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PHIA.AS - Q2 2013 Koninklijke Philips NV Earnings Conference Call

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OVERVIEW:

PHIA.AS reported 2Q13 net income of EUR317m.



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PRESENTATION

Operator

Welcome to the Royal Philips second quarter results 2013 conference call on Monday, July 22, 2013. 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.

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

Abhijit Bhattacharya - *Koninklijke Philips NV - Head of IR*

Good morning, ladies and gentlemen. Welcome to this conference call on the results for the second quarter of 2013 of Royal Philips. I'm here with Frans van Houten, our CEO, and our CFO, Ron Wirahadiraksa.

In a moment, Frans will make his opening remarks and give you an update on the progress we have made during the quarter. 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 question.



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.

With that, let me hand over the call to Frans.

Frans van Houten - *Koninklijke Philips NV* - CEO

Thanks, Abhijit. Welcome, and thank you for joining us today. The second quarter of 2013 was the fifth consecutive quarter of good progress for Philips as our operational results were 30% better than last year. Our Accelerate program is clearly driving improved performance, and all sectors achieved the year-on-year improvement in operational results, thanks to our highly engaged employees who are focused on delivering on our plans.

I'm particularly pleased that, despite challenging economic conditions, we have continued to increase our operational gross margin, which is up by 200 basis points compared to a year ago. We are continuing to make fundamental changes to the culture at Philips, driving entrepreneurship, increasing our customer responsiveness, and lowering our cost base.

We are also making our product portfolio locally relevant, driving procurement savings and reducing our cost of non-quality, which have enabled us to deliver better operating results on a comparable sales growth of 3%.

We had expected a slow start to 2013, based on the developments in the global economy, and this has indeed been the case. We are quite pleased, therefore, that our Healthcare Equipment order intake improved by a healthy 7%, compared to the second quarter of last year. The growth in order intake, in part driven by new product introductions, is encouraging, as it provides more underpinning for an improved second half of the year.

Particularly pleasing is the return of equipment order intake growth for North America, which comes after four quarters of decline. Healthcare sales were flat, due to weaker order intake in the previous quarters.

Consumer Lifestyle maintained its very strong growth momentum with the fourth consecutive quarter of double-digit growth, led by Domestic Appliances.

After flat sales in Q1 this year, the Lighting sector returned to low single digit growth in the second quarter. This was driven by strong growth in LED-based sales, which increased by 28% over the previous year. Sales from LED-based products and solutions are now 25% of the Lighting sector overall sales.

Our change in performance improvement program, Accelerate, has now just entered its third year and continues to strongly drive improved results across the organization. Most heartening is the fact that, as we adopt our new ways of working, we increasingly see success with customers.

Let me just give you a few examples. Philips and Georgia Regents Medical Center, or GRMC, signed an agreement creating an alliance for a first of its kind healthcare delivery model in the United States. With a sales value of more than \$300 million, the agreement is the largest of its kind for Philips where we will provide GRMC with strategic consultancy, technology innovation and operational services to achieve improved patient outcomes under a single consistent payment structure.

Through this 15 year alliance, GRMC will invest in the full breadth of Philips Healthcare Solutions, including imaging systems, patient monitoring, ultrasound and clinical informatics solutions, as well as solutions from our Lighting and Consumer Lifestyle sectors.

Philips will provide consulting services to lead operational improvements across GRMC to streamline planning, maintenance and education. This delivery model will infuse the highest quality care and optimal efficiency throughout GRMC's entire health system at a lower cost while improving the patient experience.



GRMC will gain faster access to future Philips' technologies and evolving best practices, which will enable them to expand access to care, provide better value and improve patient outcomes.

Our drive to improve quality is delivering results, as during the second quarter, for the first time, Philips Healthcare was named the overall number 1 ranked best-in-KLAS medical equipment company in the industry, based on ratings from KLAS, which is the independent agency that provides impartial vendor performance data based on customer interviews.

In addition, we received best-in-KLAS awards on imaging key products such as the Ingenia 1.5 Tesla MRI, the Ingenia 3 Tesla MRI, the Ingenuity 128 slices CT and iE33 US Cardiovascular, and we just earned top scores for our Pinnacle3 Treatment Planning software, IntelliSpace portal and in the fluoroscopy category the DXR Easy Diagnost. Sorry for all the abbreviations, but we are really proud of these achievements.

Improving our End2End customer value chain for LED lamps is making us more competitive, and this led to significant growth across geographies, including in Germany where we now have the leadership position. This is a very notable achievement.

Our Domestic Appliances business is consistently generating very strong double-digit top line growth by leveraging its acquisitions and network of innovation hubs, bringing relevant innovations to key markets and activating them with local consumer insights. This is delivering results across the portfolio, with double-digit growth in kitchen appliances, air purifiers, garment care as well as floor care.

We leveraged product platforms from our Povos acquisition, for example in Russia, to unlock an attractive new opportunity for kitchen appliances, and introduced the so-called Multicookers, with local Russian recipes. And in China, we responded rapidly to the increasing consumer demand for clean air in homes and, as a result, our wide range of air purifiers and humidifiers are seeing tremendous growth.

Aligned with our mission to improve people's lives, we continue to invest in new innovations that create superior value. In Healthcare, we are building on our leadership in one of the most exciting opportunities for patient care which involves minimally invasive repairs through image guided interventions and therapies.

Performing a wide range of such procedures requires exceptional ultrasound imaging and in May, we introduced a new break-through ICE catheter to reduce the need for two separate cardiac ultrasound systems. The CX50 xMatrix, the world's first portable ultrasound with Philips Industry-leading live 3D transEsophageal echocardiograms, or TEE, now offers intra-cardiac echo capability.

We have also received clearance from the FDA to market our low dose AlluraClarity interventional x-ray system in the United States. This innovative technology is also available as an upgrade for the majority of our installed base of interventional x-ray systems.

In our Ultrasound business, we have launched the ClearVue 650 which is a platform that can span a range of applications from Ob/Gyn to cardiac, abdominal and general imaging. Apart from ease of use, it has advanced imaging modes and best-in-class automation features. This versatile system is designed for superb image quality to enhance diagnostic confidence, and for intuitive workflow.

We are also strengthening our portfolio of locally relevant healthcare products for the growth geographies. We've introduced a broad range of mother and childcare solutions in India and Africa including, for example, the Efficia range of infant warmers and incubators, intended to help reduce infant mortality.

We continue to make investments in patient care and clinical informatics which is our Software Solutions business, focused on monitoring therapeutic care, cardiology, radiology and more.

We have introduced the Anywhere Viewer, which is a mobile software for our PACS solutions, which allow clinicians to view images any time and from any place. This is a significant enhancement to our existing PACS solutions portfolio, and has a positive impact on the demand for our PACS solutions in Q2.

Furthermore, we brought to the market the latest version of the IntelliBridge Enterprise, which is an IT solution that significantly reduces the cost of integrating medical devices into the hospital electronic medical record system through a single bridge solution. The IntelliBridge Enterprise provides a universal interface, allowing the hospital to connect all medical devices, such as monitors, ventilators, infusion pumps and many more.

Hospitals connect, on average, seven devices in a single patient room, which is complex. IntelliBridge Enterprise enables savings in capital equipment, as well as provide a big reduction of complexity of multiple software updates connection points, and simplifies the user interface for the medical staff.

In our Sleep business, we recently launched our Wisp minimal contact nasal mask, a hybrid nasal/pillows mask that offers the benefits of a low profile mask with best-in-class performance and delivers in four key areas; comfort, ease of use, visual appeal, and the ability to fit a wide range of patients.

The Wisp mask has a compact design for a natural fit and an open field of vision which allows patients to watch television and read a book before going to sleep. This is how we bring meaningful innovation to the market.

Switching to Lighting. As the global leader in lighting, we are leading the rapid transformation to energy-efficient lighting solutions. Underlining our leadership in LED, we installed LED systems in what is called the Change Initiatives Retail Space in Dubai, helping to make it the most sustainable commercial building in the world.

We are also pleased that the Philips Hue, our connected lighted system for the home, was awarded best innovation of the year, 2012, by Forbes Magazine. The latest update of the Hue app functionality allows it to connect to Internet services, making it even more intelligent.

We have also recently announced a partnership with Disney. The Philips Disney portfolio includes breakthrough concepts in connected lighting that allows children to interact with Disney stories and characters. The revolutionary connected lighting concept even allows children and parents to connect to e-books, with their lighting, to interactively create a magical lighting experience that makes reading more fun and allows families to become fully immersed in the story.

The products will be co-branded and sold through a variety of complementary Philips and Disney retail channels, starting in Europe, and in the United States in September with Asia and Canada to follow later this year.

Another win, which is certainly worth mentioning, is that we have been selected to provide advanced interior/exterior and architectural lighting solution for the Maracana, better known as the holy ground for soccer fans in Rio de Janeiro, making the stadium an even more colorful and vibrant place.

In Consumer Lifestyle, we further demonstrated the strength of our local-for-local business creation capabilities with the introduction of the Philips' Noodle Maker in China. This appliance has already seen significant sales during a three-day launch event with leading Chinese online retailer, Tmall.

Finally, to further expand and strengthen our innovation capabilities in China, Philips has opened an intellectual property office, as well as a development center for professional lighting, both in Chengdu and in the west of China.

Apart from market success and innovation initiatives, we continue to remain focused on operational improvements. Our inventory levels, as a percent of sales, continue to improve as we free up cash for more productive purposes.

We have reduced our inventory as a percentage of sales by 1.5 percentage points, compared to a year ago. Our overhead cost reduction program is on track, and our gross total savings through the end of the second quarter of 2013 now stands at EUR673 million.

I would like to reinforce the message that we see more opportunities to raise cost productivity at Philips in the coming years. Further, we have been working hard with all relevant stakeholders to create a sustainable pension framework for Philips' employees and for our Company.

In the United States, we have frozen two defined benefit pension plans, as per the end of 2015, for further accrual of benefits, and plan to transfer all remaining active members to the defined contribution plan, also at the end of 2015.

We have also reached an agreement to make changes to the Dutch pension plan, which comprises of a change in the retirement age, a fixed annual Company cash contribution rate for the next five years, and the introduction of an employee contribution.

The broad outlines of a new funding agreement have also been agreed upon, as part of which, Philips will no longer be liable for the funding of potential future deficits of the plan.

I'm very pleased with the strong commitment from all parties involved in the negotiations to ultimately reach a very balanced agreement in tough economic times.

With that, I will conclude by reiterating that we are pleased with the progress that we have made to date. Accelerate is working and resulting in good operational improvements.

I know that many of you are looking forward to the update of our value creation journey at the Capital Markets Day in September 2013. I can already tell you now that we will discuss a continued focus on the execution of the Accelerate initiatives, which include significant productivity improvements and investments in innovation and growth, all of which will improve shareholder value. We will also disclose the targets for the next three-year period.

Looking ahead to the second half of 2013, we are concerned about the ongoing economic uncertainties around the world. However, we remain committed to reach our financial targets this year.

I will now turn the call over to Ron to go over our financials in more detail.

Ron Wirahadiraksa - *Koninklijke Philips 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, market conditions remain challenging, with hospitals working through the implications of the sequestration and healthcare reform and the resulting delay of some of their purchasing decisions. We expect the related market uncertainties to continue in the short term, also pending the upcoming round of budgetary decision making.

Healthcare construction is forecasted to grow by 2% in 2013 and patient procedural volume is expected to slightly grow in the low single-digit range.

In Europe, we continue to see significantly differing market dynamics on a country-by-country basis. The UK and Benelux displayed signs of moderate growth, while the Nordics experienced some market softness. The larger markets, such as Germany and France, are soft. Southern Europe continues to face market declines as a result of the austerity measures undertaken.

In the growth geographies, the ASEAN region and China continued to record good growth during the second quarter of 2013. On the other hand, Middle East, Turkey and Russia witnessed low tender activity which resulted in low market momentum in the second quarter.

We expect market growth to be double digits for the overall growth geographies in 2013. We estimate market growth to be at the low end of the 3% to 4% growth estimate we made earlier in the year.

In Q2, consumer markets continued to follow the fluctuating patterns seen earlier. The eurozone real GDP growth continued to show a weak trend. Unemployment increased further to reach 12.2% overall; this is the highest since 2003.

The European Union Consumer Confidence Index has been improving since January 2013, with Germany poised for a modest economic growth. Total retail sales volume shows an increasing year-over-year trend since the beginning of 2013.

The US picture for consumer markets is improving, with the June unemployment rate remaining stable at 7.6% and improving May retail sales; that excludes motor vehicles and parts dealers. The June US Consumer Confidence Index is encouragingly on a positive trend and at its highest level of the last five years.

In China, the year-over-year growth rate for retail sales is improving since the beginning of the year.

The lighting market in Q2, 2013 showed decelerating year-on-year growth. The transition to LED products and growth markets were the main drivers. While the transition to LED continues, demand in Western Europe remains impacted by the weak economic environment.

During the quarter, real GDP growth forecasts for most markets were lowered. As a result, France is now also expected to be in a recession in 2013. Germany remains one of the few markets where real GDP is expected to grow in 2013. The outlook for the construction market in Western Europe remains subdued.

The US Q1 real GDP growth was revised down to 1.8% from 2.4%. Full-year consensus growth outlook is expected to be 1.8%, below the 2012 real GDP growth rate of 2.1%.

The US construction market remains driven by the residential sector, as sales of new and existing homes continued to grow. The Architectural Billing Index also points to a continuation of growth. Growth in the non-residential market is lower, due to access capacity and austerity measures, which will limit government investment.

LED transition remains the key growth driver in the Chinese lighting market, which continues to show growth in all segments, apart from retail, which is still impacted by weaker store openings and renovations.

Following a slight year-over-year contraction in Q1, 2013, global light vehicle production returned to growth in Q2, 2013 and remains on track for growth in the full year 2013.

Let me now move to the Philips Group results for the second quarter of 2013. As of the first quarter this year, we reported profit and loss on the Audio, Video, Multimedia and Accessories business under discontinued operations, and the net assets for the business in the balance sheet in the line assets held for sale.

The cash flow of the Audio, Video, Multimedia and Accessories business is reported under cash flow from discontinued operations. Therefore, all commentary that will follow, in terms of sales and earnings at Philips Group level and Consumer Lifestyle sector level, does not include Audio, Video, Multimedia and Accessories-related information.

Also, when I refer to adjusted EBITA on this call, this represents EBITA excluding restructuring, acquisition-related charges and other charges and gains above EUR20 million.

Comparable sales in the second quarter grew by 3% when adjusted for currency and portfolio changes. Comparable sales in our growth geographies increased double digits in the second quarter.

Our growth geographies are defined as all markets excluding the US, Canada, Western Europe, Australia, New Zealand, South Korea, Japan and Israel. Sales from these growth geographies increased to 37% of Group revenues, compared to 34% for Q2 last year.

On a comparable basis, sales in North America declined by mid single digit in the quarter. Healthcare was affected by lower order intake in the previous quarters as sentiment was affected by the uncertain environment.



Consumer Lifestyle sales in North America had mid single-digit comparable sales growth, while Lighting sales declined, mainly due to lower sales for professional lighting solutions.

Group sales in Europe saw a decline in comparable sales of 1% in the quarter, mainly due to Lighting and Healthcare, while Consumer Lifestyle grew by mid single digit. In the other mature geographies, the Group saw a high single-digit increase in comparable sales, with Japan continuing to remain strong.

Reported EBITA was EUR603 million, or 10.7% of sales, which is EUR264 million higher than the EUR339 million, or 6.1% of sales, reported for Q2 last year. EBITA for Q2, 2013 included net positive one-off gains of EUR74 million higher than Q2, 2012, mainly due to the past-service pension cost gain in the US.

Restructuring and acquisition-related charges in Q2, 2013 were EUR68 million lower than Q2, 2012.

Adjusted EBITA was EUR530 million, or 9.4% of sales in the quarter, compared to EUR408 million, or 7.3%, for Q2, 2012. The 30% improvement in the adjusted EBITA was due to improved operational performance in all sectors.

Net income amounted to EUR317 million, a year-on-year increase of EUR215 million, which reflected better operating results across all sectors, lower restructuring and acquisition-related charges, and higher past-service pension cost gains in Q2, 2013, compared to Q2, 2012.

Cash inflow from operating activities for the quarter improved to EUR124 million, compared to an inflow of EUR81 million in Q2 of 2012.

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

Currency comparable equipment order intake in Healthcare increased 7% in Q2, 2013, compared to Q2, 2012. The increase in order intake was driven by the growth geographies and North America. Order intake in North America grew by mid single digits after four quarters of decline. To clarify the point, only part of the Georgia Regents Medical Center order, that Frans talked about earlier, has been recognized in the order-intake data.

Let me clarify for you that we recognize orders where equipment delivery or, in the case of software, where implementation begins within specific time horizons. These time horizons are 15 months for Imaging Systems, excluding ultrasound; 12 months for PCCI; and 6 months for Ultrasound.

Order intake in Europe declined by low single digits, mainly due to a decline in the Nordic countries. Excluding the Nordics, order intake in Europe increased by high single digit. Order intake in the growth geographies grew by a robust 19% on a comparable basis, with both Imaging Systems and PCCI registering double-digit order intake growth.

Order intake in China, LatAm, the ASEAN region, and Africa, grew by strong double digits. Patient Care & Clinical Informatics order intake increased double digits, while order intake for Imaging Systems increased low single digit.

On a currency and portfolio comparable basis, Healthcare's year-on-year sales were flat, after growing 7% in Q2, 2012. Growth in Consumer Services, Home Healthcare, and Patient Care & Clinical Informatics, was offset by a decline in Imaging Systems. Comparable sales in the growth geographies increased double digits in the quarter. Comparable sales in China and LatAm grew by double digits in the second quarter of 2013, while sales in India grew high single digit.

Comparable sales in Europe declined by low single digit, with Southern Europe declining by double digits, and the rest of Europe growing by low single digit. Sales in North America declined by mid single digits in the quarter. Growth in Patient Care & Clinical Informatics, Customer Services, and Home Healthcare, was offset by a decline in Imaging Systems. As Frans mentioned earlier, this was due to the lower order intake in the previous quarters.

Healthcare reported a second quarter EBITA of EUR420 million, which is 17.8% of sales. This includes EUR61 million of the past-service pension cost gain in the US, and a EUR21 million gain on the sale of a business. The adjusted EBITA amounted to EUR338 million, or 14.3% of sales, which is 120 basis points higher than the adjusted EBITA in the same period last year. Higher gross margins and reduction in overhead costs resulted in improved earnings for the quarter, despite a flat top line.

Consumer Lifestyle comparable sales grew by a very strong 13%, compared to Q2 of last year. The growth geographies had a comparable sales increase of 20% in the quarter, led by Russia, China, Brazil and the ASEAN region. Sales in North America grew mid single digit, driven by high single-digit growth in Personal Care, while even Europe grew mid single digit, with Germany being particularly strong with double-digit growth.

Other mature markets, comprising of Japan, South Korea, Australia New Zealand and Israel, recorded 20% growth in the quarter, with all countries growing by double digits. This is all driven by the success of bringing local relevance into our innovation strategy, and improving execution through Accelerate.

EBITA for the quarter was EUR82 million, or 7.6% of sales. Adjusted EBITA for the sector for Q2, 2013, was EUR84 million in the quarter, or 7.8% of sales, compared to EUR48 million, or 5% of sales, for the second quarter of 2012. The improvement in adjusted EBITA was driven by higher sales and gross margin, overhead cost reductions, as well as the elimination of stranded costs related to the Television business, which were part of the Q2, 2012, results.

The lower adjusted EBITA, compared to Q1, 2013, is due to normal seasonality, of additional advertising and promotional expenses incurred in the second quarter.

For the Audio, Video, Multimedia and Accessories business which, as explained earlier, is reported in discontinued operations, the net income declined to break-even, compared to EUR33 million in Q2, 2012. The net income of Q2, 2012, included a gain of EUR20 million on the sale of the Speech Processing business, while Q2, 2013, has higher disentanglement costs of EUR7 million. On page 17 of the press release, we have provided a simple reconciliation of the results of this business.

In Lighting, comparable sales were up 2% in the quarter, compared to Q2 of last year. In our growth geographies, sales increased on a comparable basis by double digits. On a more granular basis, sales in LatAm, China, and the ASEAN region showed good growth. Europe sales were down 2% in the quarter with declines in the Benelux, Southern Europe and France, offsetting growth in the rest of Europe.

North America recorded mid single-digit sales decline in the quarter, which is, in part, related to the transformation taking place in our organization there, which is related to Professional Lighting Solutions business. We expect, however, the performance to recover once the restructuring is completed.

When taking a deeper look into each of the Lighting businesses, we continue to see strong sales of our LED products, with growth of 28% compared to the same quarter in the previous year. Light Sources & Electronics, Lumileds, Automotive, and Consumer Luminaires, all recorded year-on-year growth, while Professional Lighting Solutions declined by 1%.

The reported EBITA for Lighting was EUR153 million, or 7.5% of sales, which is a significant improvement compared to the EUR78 million, or 3.8% of sales, in the second quarter of 2012. The EBITA for Q2, 2013 included EUR15 million less restructuring and other charges, compared to Q2, 2012, as well as a past-service pension cost gain in the US of EUR10 million.

Adjusted EBITA was EUR166 million, or 8.1% of sales, a significant increase again compared to the EUR116 million in the second quarter of 2012. The improvement was also driven by a lower bill of materials, including lower phosphor prices, as well as overhead cost savings.

Reported EBITA for Innovation, Group & Services amounted to a net cost of EUR52 million, compared to a net cost of EUR87 million in Q2, 2012. The improvement was primarily due to the restructuring costs being EUR40 million lower in Q2, 2013, compared to Q2, 2012. The EBITA for Q2, 2013 included a EUR6 million gain on past-service pension cost in the US, while the EBITA for Q2, 2012, included a gain of EUR25 million on the

past-service cost on a medical retiree benefit plan. Excluding these items, the lower net cost was mainly due to the re-measurement of environmental provisions.

Inventory, as a percentage of sales, improved by 150 basis points to 15.7% at the end of Q2, 2013, compared to 17.2% in Q2, 2012. There was a significant reduction in Healthcare, where inventory, as a percentage of sales, declined by 260 basis points, compared to the end of Q2, 2012. Imaging Systems reduced inventories by 330 basis points, while Patient Care & Clinical Informatics, Home Healthcare Solutions, and Customer Services decreased their inventory by 130 basis points, 60 basis points, and 360 basis points, respectively.

Consumer Lifestyle reduced its inventories, as a percentage of sales, by 10 basis points at the end of Q2, 2013. In Lighting, inventory, as a percentage of sales, improved by 120 basis points, compared to the end of Q2, 2012, with Consumer Luminaires' inventory down by 380 basis points, and Lumileds down by 320 basis points.

Return on invested capital, at the end of Q2, 2013 improved to 6.1% from 4% in the previous quarter. Excluding the European Commission fine, the return on invested capital increased from 7% in Q1, 2013, to 9.2% at the end of Q2, 2013. The discount rate for the Group is 8.9%. The increase in ROIC was largely due to the effects of high earnings and improved working capital management.

As far as capital allocation is concerned, we have completed the EUR2 billion program at the end Q2, 2013. This year, we'll see a relatively high outflow of cash, since we have paid out the EUR509 million related to the European Commission fine, as well are paying out on the various restructuring programs that are currently running.

As mentioned on the Q1, 2013, earnings call, and as Frans mentioned earlier, we have continued our risk mitigation efforts to reduce our risk on pension liabilities, with changes in the US and the Dutch pension plans.

The Q2, 2013 results contain a one-off curtailment gain of EUR78 million, reported as a past-service pension cost gain, and this is related to a change in the Group's US pension plan rules. In Q3, 2013, the settlement resulting from a lump sum offering to terminated [vested] employees in our US pensions plan will be reported as part of EBITA. This concerns the same US pension plan for which a past-service cost gain was reported in Q2, 2013.

That settlement results, which is dependent on the discount rate on the payment date in September, relates to inactive members and, therefore, will be reported in IG&S.

Further, as a part of the change in funding of the Dutch pension fund, Philips intends to make one-off EUR600 million contribution to the Philips' pension fund. The new funding agreement and its implementation are subject to necessary approvals, and are expected to become effective on January 1, 2014.

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

The improved results for the second quarter of 2013 demonstrate further progress on our path towards our 2013 financial targets. The development of the order book, particularly in Healthcare, means that the sales and earnings for the second half of the year will be weighted more towards Q4, as Q3 is a seasonally lower earnings' quarter for Healthcare compared to Q2. However, we remain confident in our ability to continue improving the operational and financial performance of the Company, driven by the Accelerate program.

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



QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Andreas Willi, JPMorgan Cazenove.

Andreas Willi - JPMorgan Cazenove - Analyst

My first question is on Lighting. Maybe you could give us a bit more color what's going on in the growth of Lumileds, that's mid single digit, given the current LED adoption that looks quite disappointing; are you underperforming the market there?

On the Professional Luminaires business, which was down, you highlighted the issues in the US. How long are these issues in the US going to last? You have been talking about those for quite a while. Thank you.

Frans van Houten - Koninklijke Philips NV - CEO

Good morning, Andreas; thank you for your questions. Let me start with the questions on Lighting. The Lumileds turnaround is progressing well. As you recall, we put new management in place in January of 2012, and in the meantime, we have seen a good progress on the profitability improvement. We believe we are on track there.

The growth rate in the Lumileds business, we find it reasonable. We perform in the high power, high brightness LEDs. Some other industry players see strong growth in so-called mid-power LEDs; that's a different segment, so maybe not totally comparable. All in all, we are reasonably satisfied with the progress, although there is more to be done in Lumileds.

With regard to Professional Luminaires in the United States, yes, there we are not fully performing. We started the long-awaited full integration of the Genlyte acquisition in the course of 2012. The plan is progressing very well. It entails, among others, the reorganization of the sales force to cover all the Philips lighting products through a single sales force; the reappointment of agents; the closure of several factories; the consolidation of R&D centers; and the rollout of new IT.

Admittedly, that is quite a lot, but it was long overdue. We are dealing with the issues; the plan is progressing well. There is some consequence versus competitors that we are not fully performing while we are transforming the engine room. But we have great confidence that the management is on the path to recovery towards the end of this year, where we expect to come out very well. So it's a work in progress, but it's going in the right direction.

Andreas Willi - JPMorgan Cazenove - Analyst

My follow-up question just on IG&S, whether there is an update for the guidance for the full year, given some of the moving parts and maybe lower numbers in Q2 as well? Thank you.

Ron Wirahadiraksa - Koninklijke Philips NV - CFO

Andreas, this is Ron. For now, the guidance will remain the same, EUR330 million. We realize that there was a EUR6 million incidental that we had booked as a result of the pension cost gain. But then I also mentioned that, in Q3, we'll do the settlement payments for the people that we are going to settle with from the defined benefits to defined contribution plan. As Frans explained, we closed that so there will be some impact of that. We can't really estimate that right now.

Andreas Willi - *JPMorgan Cazenove - Analyst*

Thank you.

Operator

Martin Wilkie, Deutsche Bank.

Martin Wilkie - *Deutsche Bank Research - Analyst*

Just a quick question on Healthcare, a very strong order intake level. Firstly, on your market outlook, you still seem relatively cautious there, given the strength of order intake. Should we see the intake this quarter, as a result of product launches and so forth, that it's perhaps not sustainable, or are you seeing an inflection in the end market? That was question number one.

The second one was, we have seen a rebound in growth in emerging markets relative to last quarter, so if you could just let us know, has something happened in emerging markets to cause that pick up in revenue growth? Thank you.

Frans van Houten - *Koninklijke Philips NV - CEO*

Thanks, Martin. In the press release, I also warned for continued concerns on the economic outlook of the world; Japanese yen, healthcare reform, many economies like Europe still in the doldrums, China slowing. So we cannot be totally relaxed about the state of the world yet. In that volatile environment, Philips is improving its performance in Healthcare; a slate of new products coming out that should sustain momentum on the order front, which we also need in order to sustain and underpin the second half of the year.

Also, strong order growth for Healthcare in, for example, China, where we finally got a lot of approvals from the Sino FDA, SFDA, therefore, also some pent up demand that we were able to start booking.

We look, with confidence, at our ability to compete. The year started slow, and that effect of the slow start will still work its way through the whole year, as one swallow doesn't make summer yet, as they say; I think it's a Dutch expression. So one quarter of good order intake doesn't compensate for a couple of quarters prior that were quite weak, and I've already mentioned the uncertainties. With that, of course, we remain committed to our targets for this year.

Martin Wilkie - *Deutsche Bank Research - Analyst*

Okay. Thank you very much.

Operator

Ben Uglow, Morgan Stanley.

Ben Uglow - *Morgan Stanley - Analyst*

I had a couple questions. Ron, can you give us a frame of reference for thinking about the Consumer Lifestyle business, going forward? The reason I ask is, if I look at the second quarter results, and obviously there was a restatement from last year, I felt that the profit level of 7.8%, given the sales' growth, was slightly light. I don't know if you agree with that. But I wondered, was your promotion or investment or selling expenses in the second quarter particularly aggressive versus last year? That was question number one.



And a related question, if we look typically at the seasonality of Consumer Lifestyle throughout the year, there is normally a big difference, obviously, between 2Q and 4Q, something like 4 percentage points to 5 percentage points in quite a few years. Is there any reason why that normal seasonality should not apply now in terms of mix or divestments or anything? Should we still expect that significant progression over the course of the year?

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Thanks for the question. So first, let me remind that, in the four quarters of 2012, the growth in the Consumer Lifestyle business, as in the current portfolio, has been 7%, 8%, 10% and 10%, so the first quarter was also 10% and now we have 13%. I just wanted to put that data point in, so the growth compare, of course, is going to be more challenging in the second half. That is the one point I'd like to give you.

Point on advertising and promotion, yes, we have been doing more advertising and promotion, so between Q1 and Q2 the AMP was about 250 basis points higher. So we think we have a good operating leverage in the Consumer Lifestyle business.

Seasonality in Q2 and Q4, there's no reason now to assume that that would irrationally change. We don't see that. We think there's enough underlying good execution and good innovation strategy with local relevant, that Frans elaborated upon, to help to add growth. But as I said, the second half of last year there was already a pretty strong growth indication.

Ben Uglow - *Morgan Stanley - Analyst*

That's very clear. Thank you. And I had just one follow-up, a very general question on the emerging market growth. Obviously, we're reading everywhere daily about incremental concerns on emerging markets. You grew very nicely in the quarter; did you see that growth taper off across your portfolio towards the end of the quarter?

Frans van Houten - *Koninklijke Philips NV - CEO*

Ben, no, that is not the conclusion that we would like to draw. But the given volatility, we do see stops and starts across the world. Also in both the Healthcare and the Lighting business orders are sometimes lumpy, and project sizes tend to increase. Maybe we haven't talked so much about it, but with hospital consolidation, that causes more lumpy order situations. And also in Lighting, we see that, as we move more towards projects and solutions, that the average order size per deal is increasing, which will I think, continue as a trend.

Maybe back to your first question and what I still would to observe is that, as we are performing very well and taking market share, there's of course also the possibility that there will be a competitive response that we will anticipate on.

Ben Uglow - *Morgan Stanley - Analyst*

Okay, very clear. Thank you very much.

Operator

Gael de Bray, Societe Generale.

Gael de Bray - *Societe Generale - Analyst*

Regarding the overhead cost cutting program, it seems that you've changed some of the underlying assumptions there. Restructuring costs have been cut from EUR125 million to EUR80 million for this year. Annual investments have also been increased to EUR140 million. I think it was up from EUR100 million initially, so what's driving really those changes, please?

And the second question actually relates to the Lighting margins. Given the slow start to the Lighting margin in H1, I guess on a sequential basis, would you say that the Lighting targeted margin range is probably the most at risk today within the portfolio? Or do you expect really a nice pickup in profitability in the second half of the year and obviously, what would drive such a pickup if it happens? Thank you.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Thank you. Great questions. Let me first talk about the cost reduction program. It's true that the restructuring will come out somewhat lower, so as I already indicated in my part of the speech, there is somewhat lower restructuring also in IG&S. There is, in certain parts of Europe, some slowness in getting the necessary approval so, therefore, in the remainder of the year that will be somewhat lower.

Also we find, and it is quite, almost by design, I would say, that we take restructuring programs and costs on the full headcount, but much of that headcount actually finds a different destination. Many times outside or when we find different solutions we don't have to take that, so there's always some variability. Our rule of experience is that we use about 75% to 80% of restructuring provisions taken, but at the time of restructuring we have to take them.

There is also somewhat of a shift indeed in the annual investments, the EUR140 million. So as we have outlined earlier, we are literally rewiring the Company, and one-off investments that it will take to get this in place in the coming years is higher than anticipated. This is mostly cost related to IT programs, the process and data -- building process and data capability.

Maybe I can also take the opportunity to say that we are very pleased with our overhead cost reduction program, and please note that on page 31 of the investment deck, we have now given you, instead of cumulative savings the savings in the year. And we did that because we are in the second year, so it was somewhat of a more difficult thing sometimes to work with cumulative as the reference base kept being and is still 2011. So we wanted to give you a clearer picture.

And you can see that, therefore, in the year 2013 year to date, we have actually saved EUR202 million. And, therefore, we are commutative with our achievements in the end of '11 and mostly last year, now with EUR673 million whilst a full year is EUR900 million, so the run rate looks actually pretty good.

Gael de Bray - *Societe Generale - Analyst*

Just can I maybe have a follow-up on the annual investments that have been increased a little bit, compared to the prior expectations or the prior estimates? Is it something like a two-year process ending really at the end of 2014, or is it something that is expected to continue at that level, maybe at least 'til 2016 now?

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Yes, that's a very good point. We have also elaborated on that at the Capital Markets Day in March. Our Accelerate program is not saving EUR1.1 billion overhead costs by 2014. We have articulated mostly the overhead costs. Actually, Accelerate is stretching into 2017.

Now we're teeing up also more programs within that. For example, the whole DfX, the Design for Excellence, manufacture, etc., of which we have, at the Capital Markets Day in March, told you that we will expect to save on the bill of material about EUR1 billion between 2014, 2016, so that requires still a little more of expenses than anticipated.

Also, we are moving ahead with our End2End implementation and implementing the business models that will depict our new way of working. As you know, we are doing four standard business models of which the standard products models, the first one, will be up and running towards the end of next year.

So we're also going a little faster with some of the programs, but it is not until 2014; the whole Accelerate stretches in 2017, and we'll give more guidance on the way forward at our update in September.

Frans van Houten - *Koninklijke Philips NV - CEO*

Your second question related to Lighting, and you ask whether the Lighting target was the most tough to achieve versus the others. Clearly, Consumer Lifestyle is trending very well. We strongly believe in our ability to further improve operational excellence and margins in all three sectors. Lighting still has a lot of work to do, but also there we are confident that we are progressing well.

So yes, Q1 maybe a somewhat slow start on the top line, but all three sectors showed significant bottom line improvement. And again in Q2, all three sectors show significant bottom line improvement on an operational level. So with that, we look with confidence at the rest of the year, knowing that we are a case of self-help and that we can drive this improvement ourselves.

Gael de Bray - *Societe Generale - Analyst*

Thank you very much.

Operator

Olivier Esnou, Exane BNP Paribas.

Olivier Esnou - *Exane BNP Paribas - Analyst*

My first question regards the FX environment which you mentioned as a concern. Can you talk a little bit more about how this is impacting you in terms of yen decline, competition from Japanese player, your business over there, and how the hedging of the Company is mitigating that across business and region and can you give some detail? That's my first question.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Okay. Well, the impact so far for the first half has been relatively modest, I would say, so not a lot. We expect the main impact of the currency changes to take place in the second half of the year.

Of course, we have included that in our commitment to our targets. So yes, we do hedge. Of course, hedges are done overall and for, particularly Japanese yen, we also then have to reckon with the impact of competitive moves from the changes in ForEx and by other players in the market, I would say.

So, so far, the combined effect of the ForEx in terms of translation and transaction, if I combine it, and the offset in hedges, has been quite modest for the first half. But as I said, in the second half, we expect a larger impact.

Frans van Houten - *Koninklijke Philips NV - CEO*

Maybe to complement; we do see more aggressive behavior by some Japanese companies that are helped by a favorable currency for them. Our response is to be more of a solutions provider to Healthcare customers, and the Georgia Regents hospital deal in the United States, which has a very nice order of \$300 million and a 15-year duration, is exactly a great example of how we want to insulate ourselves from competition on standalone deals, which have a tendency to be more price-orientated.



Obviously, we are keen to further expand on that strategy, and I'm sure it will also be a topic that Deborah DiSanzo will elaborate on during the Capital Markets Day next year. All right, Olivier, yes?

Olivier Esnou - *Exane BNP Paribas - Analyst*

Maybe just one follow-up, please? In terms of restructuring charge for the full year, if we take everything together, not just Accelerate, but footprint and acquisition-related charge, can you give an idea when that should be this year? Thank you.

Frans van Houten - *Koninklijke Philips NV - CEO*

I'm not fully understanding your question, Olivier.

Olivier Esnou - *Exane BNP Paribas - Analyst*

The P&L charge for restructuring, so you give an indication on the slide 31. Is that everything for the year, or will there be more relating to footprint in Lighting, acquisition-related charge? Do you have a -- does that include everything?

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

So we have guided overall for the PMI and restructuring -- restructuring is the main part -- about EUR60 million in Q3. As you know, we have taken quite some provisions for restructuring of the industrial footprint in Lighting and we're executing on that, going forward, and will update you more on Capital Markets Day on how we see that, going forward.

As the conventional Lamps business, will also decline further, as we have already indicated, ongoing it will take restructuring. But for this year, we have taken the plans that we have made at the end of last year, of course, already into consideration in restructuring charges last year.

Now, maybe it's also good to say that we expect that the actual cash out this year for restructuring charges, so let's say disbursements on provisions taken last year, will be close to EUR300 million. I thought I would also give you that data point in this question.

Olivier Esnou - *Exane BNP Paribas - Analyst*

Thank you.

Operator

Fabian Smeets, ING.

Fabian Smeets - *ING Financial Markets - Analyst*

A question from my side on the pension settlement in first quarter. I think you've already indicated that, at the moment, you find it difficult to estimate exactly how much you're going to spend. But maybe for modeling purposes, can you give a slight indication of if it's in the tens of millions of euros or maybe even in the one hundreds of millions of euros?



Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

So just to make it clear, this is to settle with the fact that we have frozen the funds and that we settle with people that had before the client benefit plan.

Now, what is important there to take into account is the interest rate on the settlement date that will determine the cost of that. So there'll be somewhat of an impact; I don't think it will be very grotesque, if that is the right word, but we have to see when it happens, and that will probably also be more of a thing I can talk to about on Capital Markets Day.

Fabian Smeets - *ING Financial Markets - Analyst*

Thank you very much.

Operator

Fredric Stahl, UBS.

Fredric Stahl - *UBS - Analyst*

I actually wanted to ask you about the Lighting business and it's a high level question, but what kind of -- is there a structural reason for you guys not being able to split up the traditional Lighting business from the LED business, given the completely different dynamics in the two? So if you can give me an idea of that.

And then secondly, I wanted to ask you about the IT overall. How is that progressing? How far have you come? Thank you.

Frans van Houten - *Koninklijke Philips NV - CEO*

Maybe I'll start with IT, and then let Ron give a little bit of color on conventional versus LED.

We described, last year, our overall strategy with regard to IT, and there are four main initiatives in that; I'll stay at a high level. Part is outsourcing of mundane tasks and cost reduction; there we are very well on track.

And then the big other part is the transformation of the IT landscape at Philips, a landscape that is very diverse and old and that is not enough helping the business, with multiple SAP kernels and a lot of legacy. And there we are rolling out, in conjunction with the business process reengineering and the business models, the value chains that Ron spoke about, from next year onwards, a state of the art, realtime IT landscape, which serves the business much better, and which is also highly secure and so on.

That is what we are making the investments on at the moment; that relates to the EUR140 million, which partly goes into the design of the processes and IT and partly also in the testing in preparation of the rollout.

This is a program that is big and it will run until 2017. And I will note that, during Capital Markets Day, we'll say a few words about that topic. Overall, just going well.

Maybe then back to Ron.



Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Yes, so, of course, reporting-wise, splitting out LED and conventional is not the thing, but your question is more, I believe, why don't you split them out because of the different business dynamics. We've not done that, because we run the business from a BG consolidation perspective, that there are multiple technologies at work, actually it's not a reason to split out the one or the other. I would argue that they have to go hand in hand, and if there is such a thing as the sunset and the sunrise part of the business, then we'd better make sure that we have one combined leadership, worrying about -- and of course rejoicing, for that matter on both.

Fredric Stahl - *UBS - Analyst*

Okay. Thank you very much.

Operator

Aaron Ibbotson, Goldman Sachs.

Aaron Ibbotson - *Goldman Sachs & Co. - Analyst*

I've actually got a very similar question, but phrased slightly differently, and that's also related to the LED versus traditional. And I was curious to hear your thoughts on how the LED growth is slowing on a sequential basis. I may have my numbers wrong here, but when I look at the numbers you provide, I get very close to almost stable LED-based sales over the last four quarters, whereas very dramatic growth the quarters before. So is there a big seasonality here in LED which is not happening in traditional, or have I misunderstood the numbers in some way? Or should we expect year-over-year growth to slow very dramatically in the third quarter?

So effectively, I want to know what is happening sequentially over the last two, three quarters on the LED-based sales, which looks approximately flat to maybe plus 10% on my numbers. Thank you.

Frans van Houten - *Koninklijke Philips NV - CEO*

I recall that our LED-based sales grew with 37% in Q1 and 28% in Q2, whereas our conventional Lighting declined. So that means that LED is not stable versus the rest, so that, I think, is something to reconsider.

Overall, LED lighting is now 25% of our Lighting portfolio, and we expect a 25% proportion to grow to about 45% by the year 2015. Obviously, that will continue to require a strong sales growth.

We see very good traction in the professional markets with LED where, in terms of new quotations for projects, the majority now is based on LED technology and our market segments that are really early adopters and strongly convinced about the benefits of the technology. Whereas the consumer is lagging behind, which is logical, given the price points of LED lamps.

On the LED consumer lamps side, we see prices coming down to below EUR10. That's still not good enough for mass consumer adoption, but maybe from next year onwards we can also see that accelerate.

So we remain confident that LED is growing rapidly and, therefore, I think we have a slight different view on the analysis that you've just presented.



Aaron Ibbotson - *Goldman Sachs & Co. - Analyst*

Frans, thank you, I appreciate, but if you allow me to just probe a little bit more. In Q3 last year you said that LED-based sales were 24%; now you're saying it's 25%. So what I'm trying to get to is what's happened over the last three quarters, rather than over the last year. I appreciate the growth was very dramatic in the beginning of last year, which you're now comping, but your comps, as far as I can see, going into the third and fourth quarter is going to be dramatically much tougher.

And if I look at your decline from 51% to 28% year-over-year growth of the last three quarters, that is equal to roughly flat-lining on a sequential basis. So I'm just trying to understand if I'm missing something, or if there's a big seasonality happening.

Abhijit Bhattacharya - *Koninklijke Philips NV - Head of IR*

Let me clarify; this is Abhijit. We compare year on year, so if you look at Q2, 2012, it was 19.6%, and from there, it's gone to 25%. So looking at it sequentially doesn't give you really the correct picture.

So the improvement is on year-on-year, so last year at this stage we were at roughly 20%; that has gone up to 25%. So similarly in Q3 last year, we were at 23%; hopefully, Q3 this year we will be at a significantly higher level. That's how the math works.

Aaron Ibbotson - *Goldman Sachs & Co. - Analyst*

Okay. But you're at 24% now in the report in Q3 last year and you're 25% this, so that's a growth around 5%, is that the way to understand it Q3 to Q2?

Abhijit Bhattacharya - *Koninklijke Philips NV - Head of IR*

No, you'd have to look at Q2 to Q2, where it's 20% is now 25%; that's how to look at it.

Frans van Houten - *Koninklijke Philips NV - CEO*

Aaron, can I suggest that we take this off-line and that we work through the model, okay?

Aaron Ibbotson - *Goldman Sachs & Co. - Analyst*

Yes, okay. Thank you.

Operator

Daniel Cunliffe, Nomura.

Daniel Cunliffe - *Nomura - Analyst*

Question just on the 1.5% inventory to sales improvement, you said mainly in Healthcare and Lighting. Can you confirm that all of that was through efficiency measures, or was there any under production? I'm in particular asking because Lumileds or I think 320 basis points reduction to inventories. So that was question number one.

And then the second question. Is there any large differences we should be aware of as we think about the second half versus the first half in gross margin and EBIT movements? So particularly as we think about Consumer, should we expect SG&A costs and [UM] costs and new product launches

to fall down a little bit before we see more to the EBIT margin improvement? So I guess the second question was really, was there any division where there was a large difference between gross margin and EBIT movement for this quarter? Thank you.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Thanks for the question. You ask about Lumileds inventory, yes, there was a bit of production control that we had to do, which we consider very good stewardship. So somewhat of that is in the numbers, but overall, I would say, this is really the result of operational improvements. And if you tune your production plan, then that is something that is a bit ad hoc needed at the moment. But as said, for the second half we remain committed to our targets.

You ask if there are major shifts in the EBITAs for the various sectors. Usually, the second half is more seasonably weighted. That applies particularly to Healthcare, but also, I would say, to Lighting and somewhat to Consumer Lifestyle, with the Christmas season and Chinese New Year, usually [there's some buying] there.

So yes, there's a normal pattern of more expanded margins second half.

Daniel Cunliffe - *Nomura - Analyst*

Perhaps just one follow-up on the Lumileds question then. You said some of that was in the numbers as you adjusted production there. Is it possible to quantify, if not would that impact or repeat as we head into H2, or does that negative impact fall out? Thanks.

Abhijit Bhattacharya - *Koninklijke Philips NV - Head of IR*

Yes, Dan, this is Abhijit. There was some impact, as Ron said, on Q2, but for Q3 and Q4 we don't expect any major curtailment in production in Lumileds.

Daniel Cunliffe - *Nomura - Analyst*

Great. Thanks very much.

Operator

Philip Wilson, Redburn Partners.

Philip Wilson - *Redburn Partners - Analyst*

Two questions, please. First, I see you had a G&A increase of 52% 2Q, '13 versus 2Q, '12, or EUR79 million. Presumably, this is not affected by the A&P increase in CL which I imagine be in the selling and expenses line. So can you explain to and what that relates to and how we should think about the G&A line, going forward? That's the first question.

And the secondly, just to clarify the Lighting adjusted margin year-on-year improvement. Can you say how much of that benefit the Lighting margin saw from the EUR165 million industrial footprint program, as opposed to Accelerate savings, and how we should think about the phasing of this EUR165 million program, going forwards? Thank you.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Okay, so the difference in the G&A is EUR68 million, well noted. EUR50 million of that is due to Accelerate, so there's a program, so End2End, the DfX and the four business models, the implementation, the rewiring of the Company that I spoke of. And EUR18 million is due to a reclassification of gross margin to G&A; that's a smaller part of the equation.

The EUR165 million, we talked about that last year and we said that the EUR165 million of Lighting savings, potential restructuring, would take place over the coming two to three years, that we have not put an exact timing on it because sometimes these things go quite lumpy. But that's the timeframe in which you should think about this benefit.

Philip Wilson - *Redburn Partners - Analyst*

Okay. Thank you. And just as a follow-up, you highlighted in your presentation Healthcare seasonality. The fourth quarter has historically been the strongest quarter in Healthcare, but I just wanted to understand, are you saying the seasonality in the fourth quarter will be stronger than normal, or are you just highlighting the normal seasonality there?

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

I was highlighting in that answer the normal seasonality.

Philip Wilson - *Redburn Partners - Analyst*

Okay. Thank you.

Operator

William Mackie, Berenberg Bank.

William Mackie - *Berenberg Bank - Analyst*

If I could come back to a couple of points on Healthcare and CL? On the Healthcare orders, could you just help me understand the underlying trend in North America if we adjust for the \$300 million large 15-year order that you've highlighted, what were the trends in the business excluding that?

And how much, I think you mentioned in the \$300 million you've only booked part of it, so how much more is there to come through the rest of the year?

And on emerging markets and orders with Healthcare, a remarkable pickup again with the 19% underlying growth in Q2. Could you just maybe throw some color on which countries stand out, I think you highlighted China, but is there one that stands out above all others as driving that and whether it's sustainable?

And then coming on to CL, just coming back to an earlier question on the A&P spend, could you clarify, did you say it was a 250 basis point drag, year on year, on the margin Q2 for CL, and what would you expect in terms of A&P spend in H2?

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Okay. So typically, the second half the impact that A&P makes on the sales is less than for example in Q2, so that's not what I said earlier. Potentially the Q2 seasonality, and as I said Q2 versus Q1 was 250 basis points in advertising up. But as the season takes place more in sales in the second half,



it makes much less of an impact in the second half, but that's not the way to think about such an increase going forward, so that will have to follow, or that follows a normal pattern.

You asked about the Georgia Regents deal; less than 10% of the deal is booked as order intake. As I said, we have quite strict rules in how we recognize and report on orders, so the rest of the improvement is across the business, I would say, as outlined earlier.

I'm sorry, there was one other?

Frans van Houten - *Koninklijke Philips NV - CEO*

Emerging markets Healthcare.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Yes, emerging markets Healthcare, well, we saw particularly good strength in China, in sales growth, also in India very good sales growth. Japan is still growing, and in Latin America we've also seen very good sales growth.

Frans van Houten - *Koninklijke Philips NV - CEO*

The order and sales growth have a lot to do with a slate of new products that have been introduced. I mentioned in my introductory speech that we got an SDA, SFDA approval in China for several new Healthcare products. And that is driving this strong traction that we expect to continue also in the rest of the year. Okay?

William Mackie - *Berenberg Bank - Analyst*

Okay. Thank you. A quick follow-up, but a broad question. At Philips, you've undertaken huge amounts of change with regard to Accelerate; you've structured the balance sheet; you've ended your buyback program. At what point should we start thinking you're ready to look to capital allocation, and specifically M&A, once the Philips' business system model has become established?

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Yes, we completed the share buyback, the one we just finished, the EUR2 billion that we started in July 2011.

Our M&A strategy remains currently to bolt-on acquisitions; it's really value compelling. And for the rest, I would refer to what we said earlier on giving you an update on the capital allocations strategy go forward in September.

William Mackie - *Berenberg Bank - Analyst*

Okay. Thank you.

Operator

Peter Olofsen, Kepler Cheuvreux.



Peter Olofsen - *Kepler Cheuvreux - Analyst*

I have two questions left. First on the Lighting business, looking at the margins in the second half of the year, will there be any benefit compared with the first half from phosphor costs and pricing actions that you have taken?

And then on IG&S, comparable sales were down [14%]; in the press release you referred to lower Lighting income. I understand that there is typically some quarter-to-quarter volatility in there, but has the outlook for Lights income changed? Thank you.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

No, the outlook for Lighting income has not changed, so by in large we remain what we have said in earlier occasions.

On the phosphor, as I said in the remarks, the prepared remarks, this is in the numbers, so quantitatively it will be somewhat higher the effect in the second half of the year. But bear in mind that last year it started somewhat in Q4, though we said it's not a large impact, so towards the end of Q4 this should equalize in a compare. But for Q3 and the beginning of Q4 there will be somewhat of an advantageous effect.

Peter Olofsen - *Kepler Cheuvreux - Analyst*

Okay. Thank you.

Operator

Andrew Carter, RBC.

Andrew Carter - *RBC - Analyst*

Most of my questions have been asked actually, but I just wondered on Healthcare, I was wondering, I guess you have mentioned a couple of times that the outlook is still a little bit volatile, but I was wondering if there's any sign that things are starting to improve a little bit.

I noticed that you mentioned that North America as being back to positive for the first time in some while, and I think your US competitor talked about Europe being positive in the most recent quarter, again for the first time in some while. And so I was just wondering, does that make you feel a little bit more positive, or is it possible that some of the sequester or austerity initiatives that we're seeing in different parts of the world might yet still have to impact in coming quarters; how should we think about that?

Frans van Houten - *Koninklijke Philips NV - CEO*

Yes, thanks, Andrew. Yes, volatility will remain with us, I think with the market, but there are a few positive signs. In the United States, the Governmental orders have started to come back in, for example the veterans and other Governmental hospitals, so that is a positive sign of, perhaps, overcoming the sequestration.

Nevertheless in the US, healthcare reform continues to have major impact on the hospital systems. We see hospitals merging into a larger accountable care organizations, and that, of course, means that they are focused on that process rather than on doing capital investments.

In Europe, we see somewhat lumpy behavior. If you recall in the second half of last year we had some quite good order intake. Now currently, in the Nordics, we see some weakness, so there are ups and downs across Europe. I think it is way too early to call a turn of the market, as of yet.

The emerging markets continue to be strong, and I think there, there is so much backlog in building an effective healthcare system that, for the right offering that we have, there will be an ongoing demand.

So all in all, if you add it all up, I think we can be a bit more optimistic, but it's certainly not yet safe waters.

Andrew Carter - RBC - Analyst

Thank you.

Operator

David Vos, Barclays.

David Vos - Barclays - Analyst

Just a question on Lighting, if I may? On LED price versus cost equation, how are you seeing that evolving; are you keeping up in reducing your costs versus what you see on the price reduction side?

And maybe if you could also comment on how you see prices developing between the consumer and the professional angle, please?

Frans van Houten - Koninklijke Philips NV - CEO

Well, as can be expected in a new technology, there's a lot of trends going on at the same time. We must have an aggressive cost [down] otherwise the technology won't get adopted and so, in effect, we are driving ourselves as the leader in [lighting] down the prices.

This is especially necessary in the Consumer domain, where we need to reach price points well below \$5 in order to hit the sweet spot of adoption, something that we have experience with also in the past when you look at for example [CFLI] adoption.

We see that, on the professional side, it's more total cost of ownership decision making, so where you can really come with superior technology and premium prices because it's the overall functionality and total cost of ownership that counts.

We continue to see possibilities to run down the costs; also the DfX program is designed for excellence, that Ron mentioned is helping us to create very cost effective platforms.

In terms of ability to match costs down with price down, we are not totally there yet, to be satisfied, and currently, the profitability of LED still is trailing the profitability of conventional. But we are confident that, in the future, this will be a good business for us, and more to follow at the Capital Markets Day in September.

David Vos - Barclays - Analyst

Okay. Thank you very much.

Operator

Thank you, Mr. van Houten and Mr. Wirahadiraksa. There are no further questions, please continue.

Frans van Houten - Koninklijke Philips NV - CEO

All right, well, thanks very much all for joining in on this call where we could look at very satisfactory 30% operational profitability improvement, and a return to growth of order intake for Healthcare and quite a few other achievements.

This is all on our journey to unlock the full potential of Philips. By far we are not done yet, as we see many more opportunities down the [pipe]. And we hope that we will have a very exciting Capital Markets Day in September where we can have that discussion together with you.

Operator

This concludes the Royal Philips second quarter results 2013 conference call on Monday, July 22, 2013. Thank you for participating, you may now disconnect.

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