst

Good morning, everyone, and thank you for taking my questions. I have two questions. The first question is, can you give us, please, a margin bridge for Healthcare from Q1 to Q2? A very nice improvement in line; well, quite extraordinary, given the decline in top line performance.

And the second question I have is a general question about OEM manufacturers. You say OEM manufacturers pretty much outside Healthcare, and I was curious whether you can comment on how comfortable you are that these OEM suppliers will be around after the recession, given the difficulties that they face. Thank you

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

If I may, on your second question, you talk about all the OEM manufacturers in terms of their relationship with Philips as our own supplier. Is that the way I should understand the question?

Michael Jungling - Bank of America - Analyst

Yes, it is.

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Pierre-Jean Sivignon - Royal Philips Electronics - CFO

All right, so we're talking here about a supplier risk, correct?

Michael Jungling - Bank of America - Analyst

Correct.

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

Okay, understood. Okay, question one, the bridge of Q1 to Q2. I think if you recall, in our Q1, we had a rather significant impact in the Q1 numbers coming from ForEx, foreign exchange. And I think we disclosed at the time the particular number to you on this call, and I would say that in this particular quarter, we continued to have some impact, but at a lower level. All in all, I think the impact of ForEx was about net-net, net of translation, and transaction around EUR10 million negative in this particular quarter.

So I would see that as one cause, and the other cause is we start seeing the first elements, of course, of our cost reduction decisions. You will remember that at the end of Q4 last year, we hinted towards some obviously restructuring in Healthcare, and we said that we should start seeing the impact late Q2, second half. And I think the rest of the spread in the reconciliation of the margin in a sequential mode comes essentially from the fact that we start having some tailwind from those cost reduction measures.

Moving to your second question. Well, I think this is a broader question on how to manage your suppliers' risk. We've put in place some database and some new procedures. We've actually created a centralized function within our treasury department which is dedicated to supplier risk management. We've put a color dashboard and try to follow that as much as we can. We've seen in the last couple of quarters a handful of suppliers we've had to make sure that were staying onboard. We are checking that we reduce the number of situation where we are in a single source situation, and we try as well to have these two sources in two separate countries.

And with all these measures, combined with the fact that we stay as close as possible to them, so that if there is difficulty, we are obviously knowing as early as possible in the chain. With all these measures, I would say that so far, we've been able to pretty much be without trouble in our production chains. I'm not saying we are totally absolutely sheltered, but we believe that we've stepped up quite significantly our protection mechanism in that particular territory.

Michael Jungling - Bank of America - Analyst

Just a quick follow-up, Pierre-Jean. Can you give us some comfort that your sales growth outlook for the second half will not be materially impacted from, perhaps, a few OEM manufacturers unfortunately going bust?

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

Well, I tell you, if I knew that I would, obviously, very much guide you on this. You must be hinting to something precise, but as far as I know the key suppliers we have, the key component suppliers we have I think we stay close. I'm not aware at this point of any particular situation in this territory. I know a couple of guys basically are under some pressure, but as I've said, we try to be close to these guys. If we were to have to make sure that they needed a bit of temporary obviously support on an as needed basis in an extreme situation, we might consider that. But I'm not aware of a situation as extreme as the one you are alluding to and potentially impacting our S2 at this particular point of time.

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Michael Jungling - Bank of America - Analyst

Thank you very much.

Operator

Next question comes from Didier Scemama from RBS. Please go ahead with your question sir.

Didier Scemama - RBS - Analyst

Yes, good morning. Thanks for taking my question. Pierre-Jean, a question on inventories. You've done a terrific job on working capital reduction and cash generation. I'm just wondering if you could reconcile lower inventories in Q2 with, let's say, normal seasonality in the second half, as well as you said perhaps better a second half than previously expected. That's my first question.

Second question is on the reclassification of incubators R&D to each division. I know you indicated in September you would provide a pro forma accounting, but I was just wondering if you could broad brush give us a feel for where R&D is going to go primarily. That would be great. Thanks.

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

Okay, no problem. Okay, inventory; I think you're really asking me, why are we going so low? Are we going to be able to face Q3 revenue on the revenue -- on an inventory which has come down? Let's take a couple of data points.

If you take our inventory expressed as a percentage of revenue at the end of Q2 '09, the number you have is 13.3%. If you take that same number a year ago, you have 13.9%. So it's fair to say that it is a rather dramatic reduction Q2-to-Q2. And, by the way, if you were to look at those numbers across the three sectors, you would see improvement everywhere.

And the point there is, Didier, simply, we were just too high, regardless of the economic cycle, and I think we've always been very transparent from that perspective. We were not doing a good enough job in managing inventory. I think that was a fact. And what you are seeing right now is an adjustment to not only, of course, the lower revenue, but as well better, I would say, value chains, which are under some stricter management with better tools. So that's why the 13.9% go to 13.3%.

