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Royal Philips Second Quarter 2022 Results & 2025 Performance Trajectory

Monday, 25th July 2022

Introduction

Leandro Mazzoni

Head of Investor Relations, Royal Philips

Welcome

Hi, everyone. Welcome to Philips' Second Quarter 2022 Results Webcast. I'm here with our CEO, Frans van Houten, and our CFO, Abhijit Bhattacharya. Frans and Abhijit will take you through the second quarter results and our performance road map for the full year and through 2025.

We're also joined today by Roy Jakobs, Chief Business Leader, Connected Care; and Francis Kim, Chief Quality and Regulatory Officer, as they will provide an update on Respironics recall and quality, respectively. After the presentation, there will be an opportunity for a Q&A which will be chaired by Frans. The press release, slide deck, and frequently asked questions on the Respironics recall were published at 7.00 CET on our Investor Relations website. The replay and full transcripts of this webcast will be made available on the website as well.

Before we start, I want to draw your attention to our Safe Harbour statement on screen. You will also find this statement in the presentation published on our Investor Relations website.

With that, I'll hand over to Frans.

Opening Remarks

Frans van Houten

CEO, Royal Philips

Agenda

Thanks, Leandro, and thanks, everyone, for joining us this morning. I would like to first go through the agenda for today. We have a lot to update you on, so we decided to host a webcast instead of a call. We will also have a slightly longer session of around 70 minutes, followed by Q&A.

We will start with the discussion of our second quarter results and full-year outlook. We will then talk about the actions we are taking across different areas to drive performance improvement. This will include presentations by Roy Jakobs, who will provide an update on the Respironics recall; and Francis Kim, who will talk about our progress and continued efforts around quality. After that, I will talk about how we are driving, and will continue to drive, growth through innovative solutions and customer partnerships. And we will wrap up with our performance trajectory through 2025.

Before I hand over to Abhijit to update you on the results of the second quarter and our outlook for the full year, I would like to go over the key messages that we will cover during these presentations.

Key Messages

Our performance in the quarter was impacted by headwinds. Order book strength and improving component supplies are expected to deliver growth and profitability improvement from the second half of 2022 onwards. Comparable sales declined 7% in the second quarter, mainly driven by global supply shortages and, of course, the lockdown in China.

Adjusted EBITA was impacted by lower volumes and inflation. We expect 6% to 9% sales growth and year-on-year margin improvement in the second half of the year resulting in a 1% to 3% sales growth for the full year with an adjusted EBITA margin of around 10%. This year's margin is impacted by supplies, mix and inflation, partly offset by our pricing and productivity actions.

We are making progress on our strategic imperatives and we are stepping up actions on pricing, productivity and supply chain resilience. We will complete 90% of total Respironics recalls this year and rebuild the business gradually. We will address regulatory requirements and, of course, manage litigation. We accelerated patient safety and quality, bolstering leadership teams, and fundamental improvements are already driving better outcomes.

We are driving growth through six innovative customer-centric suites of solutions. Accordingly, for the period 2023 to 2025, we expect to deliver 4% to 6% average comparable sales growth with an adjusted EBITA margin reaching 14% to 15% by 2025, recognising the lower starting point from 2022 and the macro environment. The longer term margin potential which we communicated before, remains intact but will take longer to achieve.

And with that, I'd like to hand over to Abhijit.

Financial Performance in the Quarter and Full-Year Outlook

Abhijit Bhattacharya

CFO, Philips

Q2 2022 Performance Summary

Thank you, Frans. Good day all and welcome to this webcast. Our performance in the second quarter was impacted by global challenges, including supply chain shortages, COVID lockdown measures in China, inflationary pressures and the Russia-Ukraine war. Due to these factors and the 9% comparable sales growth in the second quarter of 2021, comparable sales declined 7% in the quarter. Adjusted EBITA was 5.2%.

The impact of global supply chain disruptions is relevant across all modalities, but particularly strong on higher volume and high margin businesses like Patient Monitoring, Ultrasound and Image Guided Therapy systems and devices. The impact of the COVID lockdown significantly affected our business in China, where comparable sales and order intake declined almost 30%.

Production in several of our factories, as well as those of our suppliers in China, was suspended for two months, which exacerbated the global supply chain and cost challenges. The China lockdowns directly impacted the adjusted EBITA margin of the Group by 120 basis points due to lower sales, and a further 110 basis points because of factory underutilisation.

In addition, global inflation and cost headwinds were higher than anticipated and had an additional net impact of around 290 basis points on our profitability. These impacts were partly offset by 320 basis points from substantial productivity and pricing actions which we have taken, and will contribute to further margin improvement in the second half of the year.

The operating cash flow was an outflow of €306 million, mainly due to temporarily higher inventories.

Business Highlights Q2 2022

Let's now look at the performance per business. In Diagnosis & Treatment, the comparable sales declined 4% on the back of 16% growth in Q2 2021. High single-digit growth in Enterprise Diagnostic Imaging and mid-single-digit growth in Image Guided Therapy was more than offset by a decline in Ultrasound and Diagnostic Imaging due to specific component shortages. Adjusted EBITA margin was 6.2% impacted by the decline in sales, cost inflation, and an unfavourable mix, partly offset by productivity measures.

The comparable sales for Connected Care declined 13%, driven mainly by a substantial decrease in Sleep and Respiratory Care as Q2 last year still included sleep therapy system sales and by supply chain headwinds in Patient Monitoring. The adjusted EBITA margin amounted to 1.1%, mainly due to the decline in sales and cost inflation, partly offset by productivity measures.

The Personal Health businesses' comparable sales decreased by 5% on the back of 33% comparable sales growth in Q2 2021. North America continued to remain strong with double-digit growth. However, this was offset by significant double-digit declines in China and Russia. The adjusted EBITA margin amounted to 12.4%, mainly due to the decline in sales, cost inflation and currency impacts.

We continue to experience solid demand for our products and solutions, which confirms the relevance of our strategy and portfolio of our innovations to our customers. During the second quarter, we partnered with 19 more hospitals across the world to help them in the transformation of delivery of care and boost staff productivity.

In our Diagnosis & Treatment businesses, demand remained strong as orders went were up 3% on the back of 29% growth in the second quarter of last year, with growth across all businesses. Diagnostic Imaging, Ultrasound and Image-Guided Therapy orders grew low single-digit and Enterprise Diagnostic Informatics grew double digit.

Excluding China, orders grew 9% in Diagnosis & Treatment, driven by strong growth in Western Europe and in other growth geographies. We continue to see solid demand in North America where Diagnosis & Treatment orders declined 6%, but on the back of over 70% growth in Q2 of last year.

Although Connected Care orders declined 2% in the quarter, demand remained strong with an average growth of 7% over the last three years. We continue to experience good order momentum in Connected Care Informatics and in hospital monitoring business where we see fundamental demand shift in the adoption of our patient care management solutions and expanding market shares. Order volumes are running significantly above pre-COVID levels in hospital patient monitoring.

Solid Order Growth and All-Time High Order Book

Our comparable order intake for the Group grew 1% in the quarter and importantly, 6% excluding China. Despite the challenging environment, we are confident in the strength of our all-time high order book. Order intake has been consistent throughout this more challenging period, resulting in an all-time high equipment order book for Philips.

Our book-to-bill is also increasing and up to 1.17, and order book coverage of the expected equipment sales in the next 12 months is trending up.

Now I would like to take you through what we expect for the rest of the year in more detail. The first half of 2022 was obviously very challenging. Our sales declined 5% on the back of 9% growth in the first half of 2021. Although this is in line with our guidance for the first half of the year of a mid-single-digit decline, we had to weather additional headwinds from the China lockdown and the Russia-Ukraine war.

Our teams are fully focused on everyday execution, delivering on the customer demand and addressing the supply chain risks. We are seeing component supplies gradually improving, although issues do pop up, and have taken action to strengthen our supply chain resilience. This gives us the confidence that we will resume growth from the third quarter onwards, which is expected to result in a 6% to 9% comparable sales growth in the second half of the year on the back of a 9% decline last year.

Q2 2022 Adjusted EBITA margin Impacted by Lower Volumes and Cost, Partly Offset by Pricing and Productivity

We further expect to deliver 1% to 3% growth in the full year, which includes approximately €500 million impact from the lower sales in China, Russia and the supply shortage compared to our January guidance after mitigation, as well as significant cost inflation. Across our businesses, we have also stepped up actions on productivity and pricing, which, together with the sales growth, are expected to drive improved profitability in the second half of the year. For the full year 2022, we expect to deliver around 10% adjusted EBITA margin.

Actions on Productivity, Pricing and Supply Chain Resilience Expected to Deliver Growth and Profit Improvement in H2 2022

Before I hand back to Frans, I would like to provide guidance for some areas of our business. We continue to expect an adjusted EBITA loss of around €80 million in the segment Other in 2022. At the EBITA level, we now expect a net cost of around €170 million for the full year 2022, which is an increase of €30 million due to higher restructuring costs resulting from the step up of our productivity initiatives.

Overall, the higher restructuring cost will be more than offset by lower acquisition-related cost that we had communicated earlier this year. Financial income and expenses are expected to be a net cost of around €190 million in 2022, excluding incidentals, if any. This is €30 million higher than what we communicated earlier due to a one-time higher interest cost resulting from the liability management transactions taken in the second quarter. These transactions extend the debt maturity profile of the company and has a neutral impact on the amount of debt outstanding.

Free cash flow is expected to be around €250 million in 2022. This is lower than in 2021 due to approximately €400 million cash flow related to the field recall action provision taken last year.

I would now like to hand it back to Frans.

Taking action to improve performance

Frans van Houten

CEO, Royal Philips

We Are Working Consistently On Three Strategic Imperatives to Drive Growth & Profitability…

Thank you, Abhijit. We will take the questions on the second quarter and full-year expectation that Abhijit presented at the end of this call during the Q&A session.

Now, before I share with you some of the key actions that we are taking to step up performance, I would like to remind you briefly of our three key strategic imperatives.

At the start of our health tech transformation journey some years ago, we clearly defined what are the drivers that we need to deliver on our strategy and unlock the full potential of portfolio. It is all about raising the bar on how we serve customers, raising quality and productivity, driving growth in the core of our business through innovative solutions and long-term partnerships to help our customers transform their healthcare delivery and help people to take better care of their health and well-being.

… Making Progress on Many of Our Imperatives…

We have actually consistently made progress on many of these strategic imperatives. Our customers and quality KPIs have been improving in recent years. Our net promoter score increased 8 percentage points to an average of over 60 in just the last few years. We have been driving growth in our core business by gaining market share, as evidenced by our record order intake over the last two years and the current strong order book.

Our solution strategy continues to resonate very well with our customers, with solutions revenue and recurring revenue both growing above company average and representing now a growing share of our total revenue.

… And doing business responsibly and sustainably…

As we continue to innovate and create value to our customers, we want to do so in a responsible and sustainable way. In addition to being carbon neutral in our operations since 2020, something that we are all proud of, we are continuously partnering with our customers and suppliers to reduce emissions in Scope 3 of the value chain.

We have actually a long track record of sustainability and have been at the forefront for many years. We have been on the CDP's A list for over nine years, for example. But we are not stopping there. We have set ambitious ESG targets for the future as well, and target improving 2 billion lives through our products and services by the year 2025.

…While Stepping-Up Actions to Improve Performance and Overcome Headwinds and Continuing To Drive Growth

While we have made significant progress, we absolutely recognise the areas where we are facing challenges and need to improve or do more right now. We are also highly conscious that we are facing significant industry-wide headwinds that present real challenges to delivery.

As such, we are driving a comprehensive set of actions to urgently improve performance and overcome these hurdles. Today, we want to update you on some of the key focus areas of our efforts. And we believe that these will have a big impact on the resumption of our value creation journey.

We will talk to you about our focus on completing the Philips Respironics recall, our progress and initiatives that we are taking to accelerate patient safety and quality. Of course, our pricing actions. The step up of our productivity initiatives by over €100 million annually. The actions that we are taking to increase supply chain resilience and the acceleration of our China 'local for local' strategy.

Finally, I will also talk to you about how we will drive growth in six key customer solution areas across the three business reporting segments.

Let's start with me handing over to Roy Jakobs, the Chief Business Leader for Connected Care, to take you through the continued progress made on completing the Philips Respironics recall.

Progress Update Philips Respironics Field Action

Roy Jakobs

Chief Business Leader Connected Care, Royal Philips

Extensive Patient, Clinician and Regulator Engagement

Good morning. Thanks, Frans. I would like to give you an update on the Phillips Respironics field action.

Before we go into detail, I want to emphasise again that patient safety is our absolute number one priority. We know how important these sleep apnoea devices are to patients and how they improve their lives. We continue with a comprehensive outreach to engage extensively with patients, clinicians and regulators.

We know that patients are waiting, and we are doing everything we can to get the devices to them as soon as possible. In the meantime, we are prioritising placements with the patients that have the greatest needs, in alignment with the regulators. We are also sharing progress on our testing programme to ensure patients and physicians are fully informed.

Around 90% of the Recall Programme Units Produced and Shipped by End 2022

Device registrations are trending in line with our model, confirming our expectation of 5.5 million devices to be remediated. To do so, we have significantly increased our production capacity to 3x our pre-recall levels and expect to further increase it in the remainder of the year, reaching 4x pre-recall levels. As of today, we have produced 3 million devices and expect to produce and ship around 90% of the devices required by the end of 2022, though recognising the challenges in supply of materials and global logistics capacity.

Extensive Test and Research Programme Continues and Shows Insightful Results to Date

Hundreds of tests

Some weeks ago, we updated you fully on the extensive test and research programme launched in June 2021 for the Respironics recall. As a reminder, we are undertaking

hundreds of tests, working with five certified testing labs and numerous external experts. At this stage in the test and research programme, we observe that the incidence is rare and the chemical characterisation of foam degradation is complex.

Results to date for DreamStation1 devices

The results to date for the DreamStation1 devices show the following:

- very low prevalence of significant visible foam degradation in the over 63,000 devices inspected;
- ozone cleaning materially increases foam degradation;
- volatile organic compound emissions were within ISO limits when not exposed to ozone;
- and foam degradation does not contribute to appreciable elevated levels of respirable particles, which were within ISO limits;
- and, even when significant visible particles are formed, they are likely to accumulate and stick inside the device.

Biocompatibility testing

Further biocompatibility testing and assessment of degraded PE-PUR foam is still ongoing to fully assess potential patient risk. Due to extended throughput times, we hope to come back to you on this assessment in the coming months.

Philips Respironics Engaged External Scientific Experts to Conduct a Systematic Review

Also very relevant, Philips Respironics engaged external scientific experts to conduct a systematic literature review of epidemiological studies. There were 13 identified studies, all of which found no consistent statistical association between the use of PAP devices, including Philips Respironics, and the risk of cancer in patients with obstructive sleep apnoea (OSA).

Two of the studies are quite comprehensive and should be reassuring for patients as they show no statistical difference in cancer risk between users of Philips Respironics PAP devices and users of other brands of PAP devices. Eleven studies provided limited additional insights, but their results also suggested no excess risk of cancer associated with the use of PAP devices.

The 2022 study by Palm reported more frequent prescription of respiratory relief medication among patients with both OSA and obstructive lung disease, but no statistical difference in hospitalisation was observed for OLD among OSA patients between the users of polyurethane PAP and non-foam PAP.

Philips Respironics Initial Rebuild Trajectory

Earlier this month, we made a Frequently Asked Questions document available on the investor relations website, related to the study by Palm. The document addresses the main points around the relevance of the study, as well as the misinterpretation of some of its content.

As we work hard towards completion of the field action, we also have established a rebuild trajectory for the sleep business. This trajectory is based on the completion of the field action by Q1 2023 and assumes a gradual resumption of sales and of our profit towards 2025. This

also takes into account that the market has been short of supply, resulting in a substantial pent-up demand, including undiagnosed patients.

The recovery trajectory of the Sleep and Respiratory Care business through 2025 is subject to consent decree, which I will come onto in a minute.

Regulatory and Legal Update

Now, onto the regulatory and legal front. As you know, in April 2022, Philips Respironics and certain of Philips' subsidiaries in the US received a subpoena from the US Department of Justice and asked to provide information related to events leading to the Respironics recall. The relevant subsidiaries are cooperating with the agency.

On 18th July 2022, we received a proposed consent decree from the DOJ acting on behalf of the FDA. This followed their inspection of certain of Philips Respironics' facilities in the US in 2021. While we understand you may like to know more about it, we are in confidential discussions with the DOJ on the terms of a consent decree and cannot speculate on the outcome, the content or the timing of any agreement. It's still early stages and Philips Respironics is committed to transparency and providing stakeholder updates when and as appropriate.

Finally, as known, various civil complaints have been filed in various jurisdictions globally, alleging economic loss, personal injury and the need for medical monitoring related to devices subject to the recall. Given the early stages of the litigation, it's unlikely that a reasonable estimate on potential exposure on personal injury claims can be made before the end of 2023.

With that, I would like to give the floor to Francis Kim.

Accelerating Patient Safety and Quality

Francis Kim

Chief Quality and Regulatory Officer, Royal Philips

Patient Safety and Quality is Our Top Priority

What we do today affects someone's life tomorrow

Thanks Roy. Hello everyone. I am Francis Kim and I head up Quality and Regulatory Function. Let me start by focusing on patient safety and customer-focused quality. I do this job to make a difference. These are not just random photos of people. Everybody you see here are our employees, friends and family members who have benefitted directly from advancements in medical technology that Philips exemplifies. I am very connected with many of them.

It's an important role I have in Philips, leading quality and regulatory, ensuring the highest standards as it is personal to me since my wife is also in the photo. Quality policy you see here, 'What we do today affects someone's life tomorrow,' resonates with all our employees and it is action-oriented.

Fundamental Improvements Driving Better Outcomes

The focus on quality is not new to Philips; we have been on this journey for a while and have made tremendous progress, the evidence of which is shown here. These are some of the metrics we follow, chosen for their objective criteria.

One Philips

Let me start by looking at our standardised ways of working as an example. In the last four years, we have moved from 107 to 75 quality management systems, and we have a plan which is firmly in place to reduce that to 32 by 2024, which will significantly simplify and standardise the way we work.

Stepping up compliance

If we move on to compliance performance, enterprise-wide we have been and continue to demonstrate improved delivery on regulatory and quality requirements.

Product Quality

Lastly, on product quality, which has implications for both safety and efficacy, again we have consistently shown material progress over the last four years.

Delivering for our Customers

One thing is how we measure ourselves, but the other is how we are perceived by our customers. Here is a set of metrics which again shows consistent progress, and I am particularly proud by the dramatic improvement in customer ratings and reviews. But we have not stopped there.

Strong Capabilities and Leadership: Quality & Regulatory

In my two years at Philips, I have hired the best team in the industry. They bring a broad range of experience, predominantly from other high-performing med tech companies in this highly regulated sector. We have been on a journey to increase our capabilities in a broad range of complementary areas to really take quality to the next level. We have over 4,000 dedicated and passionate quality and regulatory employees working very hard every day to make meaningful impact and deliver benefit to our patients and customers.

Bolstering our Leadership Team with Executive Hires

One of the main reasons I took on this challenge and saw it as a great opportunity is because of the company-wide focus on quality and regulatory, led from the top. And that is exemplified when you see how, enterprise-wide, we have increased the expertise in this area. Over 60% of executive hires now have a direct med tech and healthcare background, covering all roles that are complementary to quality and regulatory performance.

Accelerating Patient Safety & Quality Programme 2021-2023

You have heard about the accelerating patient safety and quality framework. Now, let's talk about what we are doing now. First of all, it's around the continued focus on business and quality management systems, aligned with the KPIs I showed earlier. Secondly, it's about oversight and performance management in a comprehensive manner, where we have introduced additional layers of oversight and controls. And thirdly, it's about quality culture, with multiple initiatives and employee engagements, ensuring its full integration throughout

the organisation. What I want to do now is to drill down into how these initiatives are accelerating patient safety and quality.

Compliance

This is our central programme for next-level quality and regulatory achievement. We are in a highly regulated industry, and compliance is paramount. And you see that we have gone through a rigorous process to ensure that our compliance function is absolutely at or above the standard, and we continue to improve.

Product quality & complaint handling

In terms of product quality and complaint handling, we undertook a fundamental retrospective review of complaints data and adverse events and, importantly, we identified no major issues beyond the Respironics recall to date. But we continue to stay vigilant, and currently are in the process of further optimising and transforming our complaint handling process.

Global standardisation

Thirdly, standardisation reduces complexity and increases focus within the organisation by introducing a range of global standardisation processes, further reducing risks around quality, patient safety and compliance.

External advisors

We also wanted to really test ourselves. That's why we engaged with a number of independent experts to scrutinise our activities and provide their expertise and guidance to make sure that we're not missing anything and are really achieving industry best practices.

Closing Remarks

In closing, as mentioned, we are in a highly regulated industry, and everything we do matters for the patients and customers we serve. We are accelerating our long-standing quality commitment. We are standardising enterprise-wide quality practices, and we continue to meet regulatory and quality requirements. Given the challenges we have with the recall, it is important you understand the strength, the journey that Philips has been on and the progress that has been made, while acknowledging there is more to be done. I am really looking forward to the next stage of this great journey.

And with that, I hand back to Abhijit.

Actions to improve performance

Abhijit Bhattacharya

CFO, Royal Philips

Pricing Actions to Address Inflation

Thank you, Francis. Let me now walk you through some specific pricing actions that we are taking as we go through this inflationary environment. We raised prices by mid-single digits since the beginning of this year across our businesses. In Personal Health, this is expected to have a positive impact of around 4% this year, with the rest of the impact flowing through into 2023. In Diagnosis & Treatment, due to the longer equipment order book cycles and the

annual indexation for – cycle for service contracts, the impact of the price increases will take a bit longer to be fully realised in the P&L. We expect around a 1% impact this year, with the rest being reflected in 2023. We will continue to focus on taking further pricing measures where appropriate.

Stepping Up Productivity Initiatives to €0.5 billion per year to Deliver €2.0 billion in the 2022-2025 Period

We also said we are stepping up productivity initiatives to €500 million per year through 2025, which will result in €2 billion of savings in the next four years. Many of these initiatives have been communicated to you before but are being expanded or accelerated. In procurement, savings come from the dual sourcing initiatives, supplier consolidation and the impact of our centre of excellence for value analysis and value engineering in India. This centre has been ramped up rapidly since its start in 2020 to now having 650 engineers focused on driving low-cost country sourcing, modularisation and component standardisation, reducing the number of components and suppliers for our products and reducing the number of product configurations itself.

We also expect the premium tariffs on spot buys and freight to abate gradually next year. We are driving further simplification and productivity in our supply chain through manufacturing automation, as well as footprint rationalisation, reduction in the number of warehouses as well as the standardisation and improvement on the field delivery of our services, solutions and software.

We are also driving productivity in R&D by simplifying and shifting our footprint, adopting standard platforms and modules, and to focus on fewer, better, bigger innovation projects. With that, we expect the R&D investments to get to 9% to 9.5% of sales by 2025.

We are evaluating certain parts of the organisation to make it leaner and drive savings through reductions in spans and layers in the organisation, real estate optimisation and expansion of global business services and automation. Our global business service centres provide end-to-end services and process standardisation and automation across our businesses.

In the next few slides, you can see more details around some of the examples that I just provided you.

Actions to Address Supply Chain Headwinds

Now, we mentioned that we continue to face severe supply chain disruptions across our businesses. We've been working through these headwinds for some time now, and we expect them to continue in the coming quarters, although we see the start of gradual improvement. We have been taking significant actions to increase supply chain resilience and mitigate the impact of the disruptions. Some of the actions we are taking:

- engaging with senior government officials, strategic suppliers and foundries to prioritise healthcare;
- directly working component issues across all tiers of the suppliers;
- diversifying sourcing of high-risk components, and we've now qualified over 300 alternate component suppliers till date;
- redesigning printed circuit boards or PCBs to qualify alternate sources of supply;

- driving dual sourcing in low-cost locations for magnets, tubes and detectors;
- expanding long-term contracts with strategic suppliers, including logistics;
- and driving a risk mitigation programme covering 1,500 suppliers or 70% of our revenue with actions that include dual sourcing as well as pre-build of inventories.

Accelerating 'Local for Local' Strategy in China

Finally, we are accelerating our 'local for local' strategy in China. We expect the Chinese healthcare market to continue to grow mid to high single digit. Philips has a leading position in China with a very solid and fully local team. We are further investing in the 'local for local' products and capabilities through three innovation centres in China where we will be doubling our R&D investments, solutions adapted to the local market and meaningful partnerships. As such, we expect around 90% of our China equipment sales to originate from China manufacturing in 2024.

Now let me hand you over back to Frans to tell you what we are doing to drive growth through innovation – innovative solutions and customer partnerships. Frans.

Driving Growth through Innovative Solutions and Customer Partnerships

Frans van Houten

CEO, Royal Philips

We Operate in a Large, Structurally Growing and Resilient HealthTech Market

Thanks, Abhijit, and thank you for providing transparency on how we are able to improve our performance. We'll hopefully be able to share more progress with you all next quarter. I first would like to remind you about the market that we serve. We operate in a large, structurally growing health technology market. Our customer needs align to the quadruple aim which forms the true north for the solutions that we develop and deliver. Customer needs are at the core of everything that we do at Philips and, when coupled with our strong innovation DNA, it helps us to deliver tailored solutions that address the customer pain points across these quadruple aim angles.

Over the Last 10 Years, Philips Transformed into a Focused HeathTech Company with 70% Leadership Positions

This approach has proven successful. Philips has transitioned to a focused health technology portfolio with over 70% leadership positions. We are global leaders in Image Guided Therapy Systems, Radiology, Cardiology Informatics, Hospital Patient Monitoring, to name just a few. We are continuously shaping our portfolio to serve our customers, delivering on the quadruple aim and setting the organisation on a path of higher growth and profitability.

Core to Our Strategy is our Integrated Solutions Approach Delivering Results along Care Continuum and Quadruple Aim

Our leadership positions are achieved through successfully crafting and deployment of our solutions strategy, taking the health continuum as our conceptual framework where we look at providing clinical pathways to deliver on the quadruple aim of healthcare: better outcomes, lower cost per patient, while improving the patient and staff experience. We believe that

solutions are the best way to achieve a deep and sticky long-term customer relationship, and thereby also superior results. Our solutions strategy combines innovative systems, devices, informatics, AI and data interpretation and professional services. It sets the right platform to improve clinical and operational workflows, and it helps integrate patient care management across care settings. And increasingly, we do so on the basis of a recurring as-a-service business model.

Growth in Six solutions Areas with Strong Customer Propositions

We have built a customer-centric solutions portfolio over the years to address customer needs across the health continuum and care pathways and settings. In our Diagnostics & Treatment business, we find three solution areas: one, Imaging Systems; two, Diagnostic & Pathway Informatics; and three, Image Guided Therapy. The first two – Imaging Systems and Diagnostics & Pathway Informatics – are patient- and staff-centred solutions that simplify workflow and deliver a more precise and clear pathway with more predictable outcomes. Combined with our Image Guided Therapy, the third solutions area, we are uniquely positioned to deliver superior outcomes in minimally invasive procedures, again through a combination of systems, devices, software and services. This strategy is so successful that we have been increasing market share over the last 12 months by two full points.

In our Connected Care business, we have two solution areas: Patient Care and Care Management, and Sleep and Respiratory Care. The first revolves around patient care solutions across both acute and ambulatory care settings, leveraging advanced and AI-powered systems to provide insightful analytics, and predictively drive care optimisation and workflow efficiency. The second offers therapies to support patients in their sleep and respiratory therapy needs, both in the hospital as well as in the home.

And then, last but definitely not least, our Personal Health solution area helps consumers address their personal hygiene needs, support healthier lifestyles and disease prevention.

Our solutions portfolio is set up to promote and impact health and healthcare and helps us grow. We are very happy with this portfolio. It has a lot of traction and even more potential.

Software-Defined Imaging Systems that Integrate AI and Workflow Tools for Improved Diagnosis and Efficiency

Now, I'd like to give you some deeper insights. The first area of growth is our imaging systems, which provide clinicians with first-time-right imaging through intelligent, automated and clinically relevant diagnostics. Imaging systems are the foundation of the Diagnosis & Treatment business and are the anchor proposition for the radiology service line.

Unmatched Performance and Efficiency with MR 7700, Combining High-End Capabilities with AI-Embedded Workflow Tools

For example, the MR 7700 delivers unmatched performance and efficiency, combining the high-end capabilities of MR with our AI-embedded workflow tools, thereby delivering 35% higher image quality while simultaneously accelerating the scan time up to 50%, all while taking less than one minute for a patient to be set up.

A New Standard of Care without Compromise: Spectral CT 7500 Offers Spectral Results 'Always On' in 100% of the Time

Or let's take the innovations in our new Spectral CT 7500, which reduced the overall time to diagnosis by 34% due to a 23% increase in diagnostic confidence, all resulting on 26% reduction in follow-up scans. A truly revolutionary and innovative CT.

Diagnostic and Pathway Informatics Drives New Clinical Operating Models Dramatically Improving Efficiency & Decision Making

Our diagnostic pathway informatic solutions optimise clinician workflows by connecting diagnosis with therapy selection and delivery. At Philips, we have long held the belief, and invested appropriately, that informatics, especially AI-enabled informatics, is a key future differentiator that will unlock the value of imaging to precision diagnosis. Innovations such as the Philips Image Management platform and the unique multi-vendor, multi-modality, multi-site Radiology Operations Command Centre contribute to clinical and operational efficiency. The Philips Image Management platform delivers 50% productivity improvement for radiologists and a 40% reduction in reporting time, while our Digital Pathology Solutions provides real-time tele-pathology and delivers up to 25% of increased productivity gains.

Such innovations make it possible for, for example, radiologists to focus on their images rather than managing a work list, resulting in a better staff experience but also lower cost – two of our quadruple aim aims. AI reading, moreover, will lead to better diagnosis and hence better clinical outcomes – another one of the quadruple aims.

With IGT Solutions, We Optimise Workflow and Outcomes Through Integration & Innovation Across the Care Pathway

Our Image Guided Therapy solutions: they provide integrated solutions that advance image-guided minimally invasive procedures and treatments. For example, our coronary solutions and peripheral venous solutions deliver holistic procedural advantages to the customer, thanks to our innovating the procedure, again, in a combination of systems, devices and informatics.

The Philips Azurion system actually saves 17% time per procedure while simultaneously reducing dose, thanks to an improved workflow in the interventional lab, with seamless integration and continuous monitoring across the care pathway.

Similarly, the integration of workflow of interventional structural heart procedures with our industry-leading ultrasound technology streamlines the procedural workflow. In a single-centre study, our integrated solutions along the care pathway have actually reduced the door-to-groin time from 70 minutes to 16 minutes.

Patient Monitoring and Care Management Solutions

Our next solution growth area, Patient Monitoring and Care Management, empowers clinicians and patients to manage care more effectively and efficiently, both in and outside of the hospital. This solution delivers an accurate and continuous picture of the patient, resulting in clinical and operational efficiency gains within the hospital, translating to a 40% improved staff and patient satisfaction.

Building on our leadership position in hospital patient monitoring, we have created an integrated patient monitoring and predictive care management platform for service delivery, both in the hospital and at home. Our highly accurate remote cardiac monitoring and

detection solution detects 4.6 time more patients with atrial fibrillation, thereby potentially avoiding $200,000 cost per detected patient. And our clinical data services capsule business liberates medical device data from over 1,000 supported devices. That results into data liquidity and, resulting in data fluidity, enables better decision-making and faster turnaround time in the OR, translating to operating savings for the hospital.

Sleep and Respiratory Care Solutions

Our priority in our next solution area, Sleep and Respiratory Care, as already elucidated by Roy Jakobs, is to turn around and resolve the issues pertaining to sleep recall and deliver innovative and connected patient-focused sleep therapy solutions through our comprehensive and renewed Sleep portfolio. You heard Roy talk about how we aim to gradually restore this business from 2023 and onwards. In fact, our Dreamstation 2 is the only PAP with a guided setup, starting pressure and other features, and yet it is 22% smaller and 60% lighter than our previous solution.

Our innovative patient mask solutions are stable, comfortable and intuitive. These mask solutions are also the smallest, lightest and easiest-to-use conventional mask platform.

Finally, our innovative cloud-enabled Care Orchestrator platform, the single common platform to drive care collaboration, is increasing patient compliance by 49%.

Personal Health Solutions

And then I can talk about the Personal Health solutions area. After the divestment of domestic appliances early 2021, we have focused our personal Health portfolio on expanding its role as the trusted and preferred health and well-being partner for consumers, but also in relation to the healthcare providers. We engage customers in their personal health routines, leveraging scale solutions that deliver smart devices but also novel engagement models, often through apps.

Ladies and gentlemen, this morning we also provided an update performance improvement for the 2023 to 2025 period, and I would like invite Abhijit back to take us through that in more detail.

Performance Trajectory Through 2025

Abhijit Bhattacharya

CFO, Royal Philips

Expect to Deliver Growth and Margin Improvement across All Our Business Segments

Thanks again, Frans. While we continue to see risks and a challenging macroeconomic environment, we expect the supply chain measures we just outlined to take full effect, resulting in significant improvement in the conversion of our order book to revenue, as well as the pricing and increased productivity measures to expand margins. Based on these actions, the strong fundamentals of our businesses, and taking into account our 2022 exit rate, we now expect to deliver comparable sales growth of 4% to 6% and an adjusted EBITA margin of 14% to 15% by 2025, with further improvement thereafter. This growth range is lower than previously communicated as we see a more challenging macroeconomic environment. The

lower adjusted EBITA margin range for 2025 versus what we said in the capital markets day of 2020 can be seen in light of a lower starting position this year.

As Frans mentioned, our value creation potential remains intact. Given the lower starting point, it will take us a bit longer to achieve the full potential. We expect our three business segments to grow within the 4% to 6% range. We expect Diagnosis & Treatment to deliver 14% to 15% adjusted EBITA margin by 2025, Connected Care to be in the 14% to 16% range, and Personal Health to deliver 18% to 20% adjusted EBITA margin. As you can see, compared to 2019, the step-ups are realistic and achievable. Each business segments in their own right may have the potential to do better, but we take a more cautious approach now and for Philips overall, this adds up to 14% to 15%.

Indicative Cumulative Adjusted EBITA Improvement Drivers 2023-2025

Frans spoke about the market where we play and the growth fundamentals of our businesses. Now I will break down in detail what drives the margin increase in the coming period. We are targeting a cumulative adjusted EBITA margin improvement of 4-5 basis points between 2023 and 2025, or 3% to 4% excluding Sleep and Respiratory Care. We expect 3% to 4% cumulative positive impact from the operating leverage from growth; 5% to 6% from pricing actions, better mix and cost of goods sold; and 1% to 2% non-manufacturing cost reductions. This is expected to be partly offset by a cumulative of 6% to 8% impact from inflation in the period. This cumulative bridge is indicative, and yearly numbers cannot be derived in a linear fashion.

Mid-Term Performance Trajectory in Summary

On the next page, you will see our financial framework. We expect free cash flow conversion above 90% and as you are aware, we've been above 100% in the past few years, with a €2 billion free cash flow by 2025. Double-digit adjusted EPS growth and an organic ROIC in the mid-teens – mid to high teens, and with retail tax guidance and credit rating and, importantly, our dividend pay-out – that is very important, because in line with our balanced capital allocation policy.

And with that, I'll hand it back to Frans for his closing remarks. Frans.

Closing remarks

Frans van Houten

CEO, Royal Philips

I hope we were able to convey why we are confident about our potential to grow and create value, while recognising that we need to significantly improve performance and overcome issues right now. Our customers tell us that we are relevant to them, and they want us to succeed. Our strategic road map will unlock higher growth and margins, and we are keenly focused on execution and drive operational excellence to achieve our goals and manage the near-term headwinds that we are facing.

Today we have a very strong portfolio to serve our customers and I and, together with me, the entire Executive Committee, remains confident on the performance trajectory of our

company. Thanks for being with us here today, and we will now open the line for questions. We'll invite all the colleagues back, and it will take about a two-minute break to set that up.

Q&A

Leandro Mazzoni: Welcome back everyone. Let's open the line for questions.

Operator: Thank you, sir. The first question comes from Mr Hassan Al-Wakeel from Barclays. Please state your question.

Hassan Al-Wakeel (Barclays): Thank you for the comprehensive update. I have three questions please. Firstly, on the guidance, could you talk about your confidence on the ramp assumed in the second half with margins of 13+% needed to hit guidance versus what you achieved in the first half at around mid-single digit? And then specifically, how should we think about Connected Care profitability in H2, given nothing really changes for Sleep? And whether that bulk of improvement is assumed in the Patient Monitoring business.

And then, secondly, thanks for the table on slide 20 on expectations for Respironics. Could you walk us through your recovery assumptions here? There is pent-up demand in this business and you are expecting substantial market share loss in 2025 versus 2019, despite exiting the year at four times the manufacturing capacity. How have you incorporated a consent decree into these numbers, if at all, given you would've received this proposal as you prepared these forecasts?

And then finally, on the midterm targets, could you talk about your phasing assumptions on growth and margins? Is this likely to be more backend loaded or linear in nature? And, specifically, how should we think about 2023 generally as well as with regards to your expectation around the phasing of Sleep sales? Thank you.

Frans van Houten: Yeah. Hi Hassan. Thanks for joining. Good morning. Let me take the first question. Let's start with the underpinning of the order book. For the Health system side, about 90% of the sales is already in the order book so that is not the issue. The component supply situation is gradually becoming better, partly due to our actions to qualify alternate parts and dual sourcing; and partly because semiconductor makers have given us a better allocation for the second half. Still, that's going to be gradually building up through Q3, and especially Q4 will be a very big quarter.

The margin weakness in the first half was also driven by the push-out of Ultrasound, Patient Monitoring and Image Guided Therapy, which are the three of our most profitable businesses, and we will see an overweight of those very successful businesses in the second half year. That, combined with the strong operational leverage and much better factory loading, will lead to the profitability step-up that you refer to. And that will help us then on the back – let's say, compensate for the weak first half and still get to around 10%, which, of course, is a significant step-down from where we were. We now deem this forecast to be realistic.

Adhijit will take the second question.

Adhijit Bhattacharya: Yeah. So, on profitability for the first half versus second half, Hassan, the way to look at it is normally we do about 45% of sales in the first half, 55% in the second half. And from a profit perspective, it's between 65% to 70% in the second half. This year, it'll be slightly higher because the pricing actions that we take will come in the

second half, as well as if you look back, I think, at 2020, you will see the split of first half, second half profit similar to this year.

On your question on Connected Care, the profitability in Q4, you're right, nothing much changes between Q1, Q2 and Q3 but in Q4, where we hope to get our patient monitoring supplies back on, we will – the profitability will increase. So overall, the second half profitability will be good, but more skewed towards Q4.

Leandro Mazzoni: Respironics assumptions.

Roy Jakobs: Maybe I can talk to the Respironics assumptions. You saw a slide where we showed you that we will resume gradually sales from 2023 onwards. That, based on the progress we are making in the remediation of our recall, where to date, and we shared that, we have already produced 3 million devices to do so. We also share that we will have 90% completed by the end of the year. And we will, indeed, use part of that capacity also to ramp-up further into the outgoing years.

This does include the remediation of the 483 but, as you mentioned, indeed, we only got the consent decree terms last week. We started the dialogue on that with the DOJ. So those are not yet included in the outlook for SCC[?] business towards the outer years.

Frans van Houten: Then let me comment on the ramp-up for the midterm. We have confidence in the 4% to 6% growth. We have been growing at 4% to 6% in the past and we have, of course, seen a lot of put and takes due to COVID and the ramp-up due to the crisis response. But the 4% to 6% is something that we have been consistently doing before.

As to the profitability expansion, that will come gradually over the years. We do not want to give specific guidance for 2023 at this time, also given the macro environment. We expect the improvement actions to quickly contribute to the bottom line improvement. I repeat also there, the pricing and the productivity improvement, the step-up of €100 million of cost already this year and of course next year, will all contribute to a quick step-up of profitability. But we are not quantifying, at this time today, specifically, what 2023 will deliver. I will do that hopefully later in the year.

Let's go to the next question then. Sorry, Hassan, you still had a follow-up?

Hassan Al-Wakeel: No, no, it was just a clarification. So, just to be entirely clear, the consent decree is not in your Sleep assumptions that you laid out in July 2020 and therefore not in your overall midterm targets either.

Frans van Houten: Yeah. Let me clarify, Hassan, because the remediation actions in relation to the 483 findings of last year are already in our profitability. Every quarter we have about a €40 million remediation cost that is absorbed in the results today, right? What Roy was referring to is, let's say, the full understanding of consent decree terms. And, of course, those need to be discussed. To the extent that they would exceed the remediation already put in place and in motion by us since December last year, that that could change that scope. But I want to be clear that a significant effort is already underway that remediates the 483 findings.

Hassan Al-Wakeel: Thank you all very much.

Frans van Houten: Right. Next questions.

Operator: The next question comes from David Adlington of JP Morgan Cazenove. Please go ahead.

David Adlington (JP Morgan Cazenove): Thanks for taking the questions, guys. Firstly, just on the order environment, I just wondered if you're seeing any signs of orders going down or any cancelled orders, because hospitals do appear to be getting a bit more cautious.

And then secondly, just in terms of the midterm guidance, you've lowered the bottom end of that range from 5-6% down to 4% but your margin assumption hasn't changed. So we are in a very different place with respect to inflation. I just wonder what your inflation assumptions were on the cost side. You pulled[?] up, I think 6-8% cumulatively from 2023 to 2025. Just wanted [inaudible] way you see the risk to that. Thank you.

Frans van Houten: Yeah. Thanks David. Let's first talk about the CAPEX environment. Western Europe, I think we would all assume that that's a market that is hit more severely, yet our order growth in Western Europe was around 35% positive in the second quarter. In other words, you cannot automatically correlate, let's say, macro sentiment to hospital investment behaviour.

Now, if I also make a comment about North America, some caution was already there at the beginning of the year. And then I was actually surprised, and positively surprised, by my dialogues with the C-suites of various large hospital groups, but also confirmed by a recent press release of a very large hospital system, that there will be significant CAPEX layouts in the coming period. We see, I think, across the world, a pent-up demand in elective procedures, hospitals are keen to expand on ambulatory surgical centres, they're keen to upgrade patient monitoring. Very much focus on improving staff productivity because the burnout of staff, the issues around retention and the staff cost have risen so much that the business case to leverage technology to improve staff productivity is very high.

So I see actually in the turmoil of the world, a confirmation that our strategy around solutions is highly relevant and we have more C-suite engagements than ever before.

Now, that leaves perhaps in discussion around China where a lot of turbulence in the first half year has occurred, coupled with the tighter application of 'local for local' rules, the IPPA import legislation, has led us to speed up our 'local for local' strategy. We do think also in China that structural hospital investments will resume, already starting the second half of the year, also aided by government investments. So, overall, we are not negative at all about hospitals investing in technology.

Now, then on your question with regards to inflation assumptions, I think in April we spoke about a 2.5% inflation and in the meantime, we have raised that to an average of 3%. And then Adhijit explained in his nice cumulative bridge that our overall inflation numbers are pretty elevated. Still, there could be risk around it, we are realistic, but if inflation would be higher, we would commensurately also up our price increases. Already today, we are working on the 2023 price increases, because we have learned that it takes time to work all of that through the system.

Anything to add there, Adhijit?

Adhijit Bhattacharya: No, I think you're absolutely right. So, in the bridge, it's 6% to 8% and, as Frans mentioned, if it goes up, then we will have to compensate via pricing. And if

not, then we have some flexibility to bring it down. So, we've taken fairly reasonable assumption, the current 3% we expect to taper down a bit.

Frans van Houten: Yeah. And Leandro just reminds me that if we exclude China from the second quarter, actually the Diagnosis & Treatment orders are up 9% – that back to your first question, David.

David Adlington: Perfect. And maybe to follow up on that pricing environment, particularly in PH, I'm just wondering if you're seeing any changes in demand in response to those higher prices.

Frans van Houten: I would say the China demand is very much related to the lockdown and has caused a major slowdown in that market. Whereas in the United States, demand for Personal Health has been very strong, also on the back of a good renewal of the Oral Care range. The 4% to 6% growth prediction, which of course includes price rises, does inherently reflect a more cautious outlook on the macro environment in terms of volume growth, right? So if you look at that bridge, actually volume-related leverage is a tad more conservative, whereas our cost measures have been stepped up to compensate, right? So, in that sense, the 4% to 6% that we talk about now is somewhat different than the 4% to 6% of two years or three years ago when there was actually net price decline, whereas now we are seeing net price increases. I hope that helps, David.

David Adlington: Very clear, thank you.

Operator: The next question comes from Julien Doumergue of BNP Paribas, please state your question.

Julien Doumergue (BNP Paribas): Hi, good morning, everyone. Thanks for taking my questions and thanks for the comprehensive day this morning. I will commit myself to two questions. The first one relates to the competitive situation and more particularly, Imaging and Ultrasound. There's been some noise that maybe one of your peers, General Electric, would be turning a bit more aggressive at this time. So did you see any noticeable change in the competitive situation in the space at the moment?

And the second question relates to the consent decree. So, actually two questions in one, but just making sure I understood correctly that any cost that would be related to the consent decree would be treated as incidental, so just making sure that this would be the case. And the second question relates to the implications of a potential consent decree on innovation because in some adjustment segments of med tech, whenever there's a consent decree, typically, it can reduce your ability to get new products being approved. Is that a concern we should in mind for the seed[?] business or is that relevant at this stage? Thank you.

Frans van Houten: Yeah. Hi Julian. I don't see fundamental shifts in the competitive landscape. There can always geographically be, let's say, puts and takes on the behaviour of individual competitors but across the board, we have been holding our ground on market share. In fact, in many areas, we've also seen increases, notably Patient Monitoring, Ultrasound, Image Guided Therapy. Also, the new imaging systems like MR and CT have been very well received. And on Informatics, we are a leader and we are holding our ground. So that doesn't really concern me.

Then, Leandro just tells me that MR – and that I should also mention MR orders are very strong, which we are very proud of.

Then perhaps related to the second question, Roy, if I can pass that to you.

Roy Jakobs: Yeah, on the consent decree, so two questions, one on the cost, whether they're adjusted out. As we did with the consent decree for the Emergency Care HPM business, we did adjust them out. As we also said, we are only just beginning the discussion with the DOJ. We received terms last week. We are in confidential discussion so we cannot disclose yet what the terms are and what impact they will have. But we understand that you're very much interested in that and the moment we can share, we will share more details around this.

Leandro Mazzoni: The second question on innovation.

Roy Jakobs: So, on the innovation question, I think, like we have seen also in other – take the monitoring consent decree that we have been working through, whilst you work through the remediation of any request like we are now doing with the 483, in parallel, we have been building up a very strong portfolio. And actually what we see in the HPM business to date, as also witnessed by our order book, we have an extremely strong order book and a very compelling proposition. So whilst you need to, of course, divide resources and you need to spend considerable amount of time on remediation, at the same time, you also continue on rebuilding your innovation.

And that's the same actually that we are doing with Respironics. We already started last year with rethinking how we are going to go back into the market. You saw our re-entry plan. And actually we have a plan ready to rebuild our position in Sleep and Respiratory Care. And we are also hear from the market that they're actually waiting for us to come back. So we are still going in full after that whilst we work through the remediation of any quality issue out there.

Adhijit Bhattacharya: Maybe also good to clarify, Julian, that Frans mentioned earlier that we had guided to the 483 remediation cost of €160 million for the year, which is around €40 million a quarter. So that is in. So, if the consent decree has any further measures to the 483, only that will come on top of.

Julien Doumergue: Okay. Thanks for clarification.

Operator: The next question comes from Graham Doyle of UBS. Please state your question

Graham Doyle (UBS): Morning. Thanks for taking my question. It's just one around guidance for this year and then longer term. So you've talked about this being a relatively conservative guidance, but it relies on quite a large Q4. Can you just give us a sense as to what you think is in the bag at this stage as you look to Q4, particularly around things like costs and your supply chain? And maybe gives us a sense of how you feel in terms of confidence on the new guidance for this year versus, say, when you guide in January?

And then just to follow up around the 2025 guidance, what is the purpose of that if we don't have anything in for consent decree? Should we read anything through to that? Because it just seems unusual to give us this number, given that that remains a big uncertainty. Thank you.

Frans van Houten: Yes. Well, I think your first question relates back to also my answer to Hassan, where I said the order book underpins the revenue growth of 6% to 9% for the second half of the year. The commitments from suppliers of semiconductors, as well as our actions to dual source ultimate parts, underpin the supply requirements for the second half year. Having said that, I did observe that it will be more fourth quarter weighted than third quarter so there is still a ramp-up path. The profitability will be greatly helped by the higher volume, as well as factory utilisation, next to the fact that it is a more favourable mix with high profitable products like Ultrasound, IGT and Patient Monitoring coming through.

Moreover, more of the price increases in Personal Health will come through. We spoke about mid-single digit price increases in Personal Health. We expect them to come through in the second half of the year, while on health systems, there's a time lag and the majority of the price increases only will materialise in 2023.

Yeah, then on your question with regards to the midterm targets, I dare say we have said now that the remediation effort to the direct observations of the 483 of last year's inspection are fully being worked. And that is in the plan. I acknowledge that the consent decree represents a risk to, let's say, the improvement of profitability in especially 2023 and maybe in 2024. But we are confident that we will have resolved all those issues by 2025. And this is – 2025 is a 14% to 15%. In the early Q&A, I also said I'm not going to give specific guidance for 2023 as they're still moving parts to the guidance of 2023. I hope that that gives you a better understanding.

Graham Doyle: No, that's really clear, and I'm just – it's not a 2023 guidance number, but just, relative to what you said before, when we think about the Sleep ramp-up, I think the phrase is gradual resumption of sales in the presentation. When your base case – when you refer to gradual resumption of sales, what do you mean by that? Because it sounds like there's this big pent-up demand and you've got this massive expansion of supply. So why would it not just be a really quick, sharp ramp-up in sales?

Frans van Houten: Yeah, well, you've seen in the table that Roy presented that actually you see the base of the sales of this year, right, so the business has not disappeared completely. There's, for example, mask sales ongoing and then we need to get back into the market after remediation of all the patients that are waiting. We have taken a cautious approach and I think that is, yeah, I would say advisable. And when we are later in the year, perhaps in the December timeframe or January, I think we will be being able to tell you more about the exact ramp-up in 2023.

Graham Doyle: Fine. That's really clear. Thank you very much.

Operator: The next question comes from James Vane-Tempest from Jefferies, please state your question.

James Vane-Tempest (Jefferies): Yes. Hi. Thanks for taking my questions. The first one, please, the negotiations on a possible consent decree. This often takes longer and is more expensive than many people think. So my understanding is the facility in question, before the recall, supplied more than half of the entire Sleep and Respiratory business to the US. So given we've gone beyond a warning letter now, what disruption to the US business do you envisage for the overall Respiratory business?

My second question is on slide 32, the productivity, 2022 to 2025, you've qualified in the footnotes, these are gross productivity initiatives before inflation. So how should we think about these on a net basis?

And then my final one is just follow up on your assumptions of customer behaviour for order conversions. We know that there's pent-up demand for electives and staff costs have gone up, but there are some industry concerns, hospitals will divert cash into higher wages or postpone orders if they can't get the staff to maximise returns on new CAPEX or even look