

**PHILIPS**

**Second Quarter and  
Semi-Annual Results  
2020**

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Leandro Mazzone

*Head of Investor Relations, Koninklijke Philips N.V.*

Good morning ladies and gentlemen, welcome to Philips Second Quarter 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. Abhijit will then provide more detail on the financial performance. After that, we'll take your questions. Our press release and the related information slide deck were published at 07.00AM CEST this morning; both documents are available on our investor relations website. A full transcript of this conference call will be made available by the end of today on our website. As mentioned in the press release, adjusted EBITA is defined as income from operations, excluding amortisation of acquired intangible assets, impairment of goodwill and other intangible assets, restructuring charges, acquisition-related costs and other significant items. The impact of COVID-19 on our results is not treated as an adjusting item. Finally, comparable growth for sales and orders are adjusted for currency and portfolio changes.

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

Frans van Houten

*Chief Executive Officer, Koninklijke Philips N.V.*

Thanks Leandro. Good morning to all of you on the call and the webcast. I hope that you and your families are keeping safe and well.

The second quarter was marked by the continuing social economic impact of the COVID-19 outbreak across the world. On the circumstances, I'm pleased with how we have performed as our teams were very focused on delivering against what we refer to as our 'triple duty of care': meeting critical customer needs; safeguarding the health and safety of our employees; and ensuring business continuity. The work that we are doing to support healthcare providers, medical staff and critically ill patients is a top priority for all of us at Philips.

Our operations remained fully-functional in the course of the quarter. Our salesforce is getting used to new ways of working and our field service engineers continue to deliver and install critical equipment and provide maintenance services, both physically and remotely. In close collaboration with our suppliers and partners we are making the necessary investments and we have steeply ramped up the production volumes of products and solutions to help diagnose, treat, and monitor and manage COVID-19 patients. We successfully tripled our ventilator production during the quarter, supporting the treatment of patients in the most affected regions of the world and we are on track to achieve the planned fourfold increase to 4,000 units per week in July. We've also significantly increased the production of patient monitors and created COVID-19-oriented propositions to rapidly respond to customer needs.

Moving on to the second quarter financial highlights. As expected, COVID-19 caused a steep decrease in consumer demand and postponement of installations and elective procedures in hospitals, resulting in an overall comparable sales decrease of 6% in the quarter. Our Personal Health businesses declined 19% and sales for our Diagnosis & Treatment businesses declined 9% in Q2. This was partly offset by a strong 14% comparable sales growth in the Connected Care businesses in the period. Comparable equipment order intake grew a robust 27%, driven by the strong demand for our patient monitors, hospital ventilators, computed tomography and portable ultrasound systems across the world, and further building on the growth seen in the first quarter. Customer response to our innovative products and solutions remains very positive and we expect to have continued increasing market share in the professional healthcare market. Moreover, we see increased interest in telehealth solutions like tele-ICU, tele-radiology, tele-pathology, which can help virtual working and collaboration of care professionals, as well as move care into the community to relieve the tremendous pressure on the physical constraints of the hospitals.

Adjusted EBITA margin was 9.5% in the second quarter, compared to 11.8% in Q2 2019. Free cash flow, free cash increased to an inflow of €311 million in the quarter, compared to €174 million in the second quarter of last year.

I would like to provide some colour on initiatives to respond to customer needs and support healthcare professionals. We have launched several new monitoring solutions for the intensive care unit, the general ward and the home that feature virtual monitoring capabilities. These include our Biosensor BX100 for early patient deterioration detection in the general ward and, in collaboration with BioIntelliSense, the BioSticker medical device to help monitor at-risk patients from the hospital into the home. The Philips Biosensor BX100 is designed to address a new approach to vital signs measurements, supporting surveillance of higher acuity patients moving from intensive care into the general care areas of the hospital. The lightweight, disposable biosensor is a five-day, single-use wearable patch which can be integrated with a scalable hub to monitor multiple patients across rooms. The solution has received FDA 510(k) and CE mark and is currently in use at the OLVG, a top clinical referral and training hospital in the Netherlands, to help manage the triage and surveillance of, among others, COVID-19 patients.

In the quarter, we introduced our IntelliVue patient monitors, MX750 and MX850, and IntelliVue Active Displays AD75 and AD85 in the United States. These new, acute care patient monitoring solutions offer advanced cybersecurity, functionality and clinical decision support capabilities, such as an expanded real-time view of vital signs to contextualise a patient's condition. Supporting the increased demand for flexible care capacity, we introduced a modular diagnostic imaging cabin in the Philippines, which can be rapidly deployed with a computed tomography or a diagnostic X-ray system. We also introduced a mobile intensive care unit solution in India. Each prefabricated ICU will be locally manufactured and capable of being deployed in one day. The self-sufficient units only require onsite electricity and a water connection to become operational, and come pre-equipped with critical care infrastructure. They can be furnished with a range of medical equipment, including ventilators, defibrillators, a central monitoring station and CPAP machines.

We continue to drive market share in our core businesses through deeper, more comprehensive customer partnerships to enhance patient care and improve care-provider productivity. During the second quarter we signed 14 new large-scale strategic partnerships. For example, we entered a 10-year agreement with the US Department of Veterans' Affairs, the VA, to expand a tele-critical care programme. With the VA managing 1,800 ICU beds nationwide, this will create the world's largest system to provide virtual access to intensive care expertise. Our tele-ICU programme, which combines AV technology, predictive analytics, data visualisation and advanced reporting capabilities, enables a co-located team of specially trained critical care physicians and nurses to virtually monitor patients in the ICU.

