

**PHILIPS**

**Philips – Q2 2018**

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## **Introduction**

Pim Preesman

*Head of Investor Relations, Royal Philips NV*

Thank you, and good morning, ladies and gentlemen. Welcome to Philips' Second Quarter 2018 Results Conference Call. I'm here with our CEO, Frans van Houten and our CFO, Abhijit Bhattacharya.

On today's call, Frans will take you through our strategic and financial highlights for the period, and Abhijit will then provide you more detail on the financial performance and market dynamics. After that, we will take your questions.

Our press release and the related information slide deck were published at 7:00 a.m. CET this morning. Both documents are now available for download from our Investor Relations website.

A full transcript of this conference call will be made available by end of today on our website.

I would like to remind you that Philips' shareholding in Signify, formerly Philips Lighting, is currently 18% of Signify's issued share capital. The stake is presented as an investment included in assets classified as held for sale in the financial statements of Royal Philips as from the end of November 2017. We provided you with guidance for the expected FX translation, combined with the consolidation and deconsolidation impact on sales during the respective quarter and for full year 2018. We will continue to do so twice a quarter, once immediately after this analyst call and once during the last week of the quarter. Both these updates will be available on our IR website.

Finally, as mentioned in the press release, adjusted EBITA is defined as income from operations excluding amortization of acquired intangible assets, impairment of goodwill and other intangible assets, restructuring charges, acquisition-related costs and other significant items. Comparable growth for sales and orders are adjusted for currency and portfolio changes.

With that, I would like to hand over to Frans.

## **Overview**

Frans van Houten

*CEO, Royal Philips NV*

Yes, thanks, Pim, and thank you all for joining us today.

In the second quarter, we delivered 4% comparable sales growth, a strong 9% order intake growth and a solid 100 basis point improvement in operational performance driven by growth and productivity programs. We continued the good traction of the new products and solutions that we introduced last year, and this contributed to 8% comparable sales growth for the Diagnosis & Treatment businesses.

The Connected Care & Health Informatics businesses grew 2% compared to last year with an encouraging mid-single-digit order intake growth. As mentioned during the last 2 quarters, we continue to expect further improvement to be in the second half of the year.

The Personal Health businesses grew 2% with high single-digit growth in Sleep & Respiratory Care and low single-digit growth in Personal Care. Growth of the Personal Health businesses was impacted by a high single-digit decline in China, mainly due to an inventory alignment at our online distributors and lower demand in the air purification market. After a slow start, the Personal Health businesses gained momentum in the quarter, and we expect this to continue in the second half of the year. The increase in margin was mainly driven by growth, our productivity program and operational improvements, contributing to an adjusted EBITA margin increase of 100 basis point.

Our Diagnosis & Treatment businesses and our Personal Health businesses delivered strong margin improvements with adjusted EBITA improving by 180 and 80 basis points, respectively, versus last year. The Connected Care & Health Informatics businesses improved adjusted EBITA margin with 40 basis points as the results for the quarter were impacted negatively by 2 one-off items.

In the quarter, we continued to make good progress with our productivity programs. Additionally, we took action to further reduce our interest expense.

Let me now expand a bit on our strategic journey to leadership in HealthTech. As outlined at last Capital Markets Day -- last year's Capital Markets Day, our value-creation story is built around 3 key levers. I will now proceed to give you examples on how we have made further progress on them in the second quarter.

On the first lever, by creating value in our core businesses by gaining market share through deeper and more comprehensive customer partnerships through innovative solutions and by pursuing growth through increasing geographical coverage. On this first lever, innovation partnerships and increased geographical coverage were important drivers of the strong sales growth of 8% and the continued momentum in order intake growth of 12% in the Diagnosis & Treatment businesses. Across our markets, we continue to see strong customer interest in our innovations.

For example, the installed base of our Access CT, which we introduced last year, continues to grow rapidly. And at a lower total cost of ownership, the Philips Access CT provides consistent image quality across a diverse patient population and a wide range of exam types, enabling health care organizations to expand care capabilities to treat more patients. We are also seeing continued growth for our IQon Spectral CT and Vereos Digital PET/CT systems, augmented with clinical decision support applications for enhanced patient care and operational performance management services to drive productivity.

Following the rollout of our new Ingenia Elition 3 Tesla MR with compressed sense and 3D APT in Europe earlier this year, we now also obtained the 510(k) clearance from the U.S. FDA for these innovations. The Ingenia Elition enables clinicians to perform exams up to 50% faster, increase diagnostic confidence and improve the patient experience. We completed the first installation in the United States at Hennepin Healthcare, a comprehensive health care system in Minneapolis.

I'm also pleased with the continued success of our EPIQ and Affiniti Ultrasound systems and advanced informatics across the Cardiology, OB/GYN and General Imaging clinical segments. The recently introduced transducer that is optimized for OB/GYN and General Imaging provides exceptional image quality for these specific clinical applications as well as the previously introduced 3D cardiac ultrasound transducer contributed to strong growth.

Recently, the enhanced Lumify app-based ultrasound solution with face-to-face conversation, along with simultaneous viewing of live ultrasound images and guided probe positioning is driving strong growth for us

in the point-of-care ultrasound market. Our customers recognize the value of these ultrasound capabilities that enable remote collaboration and virtual training.

In Connected Care & Health Informatics, we partnered with the Showa University to launch the first tele-intensivist care eICU program in Japan. This platform, which has already been successfully implemented in the United States, the United Kingdom, Australia and the Middle East delivers near real-time remote patient monitoring and early intervention possibility through predictive analytics and advanced audiovisual technology.

Funded by the Japanese government, the deployment of the eICU program in Japan addresses the shortage of critical care expert physicians in Japan and will drive efficiencies in the delivery of critical care.

In Europe, the Dutch Rijnstate Hospital chose Philips as its health technology partner to design and implement a regional care network and expands the delivery of care beyond the walls of the hospital. Philips' latest monitoring and connected health technologies will be at the heart of this new concept. From a virtual care coordination center and advanced central command hub, care providers will remotely monitor the health of patients both inside and outside of the hospital. This new collaboration builds on the successful existing long-term strategic partnership between Philips and Rijnstate Hospital in the field of diagnostic imaging solutions.

In the quarter, we signed 7 new long-term strategic partnership agreements across United States, Europe and Africa. In the United States, Philips and Jackson Health System, one of the largest public health systems in North America, entered into an agreement involving an industry-first enterprise patient monitoring as a service business model. This will enable Jackson Health to standardize patient monitoring at all acuity levels for each care setting across its entire network on a per-patient fee basis.

In Germany, Philips announced 2 multi-year agreements with a combined value of approximately EUR 140 million, one with the Clinics of Cologne and the other with Munich Municipal Hospital. Philips will deliver medical imaging solutions to support precision diagnosis and therapy, innovation and productivity improvements to these institutions.

We also signed a 7-year agreement to equip Ethiopia's first specialized Cardiac Care Center for state-of-the-art diagnosis and treatment of cardiac disease.

Our investments over the past years focused on building solution-selling capabilities are now paying off, and we have a healthy pipeline of pending partnerships.

Let me now move to our Personal Health business. Following the successful launch of the DreamWear Full Face mask in the United States at the end of the first quarter, the rollout of this new mask in other markets resulted in double-digit growth for Philips in this largest mask segment. Moreover, to further drive growth in the emerging sleep therapy market in China, Philips launched the connected Dream Family solution there.

In Personal Care, we celebrated the sale of our 1 billionth male grooming product, and we continued the OneBlade success story as we rolled out the Philips OneBlade Face + Body in further markets.

In the second half of 2018, growth will be supported through the rollout of OneBlade in additional markets within the Americas, Asia Pacific region and Eastern Europe. Furthermore, we will bring a new innovation into electric shaving with the launch of our series 9000 Prestige shaver, promising unbeatable closeness in skin comfort even on a 7-day beard.

On the second lever of creating value in adjacencies through organic investments, partnerships and selective M&A, we further expanded our global leadership in digital pathology solutions for primary diagnostics use. Our solution is commercially available in the United States, Europe and many countries in Asia, including Japan and most recently in Korea. In the United States, we teamed up with life sciences leader, LabCorp Corporation, to fully digitize pathology workflows for LabCorp clinical laboratory and drug development services.

We also partnered with the Dana-Farber Cancer Institute to deploy best practices in cancer care. The incorporation of the institute's Clinical Pathways in our IntelliSpace Oncology Platform will help oncologists reach the most appropriate cancer treatments for patients based on a unified view of the patient across diagnostic modalities and the embedded knowledge of both partners. IntelliSpace Oncology is our new cloud-based platform for the integration of information across different clinical domains such as radiology, pathology, EHR systems and genomics. All key patient data is seamlessly incorporated into 1 work environment, 1 location to provide a clear, intuitive view of patient status in its disease and state context, which facilitates data-driven and fast decision-making.

In addition to these and other organic growth initiatives, we further strengthened selected businesses through targeted acquisitions. For example, we acquired Remote Diagnostic Technologies or RDT, a U.K.-based leading innovator of advanced solutions for the prehospital market providing monitoring, cardiac therapy and data management. RDT's portfolio of comprehensive connected emergency care solutions will complement our emergency care response business and strengthen our leadership position in the EUR 1.4 billion resuscitation and emergency care market.

We continue to further strengthen our Image-Guided Therapy business. To drive the expansion into the adjacent EUR 2 billion market for image-guided treatment of cardiac arrhythmia, we acquired EPD Solutions, an innovator in image-guided procedures for cardiac arrhythmias or heart rhythm disorders. EPD's cardiac imaging and navigation system will help electrophysiologists navigate the heart by generating a detailed 3D image of the cardiac anatomy while pinpointing the location and orientation of catheters during the diagnostic and therapeutic procedure to ablate the cardiac arrhythmia. This breakthrough technology has the potential to greatly simplify navigation and treatment, immediately assess the treatment results and ultimately enhance procedure efficacy and patient outcomes.

Thirdly, we create value by improving margins through customer and operational excellence. Our self-help initiatives to drive EUR 1.2 billion in savings for the period 2017 to 2019 remain on track as we delivered EUR 105 million savings during the second quarter. The main 3 programs, i.e., procurement savings, manufacturing productivity and overhead cost reductions, all delivered on their milestones.

We continued to make progress in line with the terms of the consent decree, which is primarily focused on the defibrillator manufacturing in the United States, and which included inspections by a number of independent auditors and the continued shipments of our FRX and FR3 AEDs to markets outside of the U.S.

Overall, we continue to expect our markets to grow at a 3% to 5% clip, which is on a comparable basis in 2018. I would like to reiterate our midterm targets of 4% to 6% comparable sales growth and an average annual 100 basis points improvement in the adjusted EBITA margin.

And with that, I will turn the call over to Abhijit who will provide more detail on financial performance and market dynamics.

## Financial Overview

Abhijit Bhattacharya

*CFO, Royal Philips NV*

Thank you, Frans. Good morning to all of you on the call and webcast.

Let me start by providing some color on the second quarter comparable growth of 4%. The Diagnosis & Treatment businesses delivered an 8% comparable sales growth with solid growth in all the businesses, Diagnostic Imaging, Ultrasound and Image-Guided Therapy.

We are very pleased to see the continued strong traction of these businesses, specifically in Image-Guided Therapy, with strong double-digit sales growth driven by both our Azurion platform and our devices portfolio.

Comparable sales growth in Connected Care & Health Informatics businesses was 2%. High single-digit growth in Healthcare Informatics and low single-digit growth in Monitoring & Analytics were partly offset by a low single-digit decline in Therapeutic Care, which includes the impact of the consent decree on our defibrillator manufacturing in the U.S. Given the phasing of our order book, we continue to expect improved sales growth during the second half of the year.

The Personal Health businesses delivered 2% comparable sales growth, driven by high single-digit growth in Sleep & Respiratory Care. Frans mentioned earlier already the main reasons for the lower growth, visible mainly in the Health & Wellness and Domestic Appliances businesses.

As we have said earlier, we expect the second half of the year to be stronger than the first half. In China, the inventory alignment at our online distributors took place in the second quarter. Additionally, we have a number of new product launches and rollouts to new markets, which will be well supported by advertising campaigns. For example, within Health & Wellness, we will be rolling out the mid-range Philips Sonicare ProtectiveClean power toothbrush to markets outside North America. Frans mentioned already further rollouts of the DreamWear Full Face mask, OneBlade and the introduction of our new high-end shaver range.

Sales in mature geographies increased by 3% on a comparable basis, reflecting 8% growth in other mature geographies and 2% growth in North America and Western Europe. Sales increased by 6% on a comparable basis in our growth geographies, reflecting double-digit growth in Middle East and Turkey, high single-digit growth in Latin America and low single-digit growth in China.

As Frans mentioned, comparable order intake grew overall by 9%. I would like to remind you that the comparable order intake growth in the prior year was 8% in Q2.

The Diagnosis & Treatment businesses showed 12% growth where the North America and China markets were again particularly strong.

The Connected Care & Health Informatics businesses grew mid-single digit. Excluding the defibrillator business where we expected a decline, comparable order intake grew high single digit.

In growth geographies, comparable order intake grew mid-single digit compared to Q2 2017, while comparable order intake in North America and Western Europe posted both 10% comparable growth in the second quarter.

Now let me turn to the EBITA development for the group in the second quarter. The adjusted EBITA margin of 11.2% in the quarter was 100 basis points higher than the year before, including a negative 20 basis points impact from currency. This margin increase was driven by strong margin improvement of 180 basis points in Diagnosis & Treatment, mainly through growth and operational improvements. For the first half of the year, the improvement was 160 basis points.

In Connected Care & Health Informatics, margins improved by 40 basis points, mainly due to operational improvements partly offset by 2 one-off items. For the first half of this year, the improvement was 120 basis points.

Personal Health improved by 80 basis points, again due to operational improvements, and for the first half, this improvement was 50 basis points.

Our productivity programs delivered EUR 105 million in net savings. More specifically, net overhead cost reduction amounted to EUR 17 million in nonmanufacturing costs. The productivity program contributed EUR 21 million to the gross margin and productivity; and procurement savings, in part driven by our Design for Excellence program delivered EUR 67 million of bill of material savings year-on-year.

In the segment Others, the adjusted EBITA amounted to a loss of EUR 45 million, which was in line with the guidance.

In Q2, income tax expenses increased by EUR 19 million, mainly due to higher income and lower release of tax provisions compared to the second quarter of 2017.

Our effective tax rate in the second quarter was 25%. We expect to be at the lower end of our guidance of 26% to 28% for the full year of 2018.

As part of the actions to reduce interest expenses and extend maturities, we completed the early redemption of a number of bonds. We also successfully placed an aggregate principal amount of EUR 1 billion of notes due in 2024 and 2028. Combined, these actions will reduce interest expenses by over EUR 20 million from 2019.

In line with our policy of de-risking our pension liabilities, today we'll make a contribution of \$150 million to the Philips U.S. pension fund to further improve the funding ratio. This will decrease interest costs and the PBGC premiums going forward.

Discontinued operations was a loss of EUR 184 million as it included a net loss of EUR 177 million, mainly related to the value adjustment of 18% interest in Signify, formerly Philips Lighting.

Operating working capital increased by 30 basis points year-over-year, driven by higher inventories in Personal Health due to the lower sales. Net cash flow from operating activities improved by EUR 57 million, mainly due to higher earnings from continuing operations and lower working capital-related outflows.

Let me now provide you with an update on the U.S. health care market and our outlook for Western European and the China health care markets. The second quarter saw North American health care customers continue to focus on priorities around the quadruple aim, that is lower costs while delivering better outcomes with improved patient and employee experience. We see positive momentum around value-based care based on the priorities of new leadership at the Department of Health and Human Services. This underscores the importance of our strategic priority to bring value-based solutions to the market. Overall, we expect the U.S. health care market to be in the low to mid-single digit while we closely monitor further developments.

In Western Europe, we expect modest low single-digit health care market growth.

In China, we expect high single-digit market growth for 2018, mainly driven by government policies to further increase access to care via existing Tier 2 and Tier 1 hospitals.

Let me now provide you some additional 2018 guidance for certain areas of our business. In the segment Others, we expect net cost of approximately EUR 50 million in the third quarter and expect approximately EUR 125 million for the full year 2018, both at EBITA level. This is an improvement of EUR 40 million over the previous guidance. Included in these numbers are EUR 10 million restructuring costs and other incidental items in the third quarter and approximately EUR 10 million for the full year.

On an adjusted EBITA level, we continue to expect full year cost at EUR 115 million, which is an improvement of EUR 42 million versus last year. This is in line with our previous guidance.

Overall restructuring for 2018 is expected to be approximately 90 basis points. Acquisition-related costs are expected to be approximately 50 basis points.

As a consequence of the consent decree mainly related to our defibrillator business, we continue to anticipate an EBITA impact of approximately EUR 60 million in 2018, of which approximately EUR 15 million was -- in the third quarter of 2018.

With our order intake growth of 10%, a comparable sales growth of 4.5% and an adjusted EBITA margin improvement of 120 basis points, for the first half of the year, we remain confident that we will deliver on our midterm targets of 4% to 6% comparable sales growth and average annual 100 basis points improvement in adjusted EBITA margin and a free cash flow between EUR 1 billion to EUR 1.5 billion.

With that, we will now open the lines for your questions. Thank you.

## Q&A

**Ian Douglas-Pennant (UBS):** It's Ian Douglas-Pennant, UBS. So on your guidance, please, at the beginning of the year, and I think you just reiterated it today, you said margin improvement would be H2 weighted. Given you've reiterated that this morning, are you deliberately saying that there is upside risk to the 100 basis points of margin improvement this year? Or is that just accidental?

**Frans van Houten:** No, we are not flagging that. We are steadily improving and there is no change in the story. We still expect a stronger second half of the year. Anything to add, Abhijit?

**Abhijit Bhattacharya:** No, no. I think there's no second meaning to that, Ian.

**Ian Douglas-Pennant (UBS):** Okay. Given it's a very quick answer, maybe I could just ask another one. On the Personal Health slowdown, it seems like, especially in Health & Wellness, but also with the other subdivisions within Personal Health, the growth rate has slowed to low single digit from comfortably double-digit pre- 2016. This seems like more than a product issue. This seems like a structural change in the growth rates that you were able to achieve. What gives you confidence that a new product is going to fix this?

**Frans van Houten:** Well, actually, let's dissect that a little bit. So Health & Wellness, we continue to see as a high growth opportunity, Sleep & Respiratory Care, we see as a high-growth opportunity. And then Personal



Care and Domestic Appliances are more mature areas where you see somewhat lower growth. We clearly reiterate today that we continue to see Personal Health in total as a mid- to high single-digit growth opportunity. And we have flagged that the second half of the year will be stronger than the first half and we believe we can still then, in the aggregate, get to be within the range indicated, all right. We also said that already during the second quarter, we saw growth rates picking up again and we have planned several product campaigns for the third quarter with a tied-in A&P, advertising and promotion, investments that we believe will support this outlook. So overall continued belief in this business. I just wanted to be very clear about that.

**Ian Douglas-Pennant (UBS):** Okay. And the range indicated is organic growth of 4% to 6% for that division. Is that what you're saying or high single digit?

**Frans van Houten:** No, the range indicated was mid- to high single digit. So it's a wider guidance. And yes, historically, we were on the upper end -- upper side of the guidance, but we believe that with a strong second half year for the full year, we will still be in that guidance.

**Veronika Dubajova (Goldman Sachs):** I also want to go back to the Personal Health dynamics and I think Abhijit and Frans, both of you have flagged that you saw the momentum accelerate as you moved through the quarter. Can you help us understand what the exit rate was for the business? And as you look to the second half of the year, what is the single biggest risk to your ability to come within this mid- to high single-digit range that you're targeting?

**Frans van Houten:** Well, that's a very detailed question, Veronika. I'd say the exit rate in Q2 supports the given guidance of at least mid-single-digit growth for the full year, all right. And the confidence that we have is that we believe that the China impact in Q2 was largely a one-off. It was the inventory alignment with our online distributors. But we believe that the underlying demand remains strong. We also expect that the traction in North America in the second half of the year on the back of the products and the campaigns that I've referenced will be strong. And then, of course, in Sleep & Respiratory Care all along has demonstrated high growth as well.

**Veronika Dubajova (Goldman Sachs):** And if I could just ask a follow-up, I think there's been quite a lot of concerns around a tariff escalation and a trade war. I'm wondering, Frans, Abhijit, if you can help us understand what that might mean for your business if we were to see a broader tariff regime imposed on all imports from China.

**Frans van Houten:** Yes, thanks, Veronika. Well, let's say, the first wave of measures have a modest effect on Philips and we have mitigated any increase in duties within our results and therefore we don't really talk about it. Subsequent waves of tariffs and potentially the tit-for-tat reaction from other regions are more difficult to estimate. Of course, we do our scenarios, but also the underlying good flows are likely to be affected. So at this time, we don't want to get ahead of ourselves in forecasting what it will mean other than that this will have to be passed on to consumers and hospitals through increased pricing.

**Michael Jungling (Morgan Stanley):** The question I have is a follow-up really on the tariffs. We now have the product list for the additional EUR 200 billion and it seems to include hair clippers, blades, cutting hairs or shavers with self-contained motors and some domestic appliances. Can you comment on what impact this would have on your business? What percentage or what revenues are currently at risk of having a 10% tariff? And secondly, your ability to pass this on to the consumer because you mentioned before you could pass it on, but for you to be able to say that, I guess you'd have to know the competitive environment to see where the other companies may have an advantage. So can you comment on your competitive advantage versus your other players on your ability to...

**Frans van Houten:** Sure, Michael, I'll answer that. We believe that even this second wave, that is still manageable. Let me first of all clarify that blades and shavers for North America are manufactured in Europe and therefore not affected. That potentially can give us also competitive advantage because we are not linked to China there versus our competitors. To the degree that products are touched, I'm thinking about the hair clippers, for example, which, off the top of my head, do come out of China, we will definitely reflect any duties in the pricing as we believe that our competitors are in the same situation.

**Michael Jungling (Morgan Stanley):** Great. And can I just please follow up? On the free cash flow, I think your guidance is EUR 1 billion to EUR 1.5 billion. If I look at Page 16, I think your free cash flow for the first half is minus EUR 88 million. At what point do you think you're able to get to EUR 1 billion-or-so run rate in terms of free cash flow?

**Abhijit Bhattacharya:** Yes, our cash flow, Michael, is largely Q4-driven, right, so we will get, let's say, most part of the cash flow in Q4. The reason why it's minus in the first half was, of course, we ended last year very well on working capital and then you build up a little bit for the selling season in the second half, and of course, the slower sales in PH. so once those are addressed in the second half, we will see that coming back to the EUR 1 billion to EUR 1.5 billion range for this year.

**Michael Jungling (Morgan Stanley):** So by the end of this year, we'll be around 1 point -- about EUR 1 billion. Is that a fair comment?

**Abhijit Bhattacharya:** Yes, yes, above EUR 1 billion, yes.

**David Adlington (JP Morgan):** Again, just coming back to the Personal Health care, just wondered if you're able to quantify the Chinese destocking and what drove that? You talked about end market being pretty decent demand. But I just wondered if you were to strip it as if we're looking at potentially slowing down in end market?

**Frans van Houten:** Let's say, the original assumption on consumer growth turned out to be a bit too optimistic and what we had underestimated is that the traditional seasonality in China is changing with all the marketing that online channels do. Let me explain that a bit. So these online channels have these special days for singles and for -- and other days and it basically shifts the traditional seasonality away from traditional Chinese New Year and so on. We had perhaps counted too much on the old seasonality when looking at supplying our online distributors. By the way, in the meantime, online is 60% of total PH business excluding Sleep & Respiratory Care. And so given the shift in seasonality in China, we saw a slower sell-in in Q2 and we expect, let's say, a higher seasonality now in the second half of the year through these online channels.

**David Adlington (JP Morgan):** Understood. And then maybe just a quick follow-up on air purification. Obviously, that was a bigger headwind in the first quarter, but I thought seasonally the second quarter was a lighter quarter. Maybe if you could just pull out the issues there?

**Abhijit Bhattacharya:** Yes, the impact was significantly lower. If I remember right, I think first quarter was 150 bps the second quarter was less than half of that. So -- but the impact was still there. And again, like we said, it's a small business. But especially with this inventory realignment there, I think that just added to it in the second quarter. But again, for the rest of the year, overall for the PH business in China, we see good growth coming in. And maybe David, also to further clarify. This kind realignment in online channels is not the first time that it happens, we've seen that happening in India before. These are quick corrections that are made because the online channel grows so rapidly and dramatically that you have to sometimes be very quick to adjust. It's not something that we see as a structural issue.

**Yi-Dan Wang (Deutsche Bank):** Two questions, one follow-up on the Personal Health business. If I were to look at the growth by region, it seems that there was quite a large weakness in developed markets, so Western Europe and North America, in the first quarter. And then in the second quarter, North America picked up, but Western Europe is still showing a low single-digit decline. So I mean, I don't expect those regions to be growing at low single digits relatively steadily. So could you comment on the dynamics there and what we should be expecting in those regions going forward? And then, secondly, on the D&T business, so the order intake was 9% for the group as a whole and double-digit for D&T. Can you give us the order intake for the different parts of the D&T? So DI, Ultrasound and also IGT. That will be great.

**Frans van Houten:** Okay, let me just start with the D&T question and Abhijit will answer the Personal Health question. Yes, so very pleased with the continued order strength in D&T thanks to a slate of strong innovations and solutions, coupled with health informatics. In DI, we continue to see a mid- to high single-digit order growth around 6%.; IGT, even low 20s; and Ultrasound, around 13%. So basically, the story continues. These products are very well received. And I daresay as we now look at more word-of-mouth marketing support from the adopters of these technologies, it will become a self-driven story. Maybe also interesting is that the MAT, the moving annual total, order growth for D&T stands now at 11%. So we are building up a nice order book. And then at the same time, we now also see the order growth for Connected Care & Health Informatics pickup, which is great. So also there, we expect perhaps finally a stronger momentum coming in the second half year. Abhijit?

**Abhijit Bhattacharya:** Yes. Also, on PH, so I think it's good to understand the dynamics because we have a large number of new product introductions in the second half. Therefore, we also hold back some of your advertising firepower to basically strengthen the launch of these products, which, by definition, means that you go a bit slow before your new products come into the market, which is why we said in the beginning of the year that we expected the second half to be stronger. We expect both NAM and Western Europe to be in positive territory in the second half so they will resume growth and that will contribute, let's say, to the overall PH business getting back to good growth in Q3 and Q4.

**Scott Bardo (Berenberg):** So first question, please, just relates to the Diagnosis & Treatment division. Obviously, seen some relatively nice growth in the first half met by order book. Given that your orders are largely longer cycle with your interventional imaging and MRI and those orders are still to be booked, I understand, I guess can you share some comments about the sustainability of these current high growth rates into the back half of the year? Is this sort of growth rate something that we should expect? Just following on, please, for this division. You announced during in the quarter the acquisition of EPD, which was a relatively reasonable consideration, I think, of about \$0.5 billion with contingency payments. So just wondered if you could share a little bit of thoughts actually as to how and when that business will start to contribute to revenues and profitability for the company.

**Frans van Houten:** Yes, hi, Scott. Yes, let me once again reiterate that the product portfolio of Diagnosis & Treatment was renewed to about 60% of the total portfolio. And even this first half, we introduced several new products such as, for example, the new MR systems that have 50% lower scanning time or shorter scanning time, which is a great productivity driver for hospitals. We expect the order growth to sustain. I pointed to the question of Yi-Dan already that the MAT order growth was 11% and we expect this momentum to continue. On your question of EPD, we will obviously invest in this business in order to get the products to the market. Currently, we already have the CE mark. We are anticipating the FDA mark also. Next year, it will already have positive revenue to Philips, but still an operating -- modest operating loss that will be absorbed within the D&T business. And then, let's say, towards 2021, we expect a positive profit contribution. And we, of course, throughout the period, expect a very high growth rate. We think that EPD has the opportunity to become the new standard of care for ablation or for electrophysiology, an area that really needs a strong

innovative disruption. The EPD technology does not only provide a much better navigation while doing the ablation procedure by having real-time visibility of the anatomy of the heart, but also the ability to validate whether the ablation was first-time right successful, which is very important because today often a patient that is ablated needs to come back 1 or 2 times to treat the spots that were ineffective. So we think that, overall, also for -- from the point of view of insurance companies that this will be a highly preferred standard of care, which, of course, needs to be proven in the next 2, 3 years. By then, it will be a very profitable franchise.

**Scott Bardo (Berenberg):** Just a quick clarification, I haven't seen any financial accounts from EPD. So could you just give us a rough indication of what revenue would be realistic to assume for next year? Is this sort of EUR 30 million, EUR 40 million or so? Or could it be higher? And lastly, can you just confirm that your transfer of production from Cleveland is still targeted for the second half of the year and that you still expect to resume shipments of the AEDs in North America in the back half?

**Frans van Houten:** Yes, well, on EPD, this is a very small company today, which then already gives you a view on the size of the revenue. It's a new innovation that is in start-up mode, so we expect a rapid growth but from a low base. Let's say the progression of the Diagnostic Imaging business is going well. We are progressing on Cleveland as per plan. We also expect then that the R&D activities will move to downtown Cleveland and the remaining facility will focus on customer service only. And all of this is expected to happen by the end of the year.

**Edward Ridley-Day (Redburn):** Firstly, on CT, given some nice detail in terms of your product growth there, can you give us a little bit of an idea about how much quicker than the market you feel you're now growing in CT? That'd be my first question.

**Frans van Houten:** Well, maybe you give us your second question while we look up that detail and then come back to you.

**Edward Ridley-Day (Redburn):** Great. And the other one would be on monitoring. Apart from 1 or 2 strong quarters last year, you've obviously got a great position in monitoring in the hospital, but you do appear to be growing slower than the overall market. So could you give us a bit more color about why that is and how you can turn that around? I mean, clearly, you've got -- I know you're agreement with Masimo, you have taken some initiatives. But what has been the sort of operational issue there? And how can you get back to a market, which is going to continue to grow very strongly?

**Frans van Houten:** On monitoring, we have seen a quite good order growth over the last 12 months. Orders tend to become bigger and lumpier and this relates to the fact that monitoring solutions become enterprise solutions, which also means that the CIO of the hospital is much more involved than in the past. I don't see any impediment to this business. It's -- we are market leader. We are outgrowing competition especially in the market segments where hospitals see the value of this AI-driven analytics and forecasting of what will happen to patients in markets where there is shortage of staff, which applies to North America, applies to Europe, increasingly to Asia. We -- the only market that is still quite price driven is China, but it is not affecting our business outlook at all. So overall, high confidence in the monitoring business. It's just that it's a bit lumpy and we will come back to nice growth rates there. CT, high single-digit growth in the quarter, which we believe is a lot faster than market growth. We are claiming -- clawing back market share. Of course, that was always the intent. By the way, the same message applies to all of Diagnostic Imaging where we believe we are significantly outgrowing competition. Of course, we did the comparison to the company that announced last Friday and we believe actually that our order growth is at least twice as high as theirs. So we are quite happy with our product and team performance, and I think our hospitals are recognizing that we are competitive.

And maybe I can also underline that we are proud of winning orders in Munich with the Munich City Hospital as well as in Cologne.

**Max Yates (Crédit Suisse):** My first question would just be around the D&T margin expansion. Could you talk a little bit about the sub-segments within that division and whether some 180 bps margin expansion, one of the sub-segments was the key driver or whether it was sort of fairly broad based across Image-Guided Therapy, Diagnostic Imaging and Ultrasound?

**Frans van Houten:** Yes. Max. I would say it's across all the 3 sub-segments more or less evenly.

**Max Yates (Crédit Suisse):** Okay, and just follow-up would be...

**Abhijit Bhattacharya:** Maybe the drivers are slightly different. So if you look at DI, right, we have a big productivity program, which is helping to drive it whereas in Ultrasound and in IGT, these are high-margin businesses which get tremendous operating leverage for this rapid growth. So DI is a combination of growth plus productivity. There is productivity in the others, but maybe a tad less and those are high-margin businesses, which are driving improvement in profitability through the operating leverage that we get. That gives you a little more color.

**Frans van Houten:** In any case, let me underline, Max, that we are keenly aware of the, let's say, the comparative difference in profitability versus our 2 main competitors, and let's say, D&T is also designed to expand profit faster than the average of Philips, all right, in order to get closer to closing that gap over the next years.

**Max Yates (Crédit Suisse):** Okay. Just the follow-up would be on Personal Health. So when you talked about the inventory rebalancing, are you sort of relatively confident that you haven't lost market share with the distributors and this is just the fact that they took on too much inventory? Or do you think there have been instances across the Chinese end market -- or the Chinese market where you may have lost some share? And I guess linked to that, have you adjusted your pricing at all to reflect any moves in the currency there that may have potentially impacted this?

**Frans van Houten:** No, widely across the portfolio, we are not -- we don't see shifts in market share. I mean, on an individual category, it can always fluctuate through the year depending on how, let's say, competitors come up with products. But we feel very confident about our brand strength in China and about our position with the online distribution. We think that all the plans are in place for a stronger second half year. And then on the question of currency, maybe, Abhijit, you would like to answer that?

**Abhijit Bhattacharya:** Yes. No, no, we have not made any particular price adjustments. A large part of our sales in China are also produced in China. We had actually taken quite some actions few quarters ago to renegotiate a lot of Chinese purchases, which we did in U.S. dollars, which caused a currency fluctuation to basically Chinese purchases in renminbi so that we match our end exposures to our sales. So I think all that is giving us the benefits now. So if you look at, let's say, the currency impact of some of the other competitors versus us, we are, I think, on the much better side.

**Max Yates (Crédit Suisse):** Okay. But maybe just sort of a one-word answer, just on Connected Care, you mentioned a lot -- you mentioned there were a couple of one-offs in the margin. Would you just be able to give us how much in basis points that impact of the margin in the quarter?

**Abhijit Bhattacharya:** It was actually very small in terms of amount, but it was actually a small really is last year and a small booking this year, so that affects roughly 60 basis points. So if you take that out, it would

have been -- so it's not in the millions. It's probably less than EUR 5 million, but it would have cost us 100 bps in CCHI without those.

**Daniel Wendorff (Commerzbank):** It's on the Diagnosis & Treatment division. Again, if I look at the order intake growth and the sales growth in the quarter, can you potentially dissect this into what is coming from market growth and what is coming from your new product introductions and what is maybe coming from better operational or even a better regional set up? That would be my first question. And the second question is also a follow-up on the margin development in the Diagnosis & Treatment division. Given that you expect order intake to stay in this region and the consequence on sales is the 180 basis point margin improvement year-on-year in the second quarter, also a good hint for what is going to happen in the second half?

**Frans van Houten:** Yes, Daniel. We estimate market growth to be in the low to mid-single digit and we are basically growing almost twice as fast as the market across the D&T segments. The -- I think earlier questions during this call with regards to margin development in D&T, I answered that D&T should, let's say, expand profitability faster than the other 2 segments given the plan to bring Diagnostic Imaging into double-digit profitability and to close the gap for Image-Guided Therapy towards the competitors. And of course, with strong order and revenue growth, we should also expect margin development to continue to be strong.

**Wim Gille (ABN AMRO):** I've got a question on the depreciation and amortization because that increased quite a bit and expected to go to consensus expectations and then, in particular, the depreciation and amortization in the other segment. So can you give me a bit of feeling where it is coming from and whether or not this is a sticky or a temporary item?

**Abhijit Bhattacharya:** Yes, Wim, this is Abhijit. It's a one-off. It's related to an acquisition made a long time ago where it was the Povos acquisition that we made. We have moved, let's say, all the platforms and the manufacturing, the product range now to Philips and there was, let's say, a certain residual capitalized goodwill, which we took off because we have now given that brand to somebody else in China and therefore we will get a brand license fee for that. But it's a one-off.

**Wim Gille (ABN AMRO):** All right. And then my follow-up would be on IFRS 16. You indicated in the appendix that you expect the impact on the debt or you are still working out kind of what the impact of IFRS 16 is going to be. But you do give a feeling about the increase on that debt to be about EUR 745 million undiscounted. Could you also give us a bit of feeling where you expect the EBITA to end up roughly speaking?

**Abhijit Bhattacharya:** Yes, we are still working on that. So we will come back to you in the coming quarters on that, Wim, because there are quite a few moving parts and we need to get, let's say, a good idea on that, work it with the auditors before we give something externally.

**Ian Douglas-Pennant (UBS):** It seems like from looking at your competitor's numbers and yours that the imaging market has accelerated in the last year or so but I've never heard a convincing explanation as to why that's the case. Do you have one?

**Frans van Houten:** Yes, I would agree with you that it has accelerated somewhat because both in Europe and the United States, 2, 3 years ago, we were looking at low single-digit in relation to, I think, Daniel's question, I said we have been outgrowing the market by almost a factor 2. Then given our growth that would imply that the imaging market would be growing at the higher end of the guidance, the market expectation of low to mid-single digit. So let's assume then that the imaging market currently is growing around 4% or so, that indeed would be an acceleration over where the market was 2, 3 years ago. I daresay there are 2 potential explanations. One is that the installed base is really old and therefore needs to be replaced. And we have also ourselves active installed base upgrade programs, I can only imagine that our competitors do the same.

Secondly, many of the hospitals in North America have been so busy with consolidation and some of their CapEx was going to IT systems. I think we are seeing that the, let's say, the EHR market is slowing a bit, all right? I mean, the electronic health record market is slowing a bit and there is more capital available now for imaging. Moreover, then, finally, that explains why we are growing faster than the competition, that our innovations are in hot demand across the 3 sub-segments in D&T and that explains why we are growing faster than competition.

**Yi-Dan Wang (Deutsche Bank):** Somewhat surprised that you commented CT was growing at high single digit given that Diagnostic Imaging I think you reported around mid-single digit. So could you also give us the growth rate for MR and digital x-ray and provide some color on the reason for the numbers there? And then, secondly, for Ultrasound, I think Point-of-Care, you're mentioning again as a highlight versus gynecology, which we've known to be a driver for it, so in terms of Ultrasound can you also give us some sense of how the existing business is doing versus Point-of-Care and gynecology and relative contributions of those businesses to Ultrasound would also be helpful into -- for putting those comments into context.

**Frans van Houten:** Shall we send you a whole Excel table, Yi?

**Yi-Dan Wang (Deutsche Bank):** That would be perfect. That would be perfect, but some nice comments will be helpful.

**Frans van Houten:** All right, all right. Let me give it a try. First of all, on Ultrasound, please realize that our cardiac ultrasound is a very big market and our position in General Imaging Point-of-Care, OB/GYN is a much smaller business, all right. Therefore, even with very nice high growth in OB/GYN and Point-of-care, we would never hit the overall growth numbers in Ultrasound if cardiac imaging would not be very successful. So let me assure you that cardiac imaging is also good growth and then the icing on the cake is the very high growth in OB/GYN and GI. I looked now at my colleagues to what extent we have appetite to (inaudible)

**Abhijit Bhattacharya:** Yes, I mean, we give far more than a lot of other -- I think when we said CT sales were at the high single digit and overall is at mid-single digit, the gap is a couple of percent. So 7%, 8%, 9% is high single digit, that's where you see CT at around 7% and the others are a tad lower. So overall, it's still a good mid-single -- the higher end of the mid-single digit, but with CT being a little bit higher than the rest.

**Frans van Houten:** Also there, I think it's helpful to know that our MR business is far larger than the CT business and that, of course, in a weighted average, even if CT is a lot higher, then MR is still growing. Otherwise, we don't get to that number.

**Abhijit Bhattacharya:** Exactly. And the innovations that Frans spoke about in the new launches in MR, that gives us a position where we have an almost complete new range in MR now. And with this kind of 50% faster scanning than the older range, we expect there to get really good momentum going forward in the coming quarters as well.

**Julien Dormois (Exane BNP Paribas):** Just a housekeeping one. Can you just remind us how much of your Personal Health sales are made in China, just to assess the sensitivity of the rebound in H2.

**Frans van Houten:** Something that we need to look up.

**Abhijit Bhattacharya:** Yes, we probably -- I'll ask Pim to give you a call, Julien, and give you that information, take it off-line. But the rebound of the second half is less to do with where production is. It's more to do fundamentally with the new product launches and the momentum we expect from that.

**Frans van Houten:** Okay. Well, I appreciate everybody dialing in. Let me reiterate once again: solid quarter, still some work to do, high order growth. This is very encouraging. We maintain our expectations for a stronger second half year. And overall, we are absolutely confident about our ability to deliver that. Thank you.