Now your next question is, how do you reconcile that with what we would expect for Q3? But if you now compare that same 13.3% to what we had at the end of Q1 '09, there you can see that as a percentage of inventory, or, excuse me, as a percentage of revenue, our inventory is actually up end of Q2 versus Q1. And this is where you see that we are getting prepared, of course, for the seasonality of the second half.

So you see an improvement clearly on year-on-year, but you see as well that sequentially as a percentage, we go a notch up to prepare, of course, for the seasonality of Q3, which as usual, Q3 is always a particular quarter where the inventory goes up to prepare then for the strong seasonality of Q4.

The next question you're asking, Didier, is relating to the incubators. Well, if you recall, incubators, we really pretty much created a bit more than two years ago. We wanted to stand before, or I should say, we wanted to stand before we walked, and we wanted to, obviously, walk before we run. So we are kind of -- after two years, we have now these incubators which are dedicated to each of the three sectors. We have one for Lighting, one for Healthcare, and one for Lifestyle. They have now two years, a portfolio in which we have a couple of interesting things. And in order to have these incubators closer to the customer base, and closer to basically the center of gravity for this initiative, we've decided now to basically, without changing the governance really, but to put them closer to where they belong, i.e., each of the three sectors.



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And in terms of numbers, I think we had guided you on EUR10 million to EUR15 million yearly; maybe a bit more for one of them, for each of those three. And those numbers have not really changed. You will have full details, as I said, in September. So no real change, beside the fact that we go into the next step by just making those R&D efforts closer to where the center of gravity is, which is in the sector for each one of them.

Didier Scemama - RBS - Analyst

Can I have a follow-up?

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

Sure.

Didier Scemama - RBS - Analyst

Thanks for your answers. That's very helpful. I was just wondering if you could give us maybe a bit of your feeling as to wholesalers and retailers in Eastern Europe. Many of them have been hard hit by the credit crunch, so I was just wondering if you have seen a worsening of the situation, stabilization or improvement.

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

Yes, it's very difficult to conclude. I -- we've seen -- well, let's take Russia, because you are specifically talking here about consumer lifestyle in Russia. What we had seen in S2 last year was a lot of tension. We have seen in Q1 this year some, I would say, easing off, and right now, I would say all in all in Eastern Europe, and that goes beyond Russia, we're seeing globally an Eastern Europe which is under pressure.

So I would say up -- sorry, down, then up, then balanced I would say in Russia. But globally, if you extend beyond Russia, I would say Eastern Europe from a Lifestyle, Consumer Lifestyle portfolio, under pressure. And in all cases, we know we manage very, very carefully when we are not sure basically about, in particular, the customer risks, we are very, very drastic. So in case of doubt, we always, always are very, very careful in order to protect, obviously, the risk dimension there.

The one thing though I want to say on Russia is that -- and that's not basically outlined in the release, is that our Healthcare business did well in Russia in the second quarter. And I think that is something which if you step away for a minute from Lifestyle, which is where your question was essentially, there I think our Eastern Europe portfolio has actually done well in the second quarter.

Operator

Thank you, sir. And the next question comes from Scott Babka from Morgan Stanley. Please state your question.

Scott Babka - Morgan Stanley - Analyst

Good morning, gentlemen; two questions, please. First one, if you could just go through a bit more detail on the changes on the pension assumptions. I know you've said that there's no immediate cash or P&L impact, but can you give us an ongoing P&L impact for 2010 and beyond from the lower assumed asset returns?

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And then second, the outlook statement points towards a sequential improvement in top line. Can you just elaborate on what you're seeing in the healthcare market given the order trends, and now the fall off in home healthcare. It seems difficult to me that we'd see that market start improving until 2010, but I just want to know if you're seeing anything different. Thank you.

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Okay. First of all pension, let me say a few word on pension. The -- as you know, we are an IFRS company now for -- essentially for now six months. As you know, we've gone away from US GAAP, so we are totally governed by IFRS. And as part of IFRS regulations, basically, you have to give an update on a certain number of elements, media, and that's part of this particular process which has led us to basically make the decision to basically update the -- some of the key factors which drive pension calculation in our first (inaudible) numbers.

So the three indicators, or the three factors which we have updated, one is of course this so called EROA, which is the expected return on assets, where there, using a formula, we've taken a more conservative view on the expect return on those assets. There, we've been conservative. We've taken despite, of course, the current latest trends, we've taken, because we've used consistent indicator with the past, we've taken an increase in the assumed inflation rate. That, obviously, has had an impact. And finally, in our owing of credit spreads, which is affecting the pension obligation discount rate.

So I would say we've taken a bit of a conservative view media, because that's part of IFRS. That's what you are expected to do now. And as a result of course of this, the [funded] status of the plans has been reduced, and the net balance sheet position of these plans has reduced as well all in all. And you see all that being disclosed in the release, as well as in one of the detail charts which is in the pack.

