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EDITED TRANSCRIPT

PHIA.AS - Q2 2012 Koninklijke Philips Electronics NV Earnings Conference Call

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OVERVIEW:

PHIA.AS reported 2Q12 comparable sales growth (adjusting for currency and portfolio changes) of 5% and net income of EUR167m.

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PRESENTATION

Operator

Welcome to the Royal Philips Electronics second quarter result 2012 conference call on Monday, July 23, 2012. During the introduction, hosted by Mr. Frans van Houten, CEO, and Mr. Ron Wirahadiraksa, 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. Abhijit Bhattacharya, Head of Investor Relations. Please go ahead, sir.

Abhijit Bhattacharya - *Royal Philips Electronics NV - Head of IR*

Good morning, ladies and gentlemen. Welcome to this conference call on the second quarter of 2012 for Royal Philips Electronics. I am here with Philip's CEO, Frans van Houten, and our CFO, Ron Wirahadiraksa.

In a moment, Frans will take you through his introductory remarks, and provide an update on our performance. Ron will shed more light on the details of the financial performance during the quarter. After this, both Frans and Ron will be happy to take your questions.

As usual, our press release and the accompanying information slide deck were published at 7 am CET this morning. Both documents are now available for download from our investor relations website. We will also make available a full transcript of this conference call on the investor relations website by tomorrow morning, at the latest.

With that, let me hand over the call to Frans, to start proceedings for the day.

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Frans van Houten - *Royal Philips Electronics NV - CEO*

Thanks, Abhijit. Welcome, and thank you all for joining us today for our second quarter 2012 earnings conference call.

The improved results in the second quarter are encouraging, and important proof that our multiyear change and performance improvement program Accelerate!, continues to positively impact our business. I am pleased with the response of our people, and organization, to this major and fundamental transformation of our Company.

In a relatively short period of time, we have started a large number of initiatives to redirect resources to those businesses and geographies that have strong growth, and profit potential, and we have taken out costs in other areas.

We have begun to rebuild our value chain, to make it leaner, faster and more effective, to speed up time to market, to use less working capital, and above all, to improve customer service.

We are redefining our Company culture, to make it agile, and entrepreneurial, where people take ownership, are eager to win, and where they team up across geographies and businesses to excel.

We have made significant management changes in the top 200 positions in the Company, with new leaders from both inside and outside the Company, which is positively impacting cultural change.

We continue to attack our cost structure, and are ahead of plan with our EUR800 million cost savings program where we have targeted the overhead structure of the Company, in areas like IT, finance, HR, real estate, and by leaning out management layers and organization structures.

The design of this program is different from other programs, since it focuses on overhead layers, and fundamentally changing our ways of working, which means that, when these costs are removed, they will not come back, despite top line growth.

We have removed EUR176 million of cost cumulatively 'til the end of the second quarter. We have also invested about EUR34 million in various initiatives that enable these fundamental cost reductions in the second quarter of 2012.

All of this work is beginning to result in improved operational and financial results. In Healthcare, sales and order intake are growing well. The growth businesses Consumer Lifestyle are performing solidly, and in Lighting, LED-based sales continued its strong growth momentum.

In Healthcare, order intake grew 4% year on year, and very importantly, orders were up 13% in growth geographies. As we noted last quarter, we do see headwinds in Europe, where order intake actually declined by 6%.

North America, order intake declined by 3% in the quarter, as we saw a decrease in order intake for our Government business.

Healthcare comparable sales were 7% higher, year on year, with solid sales increases in all businesses, and notably, double-digit growth in Patient Care and Clinical Informatics, high single-digit growth at Imaging Systems, and mid single-digit growth in Home Healthcare Solutions.

This growth has resulted in improved earnings, with the adjusted EBITA for the quarter being 14.1% of sales, compared to 13.2% of sales in the second quarter of last year.

From an operational point of view, we've continued to strengthen the Healthcare industrial footprint in growth geographies, most recently with our strategic development and manufacturing facility in Pune, in India, starting commercial operations.

The site will drive local innovations in imaging, and improve access to healthcare for India and other growth markets. This will add to the capabilities of our manufacturing site in Suzhou, in China, which produces a portfolio of imaging solutions for China and the rest of the world.

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The Consumer Lifestyle business continues to respond positively to the changes that we are making across the organization. On a comparable basis, sales in Consumer Lifestyle increased by 3%, driven by a high single-digit revenue increase in our growth categories, Personal Care, Health & Wellness and Domestic Appliances. This has resulted in the adjusted EBITA improving from 3.1% to 7.1%.

As you know, we have made a significant move away from the Consumer Electronics legacy of Philips. And sales of remaining Consumer Electronics products are now less than 7% of Group revenues. These are all in the Lifestyle Entertainment business.

I am pleased that we have been able to improve profitability of Lifestyle Entertainment with the measures we have taken, like reducing the cost base, and focusing innovation on sound and connected entertainment, even though the overall business saw high single-digit sales decline, due to reduced demand for home audio video, and MP3.

We are considering various business models for the Lifestyle Entertainment business to drive more value. As a result, I'm happy to announce the signing of a distribution agreement for Lifestyle Entertainment in North America, with Funai.

We have a long and successful relationship with Funai, and we look forward to repeating the earlier success with the Lifestyle Entertainment business in North America.

We have also sold the Speech Processing business to Invest AG of Germany.

Going forward, we will continue to look at various business models to create value in this business, and will update you on those plans as appropriate.

In Lighting, our rapid transition to LED-based solutions continues to show positive results. LED-based sales grew 37%, compared to the second quarter of 2011, and now represents 20% of total lighting sales. Excluding Lumileds, the growth in sales of LED products was a strong 57%. More broadly, comparable sales for the whole Lighting sector increased by 6%, year on year, lead by double-digit sales growth in Light Sources & Electronics, and in high single-digit sales growth in Automotive.

From a geographical perspective, excluding Lumileds, double-digit sales growth was achieved -- I'll say that again, from a geographical perspective, excluding Lumileds, double-digit sales growth was achieved in growth geographies.