In Personal Health, while driving reduction of discretionary cost and managing manufacturing capacity we are safeguarding innovation and keeping new product introductions on track to be prepared to capitalise on recovery opportunities. We have a strong new product introduction roadmap, including products to further broaden our leading portfolio of power toothbrushes, with more entry-level propositions to attract a wider consumer population. Moreover, complementing Sonicare's existing teledentistry services for patients. In the second quarter, we announced a new teledentistry platform for dental professionals, together with dental technology company Toothpick. The multi-services platform provides a tool to build direct patient engagement, acquisition and retention, while improving office efficiency, in-chair time and virtual care.

Let me now also give you an update on the current status on the divestment of the Domestic Appliances business. Separation process is on track and expected to be completed in the third quarter of 2021. We will provide more information about upcoming milestones over the next quarters and currently estimate total separation cost to be in the range of €120 to €140 million, of which €50 to €60 million will be incurred in 2020. As mentioned before, this is fundamentally a solid business with market-leading positions and we expect to engage with interested parties after the summer. Effective August 1, Henk de Jong, current Chief of International Markets, has been designated as the CEO of the Domestic Appliances business. Henk held various business roles in floor care, coffee and kitchen appliances in the past, and also led our former Consumer Lifestyle sector in Europe and Asia. He has also successfully led Philips' Latin America business market for five years before becoming Chief of International Markets in 2017. With a strong combination of deep consumer knowledge, as well as a passion for bringing out the best in his team, I'm convinced that Henk is the right leader for Domestic Appliances as the business embarks on a new chapter in its journey to thrive and grow independently of Philips.

In view of Henk's new role, I'm pleased to announce that Edwin Paalvast will join us Chief of International Markets, effective August 1. Edwin comes from Cisco Systems, where he was Senior Vice President Global Specialists, leading a global salesforce in specialist areas, including the Internet of things, networking, data centre, cloud collaboration, cybersecurity and other services. He possess a strong informatics and solutions expertise. I'm also pleased

to announce the appointment of Deeptha Khanna as the Chief Business Leader of the Personal Health businesses, effective July 20. Deeptha brings rich consumer health and digital experience and joins us from Johnson & Johnson, where she held leadership positions in Asia and globally. Prior to this, Deeptha spent 17 years at Procter & Gamble. Both Edwin and Deeptha will become members of the Philips Executive Committee.

A progress update on regulatory matters. Our Emergency Care and Resuscitation business resumed manufacturing and shipping of external defibrillators for the United States market following the notification from the FDA that the injunction prohibiting those activities was lifted. We continue to comply with the terms of the consent decree, which remains in effect, and includes ongoing regulatory compliance monitoring and facility inspections by the FDA. In connection with the Emergency Care and Resuscitation portfolio, we received FDA pre-market approval, PMA, for the HeartStart FR3 and the HeartStart FRx automated external defibrillators and their supporting accessories. We also received an industry first 510(k) clearance from the FDA to market a wide range of ultrasound solutions, including the CX50 and the Lumify, for the management of COVID-19-related lung and cardiac complications. Portable ultrasound solutions, in particular, have become valuable tools for clinicians treated COVID-19 due to their imaging capabilities, portability, but also the ease of disinfection.

Let me conclude. As anticipated, the second quarter has seen the largest adverse impact on revenue and margins from the effects of the COVID-19 pandemic. At the same time, our teams have been working very hard to ramp up production to meet increased demand for COVID-19-related modalities. As a result, we expect to return to growth and improve profitability for the Group in the second half of the year, assuming that we can convert our existing order book for the Diagnosis & Treatment and Connected Care businesses, elective procedures normalise, and consumer demand gradually improves. Consequently, for the full year 2020 we continue to aim for a modest comparable sales growth and adjusted EBITA margin improvement.

Looking ahead, we'll remain focused on innovating with purpose, improving operational excellence and delivering on our transformation. Our mission is more relevant than ever and our strategy to transform care along the health continuum, leveraging informatics and remote care capabilities, next to our innovative systems and services, has been validated during this crisis. I'm convinced that Philips is well-positioned to serve the current and future needs of hospitals and health systems, and the growth profile of our portfolio should be very well supported post-pandemic.

And with that, I'd like to turn the call to Abhijit.

**Abhijit Bhattacharya***Chief Financial Officer, Koninklijke Philips N.V.*

Thank you Frans and thank you all for joining us today, I hope you are staying safe and well. Let me provide some colour on the second-quarter comparable sales for the Group. Our Diagnosis and Treatment businesses comparable sales declined 8.5% in the quarter. Diagnostic Imaging sales was in line with last year with strong in Computer Tomography. Ultrasound sales declined mid-single digit as strong demand for point-of-sale devices was offset by pushed out installations of cardiac systems from the second quarter. Image Guided Therapy sales double-digit as hospitals postponed elective procedures as well as pushed out installations. The volume of elective procedures rebounded to around 10% below pre-COVID-19 levels in recent weeks compared to a more than 50% decline at the start of the quarter. We continue to expect a gradual normalisation of demand for Image Guidance Therapy devices and system installations in the second half of the year.

Services sales for our Diagnosis and Treatment businesses held up well in the quarter and declined only 1% compared to the same period of 2019. Let me remind you that recurring revenue stream from services represent around 35% of total sales of our Diagnosis and Treatment businesses. The sales of the Connected Care business grew a robust 14% in the second quarter. Sleep and Respiratory Care sales grew double-digit due to strong shipments of respiratory devices. Monitoring and Analytics comparable sales grew mid-single-digit in Q2 driven by double-digit growth in Patient Monitoring.

As mentioned by Frans, we have steeply ramped up production of respiratory devices and significantly increased the production of patient monitors in the second quarter. Taking our full COVID-19 portfolio into account, we are investing more than €100 million to meet urgent demand from our customer this year, and we anticipate a high volume of shipments in the second half of the year to fulfil the orders we have on hand for these products.