We will see basically where those indicators go at the end of the year, because we will revisit again these indicators, and we will see then what happens to the end calculation. None of this, as you've mentioned in your question, has a cash flow impact. And to the latter part of your question, you're asking me what would this have now, not on the balance sheet but on the P&L, yes, I think if these particular ratios or indicators were to stay where they are, they could have an impact, a non-cash impact on the pension cost in our P&L next year. But it's too early to really quantify it. And, as I said, it's only at year end that we will be able to make that calculation. So I would not speculate on what would be that impact in year end, because those ratios could actually change and be revised again, in particular inflation I would say at the end of this year.

I think your next question was related to the healthcare market. I think on the healthcare market, you really have to -- the world is now, obviously, starting to look a little bit almost two-tier. In the US, as I said in the introduction remarks, we see two things. I think the uncertainty linked to the Obama legislation is still very much in the air. Talking to informed parties, we are told that Q3, and definitely Q4, some of that uncertainty one way or the other will be waived, and we will see, obviously, a little bit more clarity there.

And I think it's too early to comment on where these measures are going and what will be the impact, positive or negative on the Healthcare business. What we have seen in that second quarter is a very subtle softening of financing conditions for hospitals, at least our customer base. But again, way too early to derive any particular conclusion from that. If you translate that from a US perspective in terms of orders, what you can see is that for Healthcare, the second quarter as far as Emerging was concern, US Emerging, we were with the same kind of negative comps we had in the first quarter, so no worsening there. And all in all, Equipment across I would say the whole of North America being I would say double digit negative growth. But there better all in all, or at least not worse than what we have seen in the first quarter.

Let me move now to out of the US, and there you have other things. I think all in all, what we call international, there, we ended up with incoming orders growth of 6% which, of course, is a number which is significantly different from what we had seen, certainly in the first quarter. Imaging Systems there was up mid single digit so, clearly, you can see that out of the US, that second quarter was -- I mean, it's not good, but it's better than what we have seen in the first quarter.



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And the more interesting part in international markets was emerging markets, where we had seen the beginning of a trend in the first quarter to some extent on the back of the M&A we've done in those territories in the last six quarters. So there, we continue to see some tailwind. And both in terms of revenue, which was, I would say, around -- in the low teens kind of increase in terms of revenue, as well as in terms of incoming orders. We continue to see some encouraging sign in those emerging markets.

So that's as much granularity I can give to you on Healthcare for the second half.

Operator

Thank you, sir. The next question comes from Martin Prozesky from Sanford C. Bernstein. Please state your question.

Martin Prozesky - Sanford C. Bernstein - Analyst

Good morning, gentlemen, I've got two questions, please. Just continuing on Healthcare, I've got a -- I know that you've said -- you've given us the geographical details. Could you talk a bit about Home Healthcare and Respironics and what you're seeing there? It seems like the business is holding up well from the results. If you could just give a bit more color there.

And the second question, just on working capital, what are your expectations into Q3, given that we're heading into the Christmas stock season? Do you expect working capital reversals? And also, given your earlier response on supplier risk, how do you reconcile the improvement we saw in Q2, especially the accounts payable increase, with being comfortable with supplier risk? Thanks.

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

I think on the Home Healthcare portfolio, we basically had all in all a portfolio which was quasi-flat. Actually, we had a -- we have a large funnel of products and -- to come up, but all in all, the revenue, the comp revenue, including all product categories over Healthcare, was quasi-flat. The profitability held up very well, and there, we had, I would say, our traditional mid teens kind of EBITDA margin that we've seen consistently over the last previous quarters.

As far as working cap is mentioned -- is concerned, in the third quarter, we should see, indeed, the revenue to come up as, obviously, as an anticipation of the selling season of the fourth quarter. And as far as the increase of payables in the second quarter versus the first quarter, if you go, and you have I think the elements to do that in our reporting, you will see that all the elements of our working cap actually made some progress in Q2 versus Q1. I think there was no real spectacular progress from the increase of payables versus, for instance, a decrease of inventory, or the decrease of the DSO and the decrease of receivables.

So we are certainly not trying to stretch our suppliers by obviously putting them in a situation which is even more difficult than what it is today. And going back to I think one of the early questions I got into this call, we're trying to stay very close to our suppliers, and fully appreciate the status they are in, good or bad. And I think to inform all details, I will send you back to the, I think, the answer to the second question in this call, where I gave you the specific proof points on this particular one.

Martin Prozesky - Sanford C. Bernstein - Analyst

Thanks very much. One follow-up on the Respironics question, Home Healthcare. So your comment, is that globally applicable across markets in terms of the strength of the margin?