EBITA, excluding restructuring and acquisition-related charges, was 6.5% of sales, which was flat to the previous year. There was a year-on-year improvement in operational performance, which was driven by sales growth and improvements in our cost structure, enabled by the Accelerate! program. This improvement was offset by Lumileds and Consumer Luminaires, which performed worse than last year.

Following our improved results for the first quarter, our results in the second quarter were another step in the right direction. And while a lot of the foundational work has been done, we still have much more to do in Lighting. And as such, let's speak for a few moments about some of our recent successes on Accelerate!.

We clearly see the impact from our granular approach by business market combination, or BMCs as we call it. The BMC approach leads to higher local market relevance, with better underpinned plans, higher accountability, and better execution.

We saw a 50% reduction in the number of key BMCs, which have a negative deviation versus performance targets. We also see a positive correlation between market share gains and the quality of the BMC plans. This clearly indicates that our granular performance culture and performance management is working. We will continue this with full force.

We are significantly simplifying our operating model and End-to-End value chain execution. This is allowing us to bring locally relevant products and solutions faster to market. In Consumer Lifestyle, compared to the first half of 2011, the number of locally developed solutions in our portfolio in China has almost doubled, even excluding the impact of the acquisition of Povos.

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Let me mention some other early results of the End-to End initiatives. The LED lamps project, which entailed the reengineering of the entire End-to-End value chain for LED lamps between China and Europe, has delivered solid results. LED lamps is now a profitable business.

The Male Grooming project in North America, where we collaborate closely with, for example, Wal-Mart, has resulted in an 18% reduction in inventory levels.

These proof points only reinforce our firm belief that we're on the right track to reduce complexity and improve productivity at Philips, while, at the same time, gain local market acceptance.

We are also making good progress on our overhead cost-reduction program, and are on track to reduce costs to the targeted cumulative EUR400 million by the end of this year by simplifying our organization.

And, as I've said before, the culture in Philips is changing, and we are seeing people respond very positively to our actions by taking ownership at every level. To date, more than half of our leaders have been through a behavioral change program, which has been quite impactful.

With open and direct communication, our people are encouraged to actively contribute. And, as a result, we had thousands of employees competing in our business improvement competition, with hundreds of great ideas to improve our performance and unlock more value.

Of course, reengineering Philips is hard work and it will take time, but the results are well worth the effort.

Finally, we are pleased that the FTSE group industry classification benchmark has reclassified Philips to the Industrial Goods & Services Supersector , from the Personal & Household Goods Supersector before. This reflects the significant steps we have taken to transform our business, to leverage global trends in highly attractive businesses and geographies.

Following the transaction to create a television joint venture, Philips' portfolio is now well aligned to our strategy of building on our leadership positions in Health and Well-being. The reclassification will help investors more accurately value and assess the changes that we have made to our portfolio.

In closing, I'd like to say that there is no denying that the global economy is weaker now than it was just three months ago, especially in Europe which, by the way, accounts for approximately 25% of our revenue. We continue to take actions to mitigate the risks from the increased economic headwinds globally, and as we are a case of self-help, we remain confident in our ability to further improve our performance towards our mid-term targets in 2013 and beyond.

And with that, I'd like to turn the call over to Ron, to go over our financials in more detail.

Ron Wirahadiraksa - *Royal Philips Electronics NV - CFO*

Thank you, Frans. Good morning, and welcome to all of you on the call. I will begin by giving you some color on the developments in the markets we serve, and then walk you through the financial performance for the second quarter.

Let me start with Healthcare; in the US, we are seeing a steady market. Based on recent surveys, we believe that hospitals will increase their capital budgets this year moderately, although economic uncertainty may influence this in the second half of the year.

The US Healthcare industry as a whole must deal with the implications of the Patient Protection and Affordable Care Act, which was recently upheld by the US Supreme Court. Given the lack of clarity related to the implementation of this legislation, it means that market participants in the United States will have to deal with ongoing uncertainty for the foreseeable future.

Once the implications of the medical device tax are established, we intend to mitigate the negative effects by actions through various stages of the value chain.

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We remain cautious on the European markets. Southern Europe continues to be very weak, and economic growth for the remaining part of the Europe is subdued. The austerity measures undertaken in countries such as Italy, Spain, and Greece continue to significantly affect public spending on healthcare.

On a more positive note, the growth economies continue to show good momentum well into the second quarter, where demand is fuelled by government and private spending. In Japan, which is our second largest market for the Healthcare sector, recovery is happening at a steady pace. Overall, we maintain our outlook of 4% to 5% growth in the Healthcare markets we serve and expect to outperform the markets, going forward.

For the consumer markets, in the mature geographies, we have seen an encouraging recovery in the fourth quarter of 2011 for key indicators, such as consumer confidence, unemployment, and private consumption. In the first quarter of 2012, things were already leveling off and now, in Q2, we see a general stabilization, albeit still at better levels than a year ago.

In the US, the unemployment rate has been stable since the beginning of the year, at levels below that of the first half of 2011. In the monthly trends, however, we do see signs that consumer confidence is slipping, although it is still somewhat better than a year ago. Private consumption is expected to continue its modest rate of increase.

In Europe, unemployment in Germany is below last year, but in France and the UK it is higher, with France above 10%.

Consumer confidence remains low in the short term, with Germany being neutral, and France and the UK in negative territory. Southern Europe continues to remain weak.

In the growth geographies, consumer confidence remains high, and private consumption is generally growing. Growth of private consumption is picking up from low single-digit levels in Brazil. It is, however, softening in countries like India and Russia.

From a category point of view, personal care, health and wellbeing and domestic appliances markets show modest growth, whilst lifestyle entertainment markets continue to remain weak.

The lighting market in Q2 was slightly up, versus Q2, 2011, and showed some growth compared to Q1, 2012, mainly driven by LED product categories and growth geographies.

North America has continued to show some strength, relative to 2011. An uptick in residential construction, combined with the beginning of the phase out of incandescent lamps, benefitted the consumer lamps market.

Western Europe continues to feel downward economic pressures, although professional lamps in Germany and professional luminaires in France showed growth, due to mix shifts and bans on incandescent lamps.