As anticipated, the lockdown and social distancing measures did impact demand for our consumer products portfolio in the second quarter resulting in a comparable sales decline of 19% in Personal Health with all businesses declining double-digit. Consumer sales through digital channels grew mid-single-digit in the quarter, and represented around 46% of total sales for the Personal Health businesses. This compares to around 33% of total sales in the first quarter.

In-store sales declined strong double-digit in the period.

We have witnessed gradual improvement of consumer demand in the course of the second quarter with a comparable sales decline of 11% for the Personal Health businesses in the month of June. We currently expect consumer demand to sequentially improve in Q3, and Personal Health comparable sales to be back to modest growth in the fourth quarter of this year.

To round off on sales, we estimate the overall negative impact of COVID-19 on Group comparable sales growth was around 10% in the second quarter.

Moving on to orders, comparable order intake in Connected Care grew by 167% with very strong growth seen across the world. The demand for hospital ventilators increased multifold while orders for the Monitoring and Analytics business grew close to 50% in the quarter. Diagnosis and Treatment comparable order intake declined just below 20% in Q2 as strong growth in Computer Tomography and mobile X-ray was more than offset by a steep decline in other parts of the portfolio as hospitals prioritised emergency care.

The order intake growth in China was in line with Q2 of 2019, while North America and Western Europe declined double-digit for Diagnosis and Treatment. It is important to note that we have not seen significant cancellation of orders due to the COVID-19 outbreak. We expect that some areas of the Diagnosis and Treatment businesses will experience a slow recovery in demand through the remainder of 2020, but continue to expect – experience positive competitive momentum for our portfolio and are confident to be able to capitalise on recovery opportunity in these businesses.

Let me now turn to the profitability development in the second quarter. Adjusted EBITA for the Group was €418 million or 9.5% of sales compared to 11.8% in the second quarter of 2019. We estimate that the overall negative impact of the COVID-19 outbreak on our profit was around three percentage points. This was primarily due to incremental direct cost, lost gross margin on lower sales and lower factory coverage partly offset by cost mitigation efforts.

Looking at the business segments, Connected Care delivered an adjusted EBITA margin of 17.8% of sales, a 570 basis points increase compared to the second quarter of 2019, as additional investments to ramp up production were more than offset with operating leverage and productivity measures initiated from last year.

In Diagnosis and Treatment the adjusted EBITA decreased to 8.6% of sales. This was a result of the decline in sales and unfavourable product mix driven by lower growth of Image Guidance Therapy and cardiac ultrasound portfolios only partly offset by the positive impact from productivity measures.

In Personal Health adjusted EBITA decreased to 5.6% of sales due to the decline in sales partly offset by cost savings. As mentioned by Frans, we actively managed manufacturing capacity and drove reduction of all discretionary spending to partly offset margin headwinds from lower sales in the segment in this period. This resulted in an improvement of the drop through rate compared to the first quarter of the year. Adjusted EBITA for the Group was also impacted by a decrease of license income in the segment Other, in line with our prior guidance, and by adverse currency impact of about 50 basis points in the second quarter primarily due to the depreciation of the Brazilian real, the Russian ruble, the Mexican pesos, and the Turkish lira.

We remain on track to deliver over €400 million productivity savings this year, and the €1.8 billion productivity savings target for the overall 2017-20 period. In the second quarter our

productivity programme delivered €108 million net savings. More specifically, procurement savings delivered €57 million of bill-of-material savings, net non-manufacturing cost reduction amounted to €21 million, and the manufacturing productivity programme contributed €30 million.

Restructuring, acquisition-related and other charges include a €101 million gain due to the release of a contingent consideration liability related to EPD. Revisions to the financial forecast due to the maturity of the technology resulted in a decrease of the fair value of the respective contingent consideration liability. At the same time, we recognised an impairment loss of €92 million in the amortisation of acquired intangibles.

Restructuring and acquisition-related and other charges also include a non-recurring inventory valuation charge of €26 million resulting from a change in methodology enabled by the implementation of the new integrated IT landscape and a separation cost of €9 million related to the Domestic Appliances business.

Income tax expense decreased by €38 million in Q2, mainly due to the higher – lower income and higher non-taxable results from participations. Net income amounted to €210 million in the quarter and included a gain of €70 million related to a value adjustment of one of our minority participations following the public initial offering of an underlying investment. The adjusted diluted EPS from continuing operations was €0.35 in the second quarter compared to €0.42 in Q2 2019.

Net cash flow from operating activities increased by €168 million compared to the second quarter of 2019, mainly due to strong working capital management.

Free cash flow. Free cash was an inflow of €311 million compared to €174 million in Q2 2019. Therefore in the first half 2020, we had a solid free cash flow generation of €254 million compared to an outflow of €32 million in the same period last year. We continue to expect our customers to face cash pressures due to the impact of COVID-19, but this is not expected to impact the total free cash flow generation over a 12-18 month time horizon. Importantly, our balance sheet and liquidity positions remain strong.

At the end of the first quarter, we had 50.3% of our €1.5 billion share buyback programme for capital reduction purposes that was announced in January 2019. In line with our announcement in March, in the course of the second quarter, we executed the remainder of the programme through forward contracts with settlement dates extending into the second half of 2021. By using forward transactions, we were able to significantly optimise pricing compared to gradual open market repurchases while preserving our near-term liquidity position.

In the second quarter, we also completed the cancellation of 3.8 million shares that were acquired as part of the share buyback programme I just mentioned. In July, we issued a total number of approximately 18 million new common shares for settlement of the 2019 dividend adopted during the Extraordinary General Meeting of Shareholders in June. After deduction of treasury shares the total number of outstanding shares is around 909 million, broadly in line with the number of shares following the payment of the 2018 dividend.

Let me provide some guidance for certain areas of our business.



Based on the announcements made, so far, we continue to expect the full-year gross impact of tariffs to be around €70 million. Including mitigating actions, we expect the net tariff impact to be around €40 million in 2020. This is €30 million lower than the net impact seen in 2019.

In the segment Other, we expect an adjusted EBITA loss of around €135 million in 2020, which is a decline of €20 million versus our previous guidance mainly due to the lower license income. At EBITA level, we expect a net cost of around €260 million for the full-year 2020. This includes €50-60 million of cost related to the separation of Domestic Appliances that Frans referred to earlier in the call. For Q3, we expect a net cost of around €65 million at the adjusted EBITA level, and around €110 million at the EBITA level for this segment.

Financial income and expenses are expected to be a net cost of around €150 million in 2020. This is lower than our prior guidance largely due to the value adjustment of financial assets I just mentioned in the second quarter, and assumes no one-off gains or losses in the second half of the year. Our mid-term guidance of 24-26% effective tax rates, excluding incidental, remains valid. While for the full-year 2020, we currently expect to be in the range of 22-24% due to the one-off effects seen in the first half of the year. In line with our previous guidance, restructuring charges are expected to be around 90-100 basis points. Acquisition-related costs are expected to be around 40 basis points in 2020, excluding the one-off positive impact from the release of contingent consideration liability in Q2 that I explained earlier.

We expect one-time EU-MDR investments of around €50 million in the year and secondary-related cost to be around €10 million a quarter.

To conclude, we continue to expect to return to growth and improved profitability for the Group in the second half of the year starting with the third quarter and further improving in Q4, assuming we can convert our existing order book for Diagnosis and Treatment and Connected Care businesses, Elective Procedures, and consumer demand gradually improves.

Consequently, we maintain our earlier expectation of a modest comparable sales growth and an adjusted EBITA margin improvement for the full year of 2020. Given the current uncertainty and volatility, we will not provide more specific guidance for 2020 at this time. I also want to thank our employees for how they have stepped up to keep the company fully functioning and deliver against our triple duty of care.

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

## Q&A

**Michael Jungling (Morgan Stanley):** Great. Thank you and good morning all, and I really have one question but a couple of parts to it, and it's all around the fiscal year 2020 guidance. The first question is the composition of the organic sales growth performance in the second quarter different to your expectations in the previous quarter? Secondly, for your fiscal year 2020 guidance could you provide a little bit more colour on the organic sales growth performance by division – not only a specific number but directionally which ones you think will do better and worse? And finally, am I correct to assume listening to your guidance

statement of what you require in terms of recovery elective procedures, delivery of order books that it's becoming, or it's become a little bit harder, to deliver your fiscal year 2020 organic sales growth guidance? Is that a fair comment? Thank you.

**Frans van Houten:** Hi Michael, this is Frans, thanks for your questions. Composition, Q2, I think it was more or less in line with what we said in April, with perhaps the consumer side a tad stronger than originally anticipated. But, otherwise, I think the quarter unfolded more or less as we had planned for. That doesn't mean to say that it was not a turmoil itself of course.

In the third quarter, we will see a strong contribution from Connected Care. We have a big order book of monitors and ventilators that we will continue to deliver. We have mentioned that we have been successful in ramping our production to approximately fourfold by July, now, currently. And it will take us many months to deliver that order book. So strong positive growth on Connected Care.

Now, Diagnosis and Treatment will shift from a decline into kind of a flattish territory. And Personal Health will make an incremental step from the minus 19, let's say, closer to neutrality – maybe not entirely there yet. And we expect that momentum to further improve in Q4. Now, adding that up means in Q3 that we can be back into growth territory, with a strong expected Q4, then the totality of the year will show a modest growth.

That brings me to your third question – you know, is it now harder than in April? No. We maintain our guidance. We feel that the prediction is strongly underpinned by the order book and by the improvement of momentum. The caveat that we put in the guidance is very much externally-related and not so much our own execution ability because we feel strong in our own execution ability. But we are dependent on hospitals allowing us to do the installations. The elective procedures have a direct correlation with our IGT device volume. And, obviously, consumer demand can be influenced if the pandemic resurges. But, you know, it's the same caveat that we put up in April. And in the meantime, I think we have a lot of experience in how to navigate the crisis.

So it's not become harder. If anything, Q2 should give you guys confidence that we are on the right path on that guidance.

**Veronika Dubajova (Goldman Sachs):** Good morning, Frans, Abhijit, thank you for taking my questions – please, I have two. My first one is just I'd love to get a little bit of insight on how you characterise the order momentum you're seeing in the D&T business. In particular, as you progressed through the quarter were there any big differences in terms of the hospitals desire to spend CAPEX? And would just love to hear from you how you're thinking about the second half of the year when it comes to orders more from, not from a competitive perspective, but really from the end market perspective. And then I'll ask a follow-up after that if that's alright. Thank you.

**Frans van Houten:** Hi Veronika. Well, we know from the funnel of opportunities that we track that there is a lot of demand. That has to do with, you know, ageing install base. It has to do with the desire to build out ambulatory care centres, OBLs, the rise in interventional procedures as opposed to surgical procedures. So the trend lines are still in place.

I think the question mark is on the C-suite approving those CAPEX requests. So I'm not talking about order book conversion, I think we talked about that on Michael's questions, so this is very much on future order intake growth. Hospitals are currently assessing what to and where to spend their CAPEX. We do expect a shift at this time, probably a modest shift, in favour of telehealth and virtualisation of care. That is not only related to the Connected Care segment. We also provide telehealth solutions within our Diagnosis and Treatment business – think about teleradiology, telepathology, the use of our PACs solution, so all of that hangs together. We expect to get back into a positive order growth territory in the second half-year. And at this time that's all I can tell you.

**Veronika Dubajova:** And your degree of – in terms of confidence in getting to that positive order growth territory, I guess, when we look at some of the comments that hospitals have made, they are talking about some pretty substantial reductions to their CAPEX budgets for this year in particular, so I'm just curious where that's coming from. Is it the activity that you saw as you moved from April, May to June? Is this based on some of the conversions what you see in the funnel? Just if you can give us some colour to that.

And if I can quickly follow-up related to that, Abhijit, I know it's really early to be asking about 2021, but I guess you have some delays in installations this year that spillover into next year, and then potentially some softer order momentum for a couple of quarters. How do you think the two will interplay in terms of magnitude as we think about 2021 for D&T?

**Frans van Houten:** Well, on your first question, the degree of confidence, I think it would be fair that we need to have some caution, right. We see the funnel, we see the interest, we know the – I mentioned to the areas of – the build outs can happen – ambulatory care centres, OBLs, interventional diagnostic centres away from the hospital as such. Whether all of that will materialise, we'll have to wait and see. At this time, we think it will happen to get back to modest positive territory.

Abhijit.

**Abhijit Bhattacharya:** Yeah. And I think Frans also, one thing to understand, one-third of the business is also services, right. So that is in this second quarter I think we declined only 1% there, so that gives a certain amount of underlying stability.

If I could, 2021, Veronika, I would have been in a different profession. But let's say if you look at our order book today, right, it's actually the strongest it has ever been. And it has even grown in Q2, because we have not been able to install, orders have still come in. So if we have another couple of slower quarters, we still will have momentum into the next year. But after that, depending of course on how slow it is, it could start having an impact on growth for next year. But, right now, at the end of Q2 our order book has, in fact, gone higher than it was at the end of the quarter than it was at the start of the quarter. Does that answer your question, Veronika?

**Veronika Dubajova:** Yeah, that's really helpful. Thank you both very much. I'll jump back into the queue.

**Patrick Wood (Bank of America):** Perfect. Thank you very much, I have two as well please. The first would be, on the Monitoring side, I was actually surprised that the Monitoring growth wasn't a little bit higher given, you know, the ICU demand that's out there.

Was that more a function of you guys stepping up capacity within ventilators first and then monitors come later? I'm just curious about the dynamic there. So that's the first one.

And then on the second one, you guys obviously get a lot of data from scans in general, and can see a lot of data in real time. I'm just curious what are you interpreting from the scan data that you guys see in general in terms of activity within hospitals and facilities about the recovery of that surgical curve? Thanks.

**Frans van Houten:** Hi, Patrick. The monitoring installations following the ramp up of production take a bit longer than delivering a ventilator and getting it to revenue recognition, right. And so the positive waves that comes from the orders in monitoring is still largely to come there. And also the production ramp up in ventilators went a bit faster than the production ramp up in monitoring, right. But the order book for monitoring is high and we should see a very nice contribution in the third quarter onwards.

Yeah, the data we see from procedures are recovering very nicely – depends a bit on the territory. And it correlates, of course, with where the hotspots are, right. So – but 80-90-95%, there about, is where we see versus 2019 levels we see where we are. We can also measure MRI scans and other modalities in imaging. And there also we see that, let's say, normal hospital traffic is coming back. And that I think is great news.

Now, hospitals, and also related to Veronika's question, they need it very much because their P&L is very much related to the normal traffic of patients.

So it all points in the same direction of resuming, let's say, rebuilding the growth momentum in the second half of the year.

**Patrick Wood:** Super. And if I could just squeeze in a very quick extra one, are you guys signing or seeing more sort of risk-sharing agreements on the Diagnostic Imaging side with groups like Advanced Medical where maybe they get a rebate or not depending on patient volume through the clinic, and more of the, sort of, not JV exactly, but risk-sharing agreement on imaging. Is that a new model that's emerging at the moment?

**Frans van Houten:** Yeah, we talked about new business models previously. In Philips, we think that the whole market will trend more towards value-based care and embracing the quadruple aim and health outcomes – productivity, patients, time, experience. The hundreds of large-scale long-term strategic partnerships with customers all have elements of performance already. Most of the performance elements relate to operational improvement, i.e. productivity gains for hospitals. Not so much yet the clinical outcomes. Besides that kind of let's say risk sharing in the business model, you will also see more plain vanilla financial engineering through Philips Capital where instead of delivering a product under CapEx rules we turn it into an OpEx deal. That doesn't necessarily mean for Philips that revenue recognition is not there because if we can externalise that through an external party, then it's not on our balance sheet.

But yes, in short, I do expect hospitals to have a greater interest in alternative models, whether it's just financial – financing models or really operational PaaS and SaaS models.

**Patrick Wood (Bank of America):** Super. Thank you for taking my questions.

**Hassan Al-Wakeel (Barclays):** Thank you for taking my questions. I have a couple. Firstly, could you talk about your expectations for hospital CapEx both in the short and medium-term? Do you expect private hospitals to reign in CapEx over the short-term?

And secondly, connected here, top line growth overall was a little shy of expectations, and I wonder if this is due to phasing. Do you expect a meaningful acceleration in Q3 on the top line as the US contract ramps? And you've talked about the high end of the prior guidance range as a reasonable assumption for the margin. I wonder if 20% growth is also reasonable for the top line based on what you see today?

**Abhijit Bhattacharya:** Yes, shall I take the second one first?

**Frans Van Houten:** Yes, well I can – on the hospital CapEx, I think we had an earlier question already so I don't know how much more I can say about it. It depends on the geography, right? In Asia, Europe, hospitals are more easily backed up by governments, and therefore the financial challenges can be overcome. Whereas, in the US, some hospitals are really weakened by the COVID crisis without an immediate backstop from insurers or government, so there is uncertainty in the US market when it comes to CapEx.

We spoke on Veronica's question around the funnel and the opportunities that we see. So the opportunities are all there, a strong and healthy funnel. How fast it can materialise depends a bit around that uncertainty and also us adopting other business models; more OpEx-oriented business models can help overcome a CapEx constraint. So I think there are ways beyond it and out of it. It's for now too early to say where 2021 will land. For 2020 we feel very secure in our ability to perform.

On Connected Care, yes, the orders are all there. The order book is there. It took some time to ramp-up production. We spoke about that already on the monitoring side, you know, where Patrick was also alluding to that. So we expect a strong contribution in the third quarter. I don't think we guide specifically on Connected Care, unless Abhijit, you want to say more about it?

**Abhijit Bhattacharya:** No, but I think it's important because I hear now the second question on, you know, below expectation. I think as Frans mentioned earlier, we performed to what we were expecting in Connected Care, so for us, it's not a below-par performance in Q2, and you know, for monitoring – for ventilation you know, you ship boxes and you unpack them so therefore they're ready for first-patient-uses much quicker, and the revenue recognition is much quicker. In monitoring you need to ship the systems, you need to set them within the hospital networks, hand them over, so that takes a bit longer and therefore you will see that bump up in Q3.

Like we said, more specific guidance now between Q3 and Q4 is probably not appropriate but we will have good sales in Connected Care in Q3; very strong double-digit sales in Q3 and Q4. I think that's it really.

**Frans Van Houten:** Yes and monitor and ventilators are both high-margin – gross margin businesses. Of course, it greatly contributes to operational leverage.

**Abhijit Bhattacharya:** I think maybe one more point good to remind everybody is keep an eye on the government stimulus because there are a lot of questions on hospital CapEx in the mid-term. I think both in Europe and the US there are quite some stimulus packages which

would – which are being announced which will take some time before the money flows in but in the medium-term that gives us also some confidence that there will be enough and more demand going forward.

**Hassan Al-Wakeel:** And if I can just squeeze in a follow-up. So, that's very clear on the top line. I wonder if you're seeing any deceleration in orders I guess towards the end of the quarter and maybe into July on the ventilator side?

**Abhijit Bhattacharya:** No, not really. I mean, look, we booked the big US orders in April, so if you take that out, I think the order intake growth is still pretty solid both in monitoring and in ventilators. So no big decline through the quarter.

**Frans Van Houten:** Well, and looking ahead, emerging markets are grappling with the lack of infrastructure. WHO and other large schemes have not really come into play yet. They're – it's much slower, and Abhijit talked around government orders, and government infrastructure plays. I think that's all still to come. The realisation that COVID is going to be with us for at least two years, and that more capacity needs to be built – that realisation I think is top of mind of healthcare ministers. And so after the initial wave of kind of crisis demand, I think we will see an ongoing demand to build stockpiles, to build more capacity and have you know, a higher ICU bed availability, just to be safe.

**Ed Ridley-Day (Redburn):** Good morning. Thank you. First of all, on elective surgery, thank you for the guidance you have given Abhijit. In terms of geographies, are there any markets particularly in Europe where you have already seen a return to growth year-on-year in interventional cardiovascular procedures? Or indeed, close to growth. If you could give any colour on the Asian markets as well, that would be helpful. That's my first question.

And then on the Personal Health side, which we haven't discussed as much today, but can you give us additional colour on where we're relatively – which areas are relatively strong and weak? That would be helpful. Thank you.

**Frans Van Houten:** Okay, I think we are going to look up the IGT question with some geographical colour. On Personal Health, we have seen China come back relatively quickly after the first quarter, and then it started to flatten off a bit, and we are still a tad lower than last year in China. We relate that to a few factors like 6-18 shifted. We see the retail stores still not being frequented very much.

Then in Europe late in the second quarter, we saw a strong recovery and even if you take a market like Germany – was surprisingly strong domestic appliances – and that's of course also good in the light of the process that we are planning, also a strong recovery towards the end of the second quarter which bodes well.

The United States – actually consumer demand didn't go down as much as we had worried about. So strong expectations for the third quarter. The emerging markets are currently showing weakness which is logical given the fact that the pandemic is still very much raging there. I look to my side and see whether we have an answer on IGT?

**Abhijit Bhattacharya:** Yes, I think IGT there are a couple of things. One is in the US Frans mentioned, you know, 90% or so. If you look at the first three weeks of July, we are probably even back at pre-COVID levels, not of procedures but of sales. So we expect procedures to

still be around the 90% and then there's some stock building in the hospital so that kind of gets us back to last year's level in the US.

For the rest of the world, we see similar trends to what we have seen in the PH businesses. So where you see freer movement of people, you see their elective procedures returning quicker. So DACH - Germany, Austria, Switzerland, we have seen let's say, reasonable growth. Nordic countries, Russia and China, I think these are the main ones I can call out. So where you've seen consumer demand coming back more - freer movement of people you see elective procedures coming back there as well.

**Edward Lee-Day:** Thanks.

**Kate Kalashnikova (Citi Bank):** Hello Frans, Abhijit. It's Kate Kalashnikova from Citigroup. My first question is on patient monitoring business. Given recent commitments by various governments to increase intensive care unit bed capacity, how do you think about medium-term growth potential for patient monitors? Historically the market growth was in the low single digits; could it perhaps move to mid-single over the next three years? Or do you see more of a one-time demand increase this year like for ventilators replacements?

**Frans Van Houten:** Hi, Kate. Well, patient monitoring is used in multiple care settings. The intensive care unit: that is where we now see a boost in capacity likely to go on for another year, and that is good because Philips has a very strong position in ICU. But what we also see is the accelerated adoption of monitoring in other care settings; the general ward where in fact many COVID patients ended up that didn't require intensive care support, and patient monitoring at home or in ambulatory care settings. Both general ward and other care settings were relatively small markets that we will now see accelerated growth in. So we are at the beginning of an adoption curve to equip these other care settings with that infrastructure, the monitoring stations or the command centres plus the disposable wireless sensors like the biosensor that I described, and that is all a new market that will start to boom.

Moreover, the Connected Care platform that we talked about, so often - we now see a strong interest in that. I refer to the Veterans Administration - Veterans Affairs giving us a 10-year contract to build out a tele-critical care for care management, care coordination, patient engagement but also collaboration between caregivers, which is all technology informatics-based cloud-enabled. And those are new markets, right? Those markets are going to supplement our traditional strengths in the ICU. Therefore even if let's say the initial peak in Connected Care will start tapering off, and also on ventilators that will happen, then we are working very hard to get the new babies, the new areas to grow up quickly and take over from there and also then to deliver on some of the promises that we have been making around Connected Care.

**Kate Kalashnikova:** Okay, great. Thanks for this. And speaking of the Connected Care, could you provide a bit of colour on demand for the new E30 ventilator? What have you seen so far?

**Frans Van Houten:** Yes, for everybody on the call, the E30 ventilator was approved under the emergency approval of the FDA. It was a great accomplishment. What we've also learned is that not every government in the world is comfortable with that emergency approval. And several governments still give preference to the Trilogy Evo and the E300

ventilators and the V60 ventilators, which are truly intensive-care hospital ventilators, over the E30. Right. And of course, those have a much higher sales price. Therefore, if you don't mind so much that they give preference to the more sophisticated ventilators.

So the E30 was launched; we immediately got orders in April, tens of thousands. And that's where we are, currently. I think there's still opportunity, perhaps for the emerging markets to pick that up further, although, also in emerging markets, we see the strong interest in the E300 in particular.

**Scott Bardo (Berenberg):** Thanks very much. Just following on from the E30 question, I know this was a little bit more speculative or not underpinned by concrete orders, so to say, but current understanding was that you were ramping up production to 16,000 units per week as per April. Following on from your comments, Frans, is it likely now that you'll significantly scale back production of these systems?

And second question, please, Frans. You made an early comment during the initial outbreak that you saw intensive care unit capacity doubling globally as a result of this crisis. I just wonder whether any of the discussions you have with governments or hospital CEOs has reinforced that outlook? Is there any data points that would point in that direction? Thanks.

**Abhijit Bhattacharya:** Let me take the one on the E30 ramp up, right? So the E30 is basically a modified BiPAP. So while we said we ramp up production to the 15,000, as you mentioned, Scott, that was a flexible capacity, together with our BiPAP capacity. So we are producing to order now and, you know, we have sold a couple of tens of thousands of units. So it's not that it hasn't, but we are not stuck with high inventories or anything, because that is a thing that we can flex together with our BiPAP capacity. So, so far so good and, like Frans said, it's an emergency ventilator. And if there is future demand in emerging markets, we still have the ability to ramp that up very quickly, you know, but we don't mind selling the E300. A more sophisticated unit.

**Frans Van Houten:** The ICU capacity statement, that statement still holds. Of course, whether governments are going to materialize, it remains to be seen. You can see how well Germany came through the COVID crisis. They have a much bigger capacity and ability to respond, versus, for example, my own country here, in the Netherlands. In the press release we spoke about the Philippines, in India, we spoke about these emergency units to complement the existing infrastructure. And it just goes, more anecdotally underline, to the need for it. I think, so far, we have seen the initial wave of emergency response. And government policies still have to firm up when it comes to a more structural capacity increase, and this is where a lot of dialogue is going on: how to organize for it, also how to staff it. And this is where we can contribute with our E-ICU, virtual ICU technology, because staffing is more of an issue than just the CapEx itself. Abhijit referred to government spending and government programs being designed. So the European Union, in their budget discussions currently there is a big chunk reserved also to improve healthcare systems. I refer to WHO investments. So, a lot of that is still pending. I continue to believe that a policy response will be to increase that capacity. It's so far not yet in these numbers, because we are still in the phase of the emergency response only.

**Max Yates (Credit Suisse):** Thank you. Just my first question is going back to Personal Health. You made the comment about the changing mix of the China business, and I think



you said 46% of it is now online. Could you talk a little bit about how, in a kind of normalized volume environment, that mix could affect profitability? Does it require more advertising and promotion online, relative to store sales? And could we see a shift in profitability as a result of this, even if demand normalizes back to 2019 levels? That's my first question. Thank you.

**Frans Van Houten:** Max, the 46% is global, it's not China, right? In China, online is 90%, is very high, after let's say the impact of the pandemic. So 46 globally now online, it does mean that we need to structurally adapt our go-to-market accordingly, as an Amazon or other digital platforms take a different support and marketing effort than the traditional retailers. I don't see so much a shift in profitability for, let's say, the channel structure. I do see that in online channels, advertising and promotion to create a consumer pull is very, very important. And so, at Phillips, we are currently making a shift between so-called fixed selling expenses versus advertising and promotion, where we have structurally a desire to increase that while reducing other selling expenses.

And we are currently doing that in Europe. We have shifted the way serve customers like Amazon on a pan-European level, as opposed to in country, thereby also being able to optimize a mix and margin structure. And we think these are all trend lines that are there to stay, and that, in the end, will make us stronger, because I'd rather spend more money on advertising and promotion than on, let's say, an extensive infrastructure to deal with a lot of offline, you know, customers.

**Abhijit Bhattacharya:** And Max, to be clear, the profitability online versus offline for us - Both are equally profitable. So it doesn't mean that if we shift more toward - the structure of the P&L is different, as Frans just explained, but it's not that one channel is less profitable, or that online is less profitable than on offline.

**Max Yates:** Okay. Understood. Just my follow-up would be on the ventilator backlog. And I guess, from your comments, you'll be at that 4X level of a ventilator capacity by Q3. I just wanted to understand, based on the backlog that you have today, how many quarters of production revenue at that kind of capacity level do you have in the backlog? Is Q1 and Q2 2021 supported by the backlog in ventilators that you see today at that kind of 4X capacity level? Thank you.

**Abhijit Bhattacharya:** We don't see that going into Q2 next year. We will have it, of course, until the end of the year, and then we will see how Q1 develops. So it doesn't go into, as far as into Q2 of next year. So that is why I had mentioned the last time, that also the investments that we make, including the CapEx, most of it will be written off this year, itself.

**Frans Van Houten:** But as we speak, there are still orders coming in. So that's back to the discussion, you know, first wave of the emergency response, subsequently waves of building infrastructure that is still going to come, and emerging markets are also ordering as we speak. It's just that the visibility of the backlog is about two quarters at the moment, and with capacity increased, our response to delivering on those orders has greatly improved. By the way, that 4X will be achieved by the end of July. So we're almost there.

**Max Yates:** Okay, great. Thank you very much.

**Julien Dormois (Exane BNP Paribas):** Hi, good morning. Thanks for taking my questions. I have one which is on M&A, because you guys have been unusually quiet on that front for

now, maybe about two years. So I can understand that the circumstances are pretty special these days, but how should you think about your M&A appetite over the next few months and quarters? Are you willingly taking some time and waiting to get, possibly the money from the domestic appliance carve-out, or should we expect you to be aggressive on that side in the coming quarters?

And the second question relates to the order book, specifically in D&T. It's more of a housekeeping question, but I was curious if you could provide us with more granularity in the three business lines for the order book between Imaging, Ultrasound and IGT, because the growth rates are very different here for these reasons, but it's interesting to get more granularity on the book trends.

**Frans Van Houten:** I'm just wondering, Julien, what to say on your first question. The fact that we're silent means there's nothing to announce. And obviously, the main premise of the Phillips value creation story is on organic growth and improvement of execution, right? So we are not dependent on M&A, there's plenty to be done. And if and when there is a great M&A opportunity, then we are ready for it. And I'd like to leave it at that.

**Abhijit Bhattacharya:** Regarding the D&T order book, I think if you look at Diagnostic Imaging, we are actually expanding the order book, primarily driven by CT, also mobile X-ray, we see quite some movement. So those are the two lines where we see an increase. Ultrasound is roughly flattish. And then, in Image Guided Therapy, slightly down, that's how I would look at the order book now, so far.

**Falko Friedrichs (Deutsche Bank):** Thank you. I have one question, please. Can you update us on the service agreement for the big ventilator that you recently signed, have you been able to secure the contract for those and, if not, do you still expect that to happen over the next few months?

**Frans Van Houten:** Great question, Falko. Let's say the ventilators do not always get service contracts immediately. And certainly, during this emergency response, the procurement people at hospitals were just scrambling to get their hands on the ventilators. So we are following that up with a big effort to also offer services, as well as even stockpile maintenance services, because I think what some governments discovered is that they had some stockpile, but it was out of date, and therefore it was not completely useful. We are, to say, extending our technology managed service line to also extend to ventilator programs. The jury is still out on that. We certainly can, in a future meeting, give you a further update.

**Falko Friedrichs:** Perfect, thank you.

**Wim Gille (ABN AMRO):** Yes, sir. Good morning, Wim Gille from ABN. Because of the whole COVID situation, the impact of the US-China trade dispute and the import tariffs, etc, have been pushed a little bit to the background. But can you give us a bit of feeling, especially as some of the tension seems to be escalating again, to where are you in terms of what the impact of the trade tariffs is for the quarter and for the year?

And also, I seem to remember that, late last year, it was a bit of a delay in basically you guys adjusting your supply chain, manufacturing footprint, etc, which had a bit of an impact on profitability in the second half of last year. So where are you in the process of redesigning your footprint and your supply chain to deal with potential uncertainties in the future?

**Frans Van Houten:** In Abhijit's commentary, in the opening of this call, he said that the gross impact of the tariffs for the full year is about €70 million, of which we are able to mitigate around 30. And therefore, the net impact this year on the P&L is about 40 million. Yes, we are adapting our supply chain, but that doesn't mean that you can avoid all tariffs, because tariffs are not only on final assembly, but also on the component stream underneath that. And therefore, the impact will not go fully away, as we are dependent on – for example, we produce magnets in the United States. So we procure other stuff in Europe and Asia. To a degree, you can also try to find exemptions, although those are temporary. I am a bit concerned by the global narrative around supply chains. And I think, generally, people are not fully comprehending the interdependency on the supply chains globally. So even when you kind of reassure final assembly, you are still very dependent on, for example, semiconductor chips out of Asia. So I want to continue to underline the necessity that borders stay open. At Phillips, of course, we will continue to optimize our footprint and try to mitigate further these tariffs, but we need to be very vigilant about further developments.

**Wim Gille:** Thank you very much.

**Frans Van Houten:** I think that was the last question. Let me take the opportunity to thank everybody very much for joining this call, and to be part of the Phillips story and journey, a story that will lead us back to growth in the second half year and modest gross for the full year, and a modest profit improvement for the full year. And I bring to recollection that it's very exciting that our customers have validated our strategy to embrace solutions and informatics to augment the traditional way of giving care.

So thanks very much. I hope to speak with you next time. And certainly also around our capital markets day that we are still planning for the November timeframe. Thanks very much. Thank you.

[END OF TRANSCRIPT]