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Pierre-Jean Sivignon - Royal Philips Electronics - CFO

Yes, I think Respironics has always been, and I would say Home Healthcare in general is a business which, as you know, is largely US based. In our Home Healthcare business, one portion, which is more international than the rest of the Home Healthcare portfolio, is indeed, as you've said, Respironics. And there, the differential in margin, I think, is not significant. So this is a portfolio and a business model which is, I would say, consistent in terms of profit -- excuse me, consistent in terms of profitability across geographies.

Operator

Thank you. The next question comes from Gael de Bray from Societe Generale. Please go ahead with your question.

Gael de Bray - Societe Generale - Analyst

Thank you. Good morning. My first question is related to your margin target, given the reallocation of the incubators to the business sectors. Do you intend to cut your margin targets accordingly? And also, do you believe that you could revise downwards at some stage the margin target, in particular, for the Lighting division, given the change in the mix we are seeing right now with, for example, demand for automotive applications expected to remain structurally lower maybe in the coming years compared to what it's been over the past few quarters or over the past few years?

My second question is again related to pensions. So you disclosed the change in the funded status of the principal defined benefit pension plans. Could you maybe also give us an update on the level of the (inaudible) obligations, and the level of the other post requirement benefit obligations at the end of June compared to the end of December? Thank you.

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

I think you mean for the unfunded?

Gael de Bray - Societe Generale - Analyst

Yes.

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

But the unfunded, they are really non-significant. But I will try to come to that. I think the bulk, obviously, of the question is on the deferred -- so what we call the defined benefit pension plans, and there, we are essentially talking about the three countries which are the UK, the US and the Netherlands, right? No, back to your first question, are we going to change the margin targets for the three sectors on the back of the reallocation of incubators? The answer is, no.

I think we talk about amounts of money, around EUR10 million to EUR15 million; maybe slightly above EUR15 million in the particular case of one of them, and we not planning to change the margin targets. To the contrary, I think we think that by putting those incubators closer to the product line of reference, we will get some better synergy there. So the answer is no plan to revise those target margins there.

As far as, basically, your question on lighting, I think your question -- the way I interpret your question is, are we seeing a change in the business model of lighting, and accordingly other target profit margins there?

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I think the answer is, we are seeing, clearly, as you see this quarter, basically a Professional Luminaires business which is under some pressure. The other product categories have started recording some growth sequentially. But at the same time, you've seen that the bulk of the cost reduction programs, which we have actually announced at the end of last year and early this year, combined with the additional programs which were announced as part of this particular quarter, most of that, if not all of that, in the case of lighting, will start helping us in the second half.

So at this particular point of time, we are not [openly] planning to change our business model and our business targets for the Lighting business. And I think there, the answer will be from a dramatically reduced cost base, looking forward, if of course the revenue were to continue to remain under pressure for the quarters to come.

On the back of pension, I think I ought to give you many more details. I think we can maybe offline, if you have any specific questions beyond what is actually detailed on page 36 in the release, where there you have a full paragraph, it's called Note 18, where you have all the elements in the capture called recognizing consolidated balance sheet. There, you have all the disclosure that we are prepared to give you on this particular territory. If you have more than -- more question beyond what is in Note 18, I think [Stuart McCrone] will absolutely take your question offline, just to make sure that we fully answer whatever additional details you might want too on top of that page 36, Note 18, in the press release.

Operator

Thank you, sir. The next question comes from Martin Wilkie from Deutsche Bank. Please state your question.

Martin Wilkie - Deutsche Bank Securities - Analyst

Hi, it's Martin Wilkie from Deutsche Bank. A couple of questions; the first one on restructuring. You mentioned that you might still have to step up some restructuring into the third quarter. But just more generally, if you do see a demand stabilization, so not necessarily any improvement, but just a stabilization around current levels, do you think it's fair to say that the bulk of the restructuring charges are now behind us? Or are you still thinking that there's meaningful restructuring that may need to be taken as you go into 2010?

And then the second question is just on the cash effect of that. You've given the cash effect on one of the slides in the chart, but just to understand, of the charge you've taken so far, how much of that is still yet to be cash effective, and how much of it was essentially cash effective in the first half of 2009? Thanks.

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

Well, I think the -- in terms of restructuring, the sector which has gone through probably the vast majority of the restructuring is probably Lifestyle. Because there, we were, as you know, there we started pretty much in the first quarter of 2008, one, as part of the decisive measures being taken on television, and B, as part of the merger of CE and DAP which was announced in September '07, and activated, moving onward, on January 1, '08.

So I would say a good bulk of the effort is done. I can't exclude more effort. You saw that we are announcing some more effort in Q3, but I would say all in all, we've done a lot of what is to be expected in Lifestyle.

I think in the particular case of Healthcare, we -- you see that we are announcing basically, in total, about EUR50 million for the second half. This effort was expected. We've done minimal restructuring in Healthcare. We have done a little bit of restructuring in the latter part of last year. There, we are announcing EUR50 million for the second half. There could be potentially more to come.



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But this is very much playing by ear. To a previous question asked in this call, I was asked, how do you see second half? I said second half very much depending on the uncertainty of the US market, so there we will play it by ear, and we will basically update you on an (inaudible) basis, very much depending on what will happen on the Healthcare market in the second half.

And finally, in the particular case of Lighting, I think that the -- I think in the particular case of Lighting, we've always done some restructuring every year. We've stepped up the base very much -- we stepped up the base very much for the -- obviously, the -- to address the revenue downturn that we currently see. So I would say that for Lighting, this will be there as well very much a reflection of how long this downturn is.

Clearly, we are going through levels at Lighting which are normal. This will remain normal until we see a little bit more clarity on the revenue. But you should consider that the restructuring we're currently doing at Lighting as of normal. The cruising level, if you go back to this pre-crisis situation, was more in the EUR40 million to EUR60 million per year kind of level.

So right now, I would consider the restructuring in Lighting as abnormally high but, obviously, addressing, until we see more clarity, the nature of the cycle we're in.

In terms of cash, I think we are giving you essentially the complete transparency, because you can see all the costs which are being booked, and we -- you have on page 31, full details. And what we've told you is as an average, the cash as a percentage of the ultimate cash outflow, as a percentage of the cost actually booked in the income statement, is around 70%.

I think, so, if you wanted to do a macro modeling of cash, cash out that is, because don't forget that the cash income's, obviously, within a year to a year and a half post cash out, on the back, obviously, of the payback. But in terms of cash out, I'm strictly talking cash out, you should assume about 70% of the amount which is being booked on the cost line in the income statement. So with all that information, I think you can do pretty much your modeling.

Operator

Thank you, sir. Your next question comes from Jan Hein de Vroe from ING. Please state your question.

Jan-Hein de Vroe - ING Financial Markets - Analyst

Yes, good morning. I have a couple of questions. First of all, on the restructuring savings you have, what part of this could already be seen in the quarterly results, or is it just the operational leverage which helped you improve margins over the quarter compared to Q1?

And then second, on the Lighting Division, could you give some granularity how the Lamps business itself is behaving? Minus 18% for the full division this -- you've already indicated in Professional Luminaires, you're seeing the worst. But is Lamps growing at all? And could you give us some more granularity on that?

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

Yes, okay; question one, Ops leverage. Are we benefiting from the restructuring plans already in Q2? I think the answer is, there is some, but not really significant. But don't forget something which we -- beside the restructuring that we have announced in Q4, we had launched other initiative in Consumer Lifestyle almost a year and a half ago. And we told you that we would come up with EUR150 million to EUR200 million savings by the second half of the second half of 2009. So some of the operating leverage today I would say you would see in Lifestyle.

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You've seen that the margin of Lifestyle was almost EUR1 billion less of revenue in Q2 '09 versus Q2 '08 is almost now at the level -- first of all, the EBITA, the clean EBITA is now profitable, which I think is important. And second of all, that clean EBITA margin is quasi at the level of last year. And the operating leverage there is on the back of all the initiative we started taking early '08. And so if there is one sector for which there is operating leverage already in Q2, that would be Lifestyle.

As far as Healthcare and Lighting is concerned, we had a little bit of Ops leverage coming from the restructuring in the Q2 numbers. I alluded to that in a previous question on the reconciliation of the Healthcare margin. As far as Lighting is concerned, very little, if any, is yet in the numbers of Lighting, and the vast majority of the impact, as you can see on the chart, page 31 in the deck, which is as an appendix to the press release, you will see that in the particular case of Lighting, we expect the first EUR56 million to start helping us in the second half, and the rest to come in the year 2010. This is probably the one sector where there will be the biggest lag.

In the case of Healthcare, we expect about EUR65 million of savings on the second half to come in on the back of the restructuring which has been done. So I think that's as precise as I can be on the leverage.

Your last question was on some granularity in the various elements of the product portfolio of Lighting, and your specific question was on Lamps. I think on Lamps, we basically in Q1 -- so mid teens, negative growth. And in Q2, as I mentioned, all the product categories, with the exception of Professional Luminaires, so their sequential comps, negative comps, getting into the right direction.

And we had a tightening of that negative comps by a couple of points for Lamps, in the second quarter. So still in negative territory, but a few points better in terms of improvement of the sequential comp versus the first quarter of 2009.

Operator

Thank you, sir. The next question comes from Nicolas Gaudois from UBS. Please go ahead with your question.

Nicolas Gaudois - UBS - Analyst

Yes; hi there, Pierre-Jean. My first question is on Lighting. Have you seen any changes in behaviors of professional distributors in particular in how to manage working capital? In other words, is there any verity at all to come back for them to normal mid cycle levels of inventories as we enter H2?

And second question is on dividend policy; in a post -- a good quarter for cash generation, any functioning then how you look at [own line] dividend policy, obviously payable next year? Thank you.

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

Okay, Nicolas. Good morning. On -- yes, I think on the wholesalers, and we're talking now professional distributors for Lighting, what we see is clearly distributors who are now managing their inventory by very, very tight pegging between the selling in and the selling out. And we are not feeling that these distributors will restock. I think we -- what we feel is that they will, from now on, adjust their selling out to the selling in, i.e., to the purchasing from us.

So we're not counting on restocking, and we are -- the way we run our business is by assuming that these businesses will almost go to the kind of just in time pattern that we see, for instance, for years in Automotive Lighting.

Your second question, Nicolas, is on dividend policy. Now I think it's -- we certainly enjoyed the cash flow of Q2. I think it's a proof point of all the efforts being made to manage all the elements of working cap, as well as CapEx, because CapEx is playing



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a role there as well. And it's too early to say much more than -- you know our answers on dividends. You know our policy. You know our history. You know the importance we give to it, but it's very much too early to say anything more than what we've said at the end of the first quarter on that particular subject. So no more -- no update on dividend, beside the fact that we appreciate our cash flow performance in Q2.

Operator

Thank you, sir. The next question comes from Andreas Willi from JP Morgan. Please state your question.

Andreas Willi - JP Morgan - Analyst

Good morning. Just two questions left. First one on your PC Monitor business. I think you closed that transaction in Q2. Was there no effect on P&L from that, or should we expect something coming -- going forward in terms of a gain or a loss?

And the second one, you did very well on reducing corporate expense now running at EUR20 million a quarter in Q2. Is that the run rate we should use going forward?

Pierre-Jean Sivignon - Royal Philips Electronics - CFO

Yes, good morning. Yes, we have indeed closed -- thank you for mentioning it, because we basically had alluded to that transaction in, I think in the third quarter of last year, and the transaction has now closed. We did a press release, I think, during the quarter, so we felt that it was no use to re-mention it one more time in the press release of the second quarter results.

But you are correct, the transaction is now closed. The business is officially now out of our perimeter, and we've signed a brand licensing agreement with TPV for monitors. So we are out of monitors. There was a small impact in -- negative impact, but not significant, I think about -- yes, I think it was about EUR10 million to be very precise, which we felt which should not disclose. But indeed, there was a small negative impact coming from that transaction in the bottom line of Lifestyle for the second quarter.

So that business is now deconsolidated, and we -- and I think I want to take you to one slide which has been created in the pack, which is basically showing you on television what is now the impact of television in our portfolio, the evolution of that portfolio, and the evolution for the quarters to come.

And I think if you go back to the pack, you will see those slides in detail. So I bring your attention on the fact that we have created -- it's actually slide 10, where you can clearly see a good summary of where is the Lifestyle portfolio vis-a-vis television. And for those of you who haven't seen the slide, I will just call a couple of numbers.

In the -- basically, in the first quarter of '09, we now have the television portfolio representing 39%, and -- in the first quarter, going to 34% in the second quarter. And those compares to, for instance, numbers which were 45%, 48%, 44% for the first, second and third quarter of last year.

So you can see that the role and the impact of television in our portfolio is continuing, obviously, to come down and, obviously, that shows as well, not only at the Lifestyle level, but at the level as well of the entire Philips perimeter.

Operator

Your next question comes from Olivier Esnou from Exane. Please state your question.

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Olivier Esnou - *Exane BNP Paribas - Analyst*

Yes, good morning. Thank you for taking my question. What I would like you to address maybe is some comment on pricing trends you see by division. And also, maybe geographically, for example, if the non US Healthcare business become, or continues to gain ground as it is now, would that change your price mix in Healthcare? Thank you.

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

The pricing by division, I think in the particular case of Healthcare, we see some pricing pressure. I think we've been transparent about that. It's definitely not coming down. It's not massively going up. It's probably hedging up a bit, clearly, and certainly in particular in North America for Healthcare.

Across the other product categories, I would say that there is nothing particular to report; maybe on Lighting, a bit of pricing pressure. At the time we are, obviously, at the bottom of the cycle. I think in the particular domain of Lifestyle, this is where, given that we have product basically leadership position, that's probably the territory where we are the most sheltered. And you see that as well from the resilience of the DAP portfolio, which continued as well to resist well in that second quarter.

So to summarize, I would say a little bit of pricing pressure; maybe a notch above in Healthcare, in particular in the US. And certainly, a little bit of it as well in Lighting at this particular stage in the cycle.

I think your next question was more specifically on Healthcare. Would -- I think the way I interpret your question is, do we have lower margin in Healthcare out of the US versus in the US? And the answer is, no. I think we are -- it's, all in all, balanced.

And the one thing I would like to say that, one of the questions which came in the previous quarters, and certainly last year when we started gaining ground in emerging markets, there was a question on what is going to be the future profile of the Service business in emerging markets. And after now almost a year, I would say 18 months of traction in emerging markets in Healthcare, in Equipment, we see that the Service pattern and the maintenance revenue to come on the back of those service agreements, that is normalizing in a way which is not too different from what we see in the more mature part of the world.

So all in all, I am saying both from Equipment margin as well as Service margin, we're not seeing a very different pattern between the new markets versus the mature markets.

Operator

And the next question comes from Julian Mitchell from Nomura. Please state your question, sir.

Julian Mitchell - *Nomura International - Analyst*

Yes, thanks. I had two questions. The first one was on the headcount of Philips overall. I was slightly surprised that it was flat sequentially, given all the fixed cost reductions taking place. So I was wondering if you could talk about that, and where you think it goes in the second half.

And secondly, your emerging market business has continued to see revenues falling more than the mature markets. I would assume that should reverse pretty quickly in the second half. If you could just confirm that, and maybe give a bit of color on each emerging market, that would be great. Thanks.

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Pierre-Jean Sivignon - Royal Philips Electronics - CFO

Yes. I think first question, on the headcount, headcount is always a bit difficult to read because, of course, you don't know where the headcount is. This -- obviously, this document doesn't give you the geography on the first hand on second hand. It doesn't give you the split between, obviously, the fixed headcount and the variable headcount.

I think what has happened, and we've tried to explain that on page seven of the press release, basically, what we've done is that the permanent headcount has fallen by more than 2,300 people. That's indeed on the back -- or that's on the beginning of the back of the various restructuring plans that we have announced because, of course, there is more to come there, as you've seen on the expected savings on restructuring.

But that 2,300 reduction of permanent headcount has been offset by an almost equal increase in temporary labor due to the seasonality, essentially at Lifestyle and at Lighting. So in absolute number, yes, it looks sequentially flat. But in terms of the nature of headcount, it's a different ball game.

Now your next question is on the -- what's happening in the -- yes, and if I may add, there is as well, of course, an element coming from acquisitions right? which, obviously, you have to realize that we have consolidated a little bit of extra parameters in that -- beginning of -- in that second quarter which, obviously, adds a few heads to the reconciliation of headcount.

Coming to your question on emerging markets, you are correct to point that in this -- one of the particularities of this second quarter is that the emerging market negative growth was a touch worse -- close, actually, to the level of mature markets. It is actually essentially driven by Lifestyle, because, clearly, consumers in those territories have been cautious in that second quarter. And it's driven as well by Lighting, essentially on the back of Professional Luminaires. I think those are the key drivers.

The offset came from essentially, Healthcare where, as answered in a couple of previous questions, in emerging markets, as well as in Eastern Europe, because that's the question I got earlier today, there we've done well. And, actually, we've grown.

So you wanted yet another -- bit more color by country now. I think there is one country which all in all was still in positive territory across the three sectors -- sorry, I should say with the three sectors combined, and that country is India. And in the particular case of Brazil, we saw low teens negative growth, driven essentially there by the Lifestyle, obviously, prudence of consumer. And China was actually, I would say, down as well. And there, totally driven by Lifestyle and to a certain extent by Lighting. Healthcare being, I would say, high single digit growth, as previously alluded to.

Operator

Thank you, sir. And the next question comes from Philip Scholte from Rabo Securities. Please go ahead with your questions.

Philip Scholte - Rabo Securities - Analyst

Yes, good morning. Philip Scholte, Rabo Securities. As a follow-up on the Healthcare trading environment, do you also see a continued shift towards low and mid end equipment?

And the second part of that is we have seen GE announcing a pretty aggressive financing possibility. Do you see increased competition in the financing part as well, if you're also talking about a touch easier environment there?

And lastly, on the Service part, we see equipment ordering going down very rapidly. Do you see any impact on the Services part slowly kicking in as well, also in pricing pressure, or maybe hospitals taking cheaper kinds of service contracts in that?

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Pierre-Jean Sivignon - Royal Philips Electronics - CFO

Yes, three questions. I think the first question was -- let me answer the second one, while I come back to the -- the second one was increasing competition in financing. Well, as you know, our model there is different from the one of our peers. We have, basically, joint ventures in which we have an equity -- minority equity presence in those particular joint ventures across the planet.

These joint ventures have been certainly found to be very competitive, because they are on the back of banks with a very, very good rating. And we find that the offering from these particular banks has been competitive. And we do see an increased volume of transactions taking place via these financing arms which, as I repeat, are out of the credit balance sheet with no recourse, no credit recourse, risk exposure to us.

So you could say that there is increased competition in the sense that there is increased volumes there, which means that there is an increasing portion of the sales in Healthcare Equipment which is being financed. I think this is fair to say that, and we are addressing it the way I just mentioned it.

Your first question was, actually, do we see continued trending down on Equipment. I think, yes, I think that trend is there. But interestingly enough, let me give you a couple of interesting other proof points on elements of, I would say, of data on Q1 -- excuse me, on Q2.

We saw in Q2 some growth in a few modalities which had been struggling in the recent past, which is MR and CT. And it's interesting to note that we have booked our 100th order for the iCT256. I think that you will find that in the release. You'll remember this is by far the most sophisticated piece of scanner which today is certainly in our portfolio, and I would say probably, to some extent as well, on the marketplace. And we are now up to the number 100. So it does show that at the time, obviously, the market is trending down. The upper end of the market is still very much there, as indicated in the domain of CT. But the trend you are alluding to is there, and there is no denying of that.

And finally, I think your third question was related to Service. And, yes, I think on Service, our Service business has grown in the second quarter on the back, of course, of our increased install base. Of course, if the incoming orders on Equipment were to continue very much longer, you would see an impact. At this particular point of time, we don't see it yet, but you can't exclude this would come on an extended period of negative growth on incoming orders.

As far as pricing pressure is concerned, there are discussions, of course, on a, I would say, punctual basis with our customers, but we try to address that as much as we can. And as mentioned in the release, the profitability of that business has been pretty consistent and pretty resilient in Q2 versus what we've experienced in the past.

Operator

The last question is a follow-up question from Michael Jungling from Bank of America. Please state your question, sir.

Michael Jungling - Bank of America - Analyst

Great. Thank you very much for the follow-up questions. The first question I have is can you please comment on what you think the impact will be for 2010 following the draft reimbursement release from the Medicare for outpatients, or for [prepay] facilities about 1.5 weeks ago?

And secondly, we saw from the commentary from Zumtobel, and also from Acuity, that they expect the Lighting market to bottom or so in 2010. And I was curious whether you can provide me with your comments on whether you would agree with that, or perhaps a later or an earlier recovery in the Lighting market. Thank you.



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Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

Yes. I think on the first question, and it's -- I think the particular piece of legislation you are referring to, to the best of my knowledge, has not been voted yet. I think there are -- we are hearing that there is a strong chance that it gets voted. Hard to see how much impact that will have. I think this is a measure which is largely expected, from what we understand.

I would expect, obviously, a good chunk of it would be already more or less anticipated. But you have to realize, we should always keep in mind that the measure you are alluding to is impacting the out-of-hospital, obviously, business. And as you probably remember, in terms of customer mix, historically, Philips has been essentially a hospital play.

So this legislation has not been voted, but most probably will be voted; probably anticipated to some extent; will be impacting the non-hospital world, and beyond that, hard to really quantify what will be the impact on 2010. I think we probably need another quarter. I think by the end of Q3, we probably can specifically decide the -- discuss the impact, and by then I guess a piece of legislation will have been voted.

Your second question relates really to -- my understanding of it is really, when is the Professional Luminaires business bottoming? I think this is a very fundamental question. We have seen -- indeed, this is the only product category in the Lighting portfolio where the comps of Q2 were worse than the comps of Q1. So this is -- the Commercial Construction, as we speak, is still, obviously, contracting. I think we said that in the release. If you look at all the regions, it's true; just about, I think, all geographies with the exception of one.

Now if you look at the lead indicators, whether it's purchasing indices, whether it's architect demand, and there are some early indicators for that, and we've looked at that very carefully, you start seeing some very early signs, in particular for architect demand, architect design, some very early signs of something which could start moving the other way around. But I would say it's good to have that.

If it were to have an impact on the business, there will be the usual lag because there is always a lag, of course, because of the value chain, and certainly too early to talk about it. But we would hope that in the course of the second half, we see something a little bit more substantial and a bit more structured.

The other thing I would like to say is that Professional Luminaires is the one product category which could benefit from, obviously, government incentives. There, there are three countries at stake, which are US, Germany and China; to some extent, a little bit of France as well, but to a smaller extent. And those plans are expected to kick in, to start kicking in, in the second half. And from that particular perspective, which is beyond the architect design leading index, we have to wait and see, later in the second half, to see if there is a little bit of better news on the back of those trends.

I think that's as much clarity and as much lead I can give to you on the Commercial Construction/Professional Luminaires product category.

Operator

Thank you, Mr. Sivignon. That was the last question. Please continue.

Pierre-Jean Sivignon - *Royal Philips Electronics - CFO*

I think I want to, obviously, thank all of you for being on the call, especially for those of you who are on the east side of the loudspeaker; sorry, excuse me, on the west side of the loudspeaker, because it's very early for you. And for those of you who



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can take a little bit of time off, I wish you, and I wish some of us, all the best in terms of that time off. Thank you very much. Goodbye.

Operator

This concludes the Royal Philips Electronics' second quarter results 2009 conference call on Monday, July 13, 2009. Thank you for participating. You may now disconnect.

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