In growth geographies, construction remains strong, especially in the Asia Pacific region, driving growth in the lamps and luminaires markets across categories.

The Indian market saw a good growth, especially in consumer luminaires. Global vehicle production in Q2 is anticipated to increase significantly, compared to the same period in 2011, driving growth for the automotive lighting market.

We expect construction in Asia Pacific and Central and Eastern Europe to grow throughout 2012, though at a slightly slower rate than in 2011. Although the construction growth rate across Asia is slowing, it remains a clear growth engine across all lighting categories.

Declines are expected in Western Europe, though the decline will be muted in Germany and France. We expect that the market in North America will ease in the latter part of this year.

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Let me now move to the Philips Group results for the second quarter of 2012. Please note that when I refer to adjusted EBITA on this call, this represents EBITA excluding restructuring charges, other one-off items above EUR20 million in the year, and acquisition-related charges.

Comparable sales in the quarter grew by 5%, when adjusted for currency and portfolio changes. On a geographical basis, comparable sales in our growth geographies grew by 11% in the second quarter. Our growth geographies are defined as all markets, excluding USA, Canada, Western Europe, Australia, New Zealand, South Korea, Japan, and Israel.

Sales from these growth geographies increased to 35% of Group revenues, compared to 33% for Q2 last year.

Sales in North America grew by 7% in the quarter, on a comparable basis, led by Lighting and Healthcare.

Europe saw a decline in comparable sales of 4% in the quarter, mainly due to the market-related weakness I spoke about earlier, which significantly affected Consumer Lifestyle.

Healthcare and Lighting sales declined marginally. Healthcare recorded a 1% decline, mainly due to lower sales in Southern Europe, Netherlands and France. Sales in Germany, Austria, and Switzerland, as well as in Nordic countries, continued to remain solid.

In other mature markets, the Group saw a 2% increase in comparable sales, with Japan continuing to remain strong, with a 7% growth.

Reported EBITA was EUR450 million, or 7.6% of sales, which is higher than the EUR371 million, or 7.1% of sales, reported for Q2 last year.

The restructuring and acquisition-related charges for the second quarter for this year were higher than the second quarter of last year by EUR75 million. This is mainly due to increased restructuring charges in Lighting related to the rationalization of the industrial footprint, and increased restructuring charges in Innovation, Group & Services related to the overhead cost reduction program.

Q2, 2012 EBITA was favorably impacted by the profit on the sale of the Speech Processing business of EUR20 million, and a one-time prior service cost gain in a retiree medical plan of EUR25 million.

Adjusted EBITA was EUR504 million, or 8.6% of sales, in the quarter, compared to EUR395 million, or 7.6%, for Q2, 2011. The improvement in the adjusted EBITA was due to improved performance across the Group.

Net income of EUR167 million was EUR1.5 billion higher, compared to Q2, 2011, largely due to goodwill and intangible asset impairments of EUR1.4 billion taken in Q2, 2011.

Excluding impairments, net income was EUR127 million higher than in Q2, 2011, reflecting higher operating earnings, and a profit in discontinued operations compared to a loss in Q2, 2011. The profit on discontinued operations is due to lower cost, leading to an improving deal result.

Cash from operating activities for the quarter was an inflow of EUR52 million, which is similar to the inflow of EUR63 million in Q2 of 2011.

With that summary, let me now walk you through the performance of each of our businesses during Q2, starting with Healthcare.

Currency comparable equipment order intake grew 4% in Q2, 2012, compared to Q2 of last year. The increase in order intake was led by a good performance in the growth geographies, which increased by 13% on a comparable basis.

In these geographies, Imaging Systems recorded double-digit increases in order intake for the quarter, while Patient Care & Clinical Informatics grew by high single digit.

Central and Eastern Europe and India performed well, with an increase of 26% and 24% respectively. China recorded an increase in order intake of over 11% for the quarter, while Brazil increased by mid single digits.

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Japan, our second largest market for Healthcare, recorded an impressive Order growth in the quarter of over 30%. South Korea also performed well in the quarter, with order intake increasing by over 65% for the quarter.

Order intake in Europe declined by 6%, reflecting the general economic situation. This was seen across most geographies except Benelux, the Nordic countries, and France.

Currency comparable order intake declined in North America by 3%, mainly due to a decline in Imaging Systems, largely caused by lower Government orders in the quarter. It is relevant to point out that Q2, 2011 was a particularly strong quarter for North America, with a 10% growth in order intake last year.

On a currency and portfolio comparable basis, Healthcare had a year-on-year sales increase of 7%. Patient Care & Clinical Informatics had a double-digit comparable sales increase. Imaging Systems registered high single-digit growth, while Home Healthcare grew mid single digit.

Growth geographies delivered a sales increase of 22% in the quarter. This was led by Russia, which saw a comparable sales increase of above 126%. Africa was close to 30%; China above 20%; and LatAm around 20%.

Europe registered a comparable sales decline of 1%, with Southern Europe, France, and the Netherlands declining. Germany, Austria, and Switzerland, and the Nordic countries, registered solid growth, while sales in the UK increased marginally.

Sales in North America grew by 7% in the quarter, with both Imaging Systems and Patient Care & Clinical Informatics recording double-digit growth.

Healthcare reported a second quarter EBITA of EUR333 million, or 13.8% of sales, an increase of EUR57 million, compared to Q2, 2011 when the EBITA was 13.3%.

Adjusted EBITA was EUR341 million, or 14.1% of sales, which is above the EUR275 million, or 13.2% of sales, in the same period last year. Positive growth momentum resulted in the improved earnings for the quarter.

Consumer Lifestyle sales, when adjusted for currency and portfolio changes, grew by 3%, compared to Q2 of last year. We're pleased with the continuing momentum of sales growth in Q2, 2012 for the Personal Care, Health & Wellness, as well as the Domestic Appliances businesses, which registered 8% comparable sales growth in aggregate.

Shrinking markets, specifically for DVD players and MP3 and MP4 players, led the Lifestyle Entertainment business sales to a high single-digit decline for the quarter, partly offsetting the good increase for the growth businesses.

The growth geographies grew by double digits in the quarter, led by China, Russia, and India. Sales in North America grew by mid single digits, while Europe declined by double digits.

Other mature markets, comprising of Japan, South Korea, Australia, New Zealand, and Israel, grew close to 20% in the quarter.

The reported EBITA at Consumer Lifestyle improved to EUR103 million, from EUR26 million in the second quarter of 2011. Of this, EUR20 million is due to a gain on the sale of the Speech Processing business to Invest AG of Germany.

The adjusted EBITA for the sector for Q2, 2011, excluding restructuring and acquisition-related charges, as well as the gain on the sale of the Speech Processing business, was EUR96 million in the quarter, or 7.1% of sales, compared to EUR39 million, or 3.1% of sales, for the second quarter of 2011.

The improvement in adjusted EBITA was driven by the improvement across all the businesses, due to cost reductions, as well as significant reduction in the stranded costs related to the Television business, from EUR18 million in Q2, 2011, to EUR9 million in Q2, 2012.

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In Lighting, comparable sales grew strongly by 6% in the quarter, compared to Q2 of last year. The increase in sales was led by our growth geographies, where sales, excluding Lumileds, grew on a comparable basis by 13%.

On a more granular basis, sales in Japan, India, Latin America, ASEAN and China showed good momentum with strong growth. Sales in North America were strong, with 9% growth, led by our Light Sources and Electronics business.

Weak markets in Western Europe caused a 1% decline in comparable sales for the quarter.

But taking a deeper look into each business, we continue to see strong sales of our LED products with growth of 37%, compared to the same quarter in the previous year.

Excluding Lumiled sales, which declined year on year, LED product sales grew around 57% in Q2, 2012, compared to Q2, 2011. Light Sources & Electronics recorded a strong double-digit growth for the quarter, while Automotive sales were up 8%.

Consumer Luminaires had a low single-digit decline, while Lumileds showed a double-digit decline in sales for the quarter, compared with last year.

The reported EBITA at Lighting declined to EUR93 million from EUR101 million in Q2, 2011. This was mainly due to an increase of EUR24 million in restructuring costs related to the overhead cost savings program, and the rationalization of the manufacturing footprint in the Lighting sector.

Adjusted EBITA was EUR131 million, or 6.5% of sales. An improvement, compared to the EUR115 million in the second quarter of 2011.

Organizational changes and operational improvements that the Lighting team has been working on have resulted in the sequential improvement of the adjusted EBITA from 5.5% of sales in Q1, 2012, to 6.5% in Q2, 2012.

The year-over-year results improved, due to actions taken to lower the cost structure and higher sales, offset by operational issues at Lumileds and Consumer Luminaires that we have previously described, and are being addressed.

Reported EBITA for Innovation, Group & Services amounted to a net cost of EUR79 million, an increase of EUR47 million, compared to Q2, 2011; mainly due to investments related to the Accelerate! program and higher restructuring cost.

Excluding the Q2, 2012 restructuring costs of EUR40 million, and the one-time prior service cost gain in a medical retiree benefit plan of EUR25 million in Q2, 2012, EBITA amounted to a net cost of EUR64 million, compared to the net cost of EUR34 million in the prior year.

The year-on-year increase was mainly due to Accelerate-related investments. Stranded costs related to the Television business, which is part of Innovation, Group & Services, declined from EUR21 million in Q2, 2011, to EUR9 million in Q2, 2012.

Inventory value at the end of Q2, 2012 decreased on a currency comparable basis by EUR107 million, compared to the second quarter of 2011.

Both Consumer Lifestyle and Lighting reduced their inventory on a comparable basis. This was partly offset by an increase in the Healthcare sector, primarily attributable to Imaging Systems, which is due to the buildup of production inventory related to further rollout of the new range of imaging products.

Inventory as a percentage of sales remained stable, compared to Q2, 2011, at 16.8%. However, we saw a significant reduction in Consumer Lifestyle, where inventory, as a percentage of sales, declined by 180 basis points, compared to the end of Q2, 2011.

In Lighting, inventory, as a percentage of sales, improved by 40 basis points, compared to the end of Q2, 2011. Healthcare inventories increased by 120 basis points at the end of Q2 of this year, for the reasons mentioned above.

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Across our businesses, as a result of our hedging policy, currency movements had a limited impact on our results. Since the commencements of the share buyback program in Q3, [2011] (corrected by company after the call), we have completed 56% of the EUR2 billion program, as at the end of Q2, 2012.

As mentioned in the last quarterly call, going forwards we expect to buy back our shares at a rate between EUR150 million to EUR300 million a quarter. We will continue to closely monitor the availability of liquidity in the financial markets, and our cash position, and manage the pace of this program appropriately.

We have performed our annual impairment tests, which we do in the second quarter of every year. Based on this test, there was no need for impairment at this stage.

The Professional Lighting Solutions estimated recoverable amounts approximates the carrying value. The results are published on page 41 and 42 of the press release.

Ladies and gentlemen, before opening the line to questions let me briefly summarize where we stand.

The improved results for the second quarter of 2012 are another step forward on our plan to unlock the potential value of Philips. We expect the benefits of Accelerate! to further improve our cost structure in the second half of 2012, compared to 2011.

We do see economic headwinds getting stronger, which may, to some extent, reduce the positive impacts of our improvement actions, going forward.

We will continue to closely monitor economic developments, and make adjustments to our expense levels, when required, so that we exit the year at a performance level that places us on a trajectory to achieve our financial targets for 2013.

With that, let me now open the line to your questions, which Frans and I will be happy to answer. Thank you.

QUESTIONS AND ANSWERS

Operator

Thank you, sir. (Operation Instructions). Andreas Willi, JPMorgan.

Andreas Willi - *JPMorgan - Analyst*

My question is on the cost savings, where you made further good progress in Q2. You seem to be a bit ahead of plan, at least of the trajectory I had in my model.

Should we expect to see upside to the EUR400 million, or is it just the planned savings coming through quicker?

Ron Wirahadiraksa - *Royal Philips Electronics NV - CFO*

Andreas, you're right, it looks slightly better. If you take the EUR176 million by 2 you are at about EUR340 million, EUR350 million. So we are on the run rate to achieve the EUR400 million. These things sometimes come a bit more lumpy, so for now, we'll stay with the EUR400 million.

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Andreas Willi - *JPMorgan - Analyst*

And my follow-up question on foreign exchange; obviously, with your business model you buy in a lot of components. A lot of them are probably end products; many of them may be quoted in dollars.

With the continued weakness of the dollar, maybe you could give us some estimate on how that could impact your profitability, going forward, when you buy in products and sell them in Europe, or other emerging markets where currencies are weak. And to what degree you're protected from hedging, and for how long, and how you can offset that with price increases?

Ron Wirahadiraksa - *Royal Philips Electronics NV - CFO*

Yes, well, actually you've given kind of the answer in a way. So for this quarter, the ForEx impact was slightly positive. Of course, there's an impact in the sales line which is offset by cost of sales; and then we have the unwind of hedges that we take.

And that brings me to the point that, actually, through hedging we have been, ongoingly, we have been able to mitigate the impact of ForEx, hedges run out.

In the meantime, of course, we configure our operating base as much as possible to cater for the economic exposure mitigation, and then the rest we will have to drive through price increases.

Andreas Willi - *JPMorgan - Analyst*

But are you getting price increases in places like Europe or Brazil, to offset the higher sourcing costs?

Frans van Houten - *Royal Philips Electronics NV - CEO*

Andreas, this is Frans, good morning. If we look in particular at Consumer Lifestyle, where the effect that you describe is applicable, then, yes, we are repositioning some of our products to a slightly more elevated price level to compensate for the sourcing costs, which are up.

In Lighting, the situation is more complex. Yes, the euro is down, but we can also expect some raw material benefits to come through in the second quarter -- second half of the year. Also raw materials we take term contracts, which protect us up as well as down on the short-term fluctuations.

Overall, we want to continue to work on our gross margin and look for opportunities there.

Andreas Willi - *JPMorgan - Analyst*

Thank you very much.

Operator

Mark Troman, Bank of America Merrill Lynch.

Mark Troman - *BofA Merrill Lynch - Analyst*

First question on -- main question on Healthcare; it sounds as though, I could be wrong in interpreting this, but it sounds as though you're a little bit more cautious on the US than maybe in prior quarters. We noticed orders were down a little bit. Have you seen a change of situation in the US, or were you just highlighting more uncertainties? Perhaps a little bit of color on what's going on in US Healthcare. Thank you.

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Frans van Houten - *Royal Philips Electronics NV - CEO*

[Mark] the tonality of how we talk about on the US is indeed a little bit more cautious. It sounds a bit paradoxical, because we see strong traction in the US in the first half of the year with 7% growth; that's really great. We also have spoken to hospital directors, and they tell us about the need to invest. I guess, for many hospitals, the Supreme Court announcement was not really earth shattering as -- no matter what the outcome was, the need to take these patients in was there anyway.

But the weaker order intake situation in the US is something to pay attention to, and we cannot -- let's say the outlook is certainly not secure, and we need to be very vigilant.

Mark Troman - *BofA Merrill Lynch - Analyst*

Okay, thank you. Just one follow-up; I think during Q3 and Q4, and maybe even Q1 this year, you have the step-up costs, which, correct me if I'm wrong, I think were around EUR200 million, I think what you called step-up cost to stimulate growth and catch up on the plan that you wanted to implement. Do those costs stay in Philips, or do they unwind over time? So in other words, has your fixed cost base -- presumably has increased by rough EUR200 million to help growth, does that EUR200 million stay there or will that reduce over time? Thank you.

Frans van Houten - *Royal Philips Electronics NV - CEO*

Mark, those costs are invested to accelerate growth, and I think some of the benefits we see was the 5% growth in Q2. If you look across the world, then there are many pockets of growth where we need to invest in order to realize growth while, at the same time, we cut cost elsewhere.

So the decision last year to step up the cost was very much in reflection of the opportunities that we see, so you could reason as follows. Those costs are there to stay, but as a percentage of sales, over time that will normalize. Moreover, at the same time, we cut costs in overhead areas and in markets where we grow less and, of course, that also provides compensation. I guess I'll leave it at that.

Mark Troman - *BofA Merrill Lynch - Analyst*

Very clear. Thank you very much.

Operator

Martin Wilkie, Deutsche Bank.

Martin Wilkie - *Deutsche Bank Research - Analyst*

Just a couple of questions on Lighting. You've given us some stats on the growth in LEDs, and the implication is that Lumileds sales are still falling year on year. I was wondering if you could let us know how much of that was the exit from backlighting, and if you could give us some sense of the underlying growth trends inside Lumileds?

And then related to that, the second question, I think you had mentioned previously you were looking to get Lumileds back to break-even in Q4, just generally, are we still on track to see that improving by the end of the year? Thanks.

Ron Wirahadiraksa - *Royal Philips Electronics NV - CFO*

It is indeed so that, for Lumileds, it was mainly for the withdrawal from the backlighting, so that answers that part.

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On Lumileds being on track to break even for the second half of the year, yes, we are on track to do that.

Martin Wilkie - *Deutsche Bank Research - Analyst*

And can you give us some sort of sense as to what amount of margin drag we're seeing from that loss making at the moment and, therefore, how we should think about that improving in the second half?

Ron Wirahadiraksa - *Royal Philips Electronics NV - CFO*

Well, last year on a full year basis, 2010/2011 the 600 basis points of Lighting down we were -- 120 basis points was from Lumileds, but I give you a sense on the impact that it has made. And we intend to bring that to at least break-even in the second half of this year.

Martin Wilkie - *Deutsche Bank Research - Analyst*

Okay, thank you.

Operator

Ben Uglow, Morgan Stanley.

Ben Uglow - *Morgan Stanley - Analyst*

I wanted to head back just to Healthcare. On the Healthcare side, Ron, could you give us a little bit more of an understanding of the margin improvement, which was quite significant? Obviously, there is normal seasonality between the first and second quarters, but what I was curious to understand was whether there was a mix effect as well from Patient Care & Clinical Informatics, the growth that we were seeing there. So question number one, how much is mix impacting Healthcare margin?

Question number two, I don't know whether this is for Frans or for Ron, can you just give us a general sense on the Affordable Care Act, what part of that legislation directly affects your businesses? Is it via reimbursements, is it via excise taxes, or is it a more general overall effect on demand for healthcare?

Frans van Houten - *Royal Philips Electronics NV - CEO*

Let me start with the second one, and then Ron picks up on the first question. So first of all, we are happy that there is a decision on the Affordable Healthcare Act. Having said that, it doesn't mean everything (technical difficulty); many of the provisions still need to be turned into operational effect, and that is where the details are still missing. For example, the excise tax levy on how it will be implemented and to what extent is unclear. We are awaiting further details on that.

When speaking with the hospital directors, there is, to cater for the wider patient base, a need for investments. We see that higher investment level in the first half of 2012; there is a good chance that that pattern will continue. At the same time, we are a bit concerned about slowing effects of the economy. And as we flagged, the Government are giving fewer orders. All of these things amalgamate into a combined effect that makes us still cautious on the second half of the year and 2013. But overall, I think the Affordable Care Act should have, in the end, a positive effect.

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Ron Wirahadiraksa - *Royal Philips Electronics NV - CFO*

On the margin question, it's not so much of a mix effect, maybe slightly; it's much more an effect of the increase that we have seen, the good growth in sales and managing cost very, very frugally. As you know, in Healthcare we're ongoingly working on operational excellence, so that has contributed to the improved results.

Ben Uglow - *Morgan Stanley - Analyst*

Okay, thank you. So obviously, I guess it's implied, but it's fair to assume that your Healthcare margin across all segments improved during the quarter, is that a fair assumption?

Ron Wirahadiraksa - *Royal Philips Electronics NV - CFO*

Yes, by and large, that's correct.

Ben Uglow - *Morgan Stanley - Analyst*

Thank you.

Operator

Ludovic Debailleux, Natixis Securities.

Ludovic Debailleux - *Natixis Securities - Analyst*

Two questions please. First, the growth economy grew by 11% in Q2, which is very positive, considering the growing concern especially in China. What do you see there for the coming quarters, and do you expect the business to slow down in this country? And for you, which division would be the most at risk? That was question number one.

And question number two, IG&S is better than expected at minus EUR79 million; do you confirm the minus EUR300 million on the full-year basis that you gave as an indication? Thank you.

Frans van Houten - *Royal Philips Electronics NV - CEO*

Yes, good momentum still in the growth economies; perhaps a little bit less than before, but still good. We are outgrowing GDP in most growth markets, and I think it's a reflection of a couple of things. First of all, growth markets like China or, for that matter, I was in Turkey and Russia a few weeks ago traveling, there is still a big demand to further step up healthcare. And those healthcare sectors, it is our conviction, will outperform GDP growth as a matter of course. So that certainly also applies to China where the second and third tier cities still have a healthcare demand, and where we also expect that, as part of managing the population, the Government will continue to place emphasis on this.

Then if I move to Lighting for a moment, the LED energy efficient lighting is attractive as it slashes energy cost, and we also expect that to continue to be a priority sector for many markets across the world. Then the middle income groups, the population in China that has been pretty good to our Consumer Lifestyle business, continues to buy, so we have not seen that significantly slow down. As a rule of thumb, in China we expect to continue to grow at a rate of approximately 2 times GDP for the Group.

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Ron Wirahadiraksa - *Royal Philips Electronics NV - CFO*

On your question on IG&S, yes, it was somewhat better. We reiterate our guidance for the year of EUR300 million and, of course, we will try to improve somewhat.

Ludovic Debailleux - *Natixis Securities - Analyst*

Thank you.

Operator

Gael de Bray, Societe Generale.

Gael de Bray - *Societe Generale - Analyst*

I have a couple of questions, actually. The first one relates to the margin in Healthcare, which looks exceptionally good for the second quarter, but given the rise in inventories we've seen, is there a risk that you could start reducing the manufacturing level in the coming quarters, and that this could weight down on margins?

The second question I had is related to the distribution agreement you signed with Funai in North America. Do you think that distribution agreement could be expanded to a more complete license agreement? And do you think that are other opportunities for this kind of agreement in other geographies as the year progresses?

And maybe a final question on M&A. There were no acquisitions during the last four quarters, but with the turnaround progressing well, especially in Healthcare and Consumer, do you now feel more comfortable about M&A, going forward?

Frans van Houten - *Royal Philips Electronics NV - CEO*

Let me take the second and the third question, and then have Ron take the first one. We announced the distribution agreement with Funai; basically, they take over the distribution of our products there.

I don't immediately see similar deals elsewhere in the world. We did flag that we are studying alternate business models for Lifestyle Entertainment in order to create value.

I'd like to underline that, with all the measures we have taken already, Lifestyle Entertainment continues to be profitable, despite the diminishing top line. I think that's testimony to a good management team that is cutting costs, but also bringing out some exciting new products like the docking stations.

On M&A, you're right, we have consistently said that it's not our priority to do M&A. We are convinced the unlocked potential that we have in the Group and, therefore, organic growth and organic operational improvement execution is what we need to do.

We don't close our eyes for M&A. If smaller deals pass by, then we can consider it. But our priority is operational execution and unlocking the full potential of the businesses that we have already. Ron, first one?

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Ron Wirahadiraksa - *Royal Philips Electronics NV - CFO*

Yes. So on the Healthcare margin, we're, of course, very pleased with what we have seen in the margin, mainly due to better growth and cost management, and that is what I can tell you.

We will reiterate our guidance for the midterm targets 2013, being 15% to 17% reported EBITA.

Gael de Bray - *Societe Generale - Analyst*

Okay. Thanks very much.

Operator

Martin Prozesky, Bernstein.

Martin Prozesky - *Sanford C Bernstein - Analyst*

A few questions on Lighting, please. In terms of the US, the construction market, can you give us an update on how Professional Luminaires is doing in the US?

And then second question on florescent, just an update on the stickiness of price increases from end of last year and how rare metal input costs are trending please?

Frans van Houten - *Royal Philips Electronics NV - CEO*

Yes, the Professional Luminaires market in the US, we are looking for the data --

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Abhijit Bhattacharya - *Royal Philips Electronics NV - Head of IR*

Martin, this is Abhijit. For professional luminaires, we were flattish to slightly up in North America. But overall, for Lighting, we had a strong quarter, as Ron mentioned. We had high single-digit growth, so 9% growth for Lighting overall. So overall, in the US, we've done well, but this quarter, Professional Luminaires' growth was not as high as the earlier quarters.

Frans van Houten - *Royal Philips Electronics NV - CEO*

Then, on the florescent, I think we have flagged in the past already that, on the Professional side, the price increases stick, while on the Consumer side, also due to private label brands, this is under pressure.

On the input side, we make use of term contracts on the rare earth sourcing, which protects us, of course, both for upsides and downsides. At the moment, the spot rates are slightly lower than our term contracts, so we are not seeing full benefit of the decline of rare earth markets through in our margins yet. This will continue for a while as they will run out later in the year only.

Martin Prozesky - *Sanford C Bernstein - Analyst*

Thanks. Then just one follow-up. On the outlook for Professional Luminaires in the US, we're getting, I think, pretty conflicting signals about the strength of the construction recovery. What are you seeing in terms of your business?

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Frans van Houten - *Royal Philips Electronics NV - CEO*

Well, we've looked at some of the competitors, and they actually have done slightly better than us. So I'm not sure that we are fully benefiting from that uptick.

We are taking measures to improve our performance in Lighting, also, in the United States. The construction indicators seem to trend downwards a little bit in the second half of the year, so maybe that is where, indeed, the hesitation also that you picked up on, falls.

But what you can also take from my own explanation is that I think we should be able to improve our own act across the world, but also in North America.

Martin Prozesky - *Sanford C Bernstein - Analyst*

Thank you.

Operator

Olivier Esnou, Exane.

Olivier Esnou - *Exane BNP Paribas - Analyst*

I have a question on the P&L. Actually, I was looking at the development of G&A in the quarter, which was quite down, quarter over quarter and year over year. I was wondering if you could just give us a bit of a flavor on that number. Is it a new run rate you see here, or was there some exceptional?

And secondly, talking about the quarter development, is there any meaningful trend during the quarter, when you look at the monthly development in each of the divisions, you can share with us, as we had the impression that things have materially slowed? Is it the same for you, or you've seen an even development? Thanks.

Ron Wirahadiraksa - *Royal Philips Electronics NV - CFO*

We generally do not comment on the actual trends within the quarter or months; we communicate with you on the quarter. What I can say is that project business and big sales like in Healthcare, it could be somewhat lumpy at times. So there's not always much to say, whilst in Consumer the trend is sometimes better readable.

On your question on G&A, as I said, there was a EUR25 million one-time gain of prior service cost to a medical retiree plan; that's what I talked about. There have been also some lower pension costs in a number of countries. And then overall, we also had savings from the efforts that we make in salaries, and that explains the much lower G&A.

Olivier Esnou - *Exane BNP Paribas - Analyst*

Okay. So in terms of underlying trend for that, do you have an indication, going forward?

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Ron Wirahadiraksa - *Royal Philips Electronics NV - CFO*

No. So as I said, there is two items here clearly that are somewhat of a one-off gain. Other than that, structural component is the savings in the salaries that we've seen, which are also, I think, in the EUR20 millions.

Olivier Esnou - *Exane BNP Paribas - Analyst*

Okay. Thank you.

Operator

Michael Hagmann, HSBC.

Michael Hagmann - *HSBC - Analyst*

I was wondering about Healthcare. Obviously, the quarter was very strong in terms of sales and in terms of margin improvement. Now, Deborah has been there for three months and I was wondering if, despite or because of that strong development, she has now started to question the strategy? And in your conversations with her, do you sense that changes are imminent in the strategy of Healthcare? Or will it just continue as before?

Frans van Houten - *Royal Philips Electronics NV - CEO*

I am pleased with how Deborah has taken over the business quite seamlessly, and her teams have rallied with her, too, behind the strategy that is in place; the strategy that she, as you remember, elucidated during Capital Markets Day, where she and her team clearly said it's a good strategy, but operational improvement and execution can also do better in Healthcare.

So the Accelerate! program gets also strong traction there. So overall, a strong start. The whole team supports her, and we can expect that the Accelerate! program will also show benefits on the journey to the 15% to 17% EBITA that Ron already reiterated for 2013.

Michael Hagmann - *HSBC - Analyst*

Then certainly no change to the strategy in Healthcare?

Frans van Houten - *Royal Philips Electronics NV - CEO*

Deborah already said, during Capital Markets Day, that she is fully behind the strategy and that it's a matter of execution, and so this is exactly what is going on.

Michael Hagmann - *HSBC - Analyst*

Thank you.

Operator

William Mackie, Berenberg Bank.

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William Mackie - *Berenberg Bank - Analyst*

I'd just like to come back to Lighting, if I could, and ask, as you look into the second half of the year, I think you've reiterated expectations of a continual improvement in operating profitability. Could you perhaps break out the constituents, or the relevant importance of the constituents that will drive that step up with regard to the prospects of a turnaround in Consumer Luminaires and Lumileds, plus improving pricing trends, plus the payback from the ongoing restructuring?

Ron Wirahadiraksa - *Royal Philips Electronics NV - CFO*

So if you look at the improved margin, versus last year, then we can see that there is an improvement in the gross margin on the back of operational improvements and Accelerate! savings. As you know, Lighting is very well underway to implement the Accelerate! program, which is still somewhat dampened by the negative variance we still have for now between Lumileds and Consumer Luminaires, compared to Q2 of last year.

So that explains why the margin, in effect, actually is the same, 650 basis points.

Also for Lighting, as you know we want to break even in both Consumer Luminaires and Lumileds, second half of this year which will, if you compare with last year, the combined impact of the two I just mentioned on the call, 120 basis points for Lumileds, it was 130 basis points for Consumer Luminaires, so that would improve the margin, compared to last year, by 250 basis points on a run-rate basis, if you will.

So we're working hard to make that happen to work on other improvements and, for now, we'll stay with the guidance that we have given already for 2013 of 8% to 10% reported EBITA for Lighting.

William Mackie - *Berenberg Bank - Analyst*

That's great. As a follow-up then, perhaps, could you give an indication of the benefits from pricing effects in the Lamps and Electronics business that you enjoyed in the second quarter?

Frans van Houten - *Royal Philips Electronics NV - CEO*

No big changes, really, in the second quarter versus the first quarter. I already, earlier in the call, spoke about the fluorescent situation. On LED the LED prices in the Professional Luminaires are actually better than the conventional Luminaires which I find logical, because it's a better value proposition. And in the LED lamps area, thanks to the reengineering of the End-to-End value chain, we've seen that LED lamps are benefiting from a slightly better gross margin, and certainly a better bottom line, than before. So that is good news. But those are not market trends, but much more what we are able to implement as operational improvements.

William Mackie - *Berenberg Bank - Analyst*

Super. If you'll excuse me one last moment which was, with regard to the step-up that you've highlighted, the EUR200 million increased investment for growth within the Accelerate! program, are we coming close to the normalization of the run rate of investment now, i.e., should we expect an incremental headwind from further R&D and promotional spend and the like, or is that now at a neutral or declining level relatively saying?

Frans van Houten - *Royal Philips Electronics NV - CEO*

I think you have seen, that. All those step-ups being done already, don't see immediately extraordinary further step-ups taking place. We will continue to adjust our cost base to where the growth opportunities are. In other words, if Russia grows then we will expand our organization there, and if South Europe declines we will reduce our organization there. So these shifts will take place as a matter of normal course.

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Overall, the message I'd like to leave with you is that, in Philips, we need to, and can, further drive productivity. And the need for the EUR200 million last year was because we did not want to do it sequentially. In other words we did not first want to drive productivity and then say, but now we are shrinking and now we need to grow.

So we needed to do both at the same time. That has, I think, helped us to grow. Overall, we are still a case of self-help; we can still drive productivity further and get more bang for the buck in R&D, in sales. The story still holds.

William Mackie - *Berenberg Bank - Analyst*

Thank you very much.

Operator

Andrew Carter, Royal Bank of Canada.

Andrew Carter - *Royal Bank of Canada - Analyst*

Most of my questions have actually been covered, but if I could just ask a couple of small ones, then that would be helpful. The first one was just, in terms of the restructuring benefit that was secured in the second quarter, could you tell us what the year-on-year benefit was there?

Then the second one was just relating to the Healthcare and the equipment orders that you gave us the trends on. Could you remind us what the geographical split of your equipment orders has been, most recently?

And then finally, just on Lighting and Consumer Luminaires, obviously there's a seasonality to that business, and I understand that you're looking to win market share back, should we start to see that in the next quarter, or is it phased through the second half? Thank you.

Ron Wirahadiraksa - *Royal Philips Electronics NV - CFO*

So the cost run rate compared to last year, as we've said cumulatively, we're now at EUR176 million. So as said in the earlier question on this, if you multiplied it by 2, a little over EUR340 million, so we're well underway to achieve the EUR400 million. So for now, compared like for like, it's EUR176 million cumulatively. That includes somewhat of an impact of Q1.

Then in Healthcare, the geographical order intake, it's roughly the same as sales because the order book is also split like that.

Frans van Houten - *Royal Philips Electronics NV - CEO*

And then Lighting Consumer.

Ron Wirahadiraksa - *Royal Philips Electronics NV - CFO*

Yes, Lighting Consumer Luminaires in the next quarter, well, we're not guiding for the next quarter. What I can tell you is that we're working hard to make this break even. It's another effort to win back customers; this is a listings business, so we need to work harder on getting listings back in there. That is currently underway.

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Frans van Houten - *Royal Philips Electronics NV - CEO*

I think his question was about when in the year, so I think the way to look at it is that it's going to take us a lot of effort and it will be quite late in the year.

Andrew Carter - *Royal Bank of Canada - Analyst*

Thank you.

Operator

(Operator Instructions). We have a follow-up question from Andreas Willi, JPMorgan.

Andreas Willi - *JPMorgan - Analyst*

The follow-up question is on cash flow and their payables, receivables. A few companies that have reported recently have shown a weaker working capital performance, because sometimes they have to pay earlier, but certainly they get paid later. And the number of companies mentioned distributors, mentioned Asia as a region of concern, maybe you could tell us what you see in the market in terms of customers paying on time? Thank you.

Ron Wirahadiraksa - *Royal Philips Electronics NV - CFO*

Yes, so by and large, customers are paying on time. Of course, there is some more difficulty in Southern Europe; we're on that. We have, as part of our standard operating procedures, quite strong payables' and receivables' management.

The question of free cash flow, there was, oddly speaking, like Q1, also Q2, the quarter ended in a weekend. So that has caused somewhat of a, let's say, distorted insight in a way, if you will. We like to look at the year-to-date number of free cash flow, which is actually about EUR400 million, which is, year to date, an improvement of about EUR1.3 billion over last year. So we're very happy with that.

As you know, last year we have increased our payables' discipline, so we adhere to that. There was a major setback in mainly the first quarter of last year, so we don't have that any more. We're pleased with the progress in the free cash flow, Andreas.

Frans van Houten - *Royal Philips Electronics NV - CEO*

All right. Thanks, Ron, thanks Andreas. I've got the signal that there are no further questions in the queue and, therefore, I'd like to close this call, but not before thanking you for your tracking us and confidence.

I continue to reiterate that we have, in Philips, a large unlocked potential, and that we are well on our journey to our midterm targets, and that it is primarily a case of self-help. Second quarter was good proof that we are on the right path, and I'm thankful to all the employees who are embracing the Accelerate! program and putting their shoulders underneath this quite big task.

Thank you for that, and we'll talk to you soon.

Operator

This concludes the Royal Philips Electronics second quarter results 2012 conference call on Monday, July 23, 2012. Thank you for participating, you may now disconnect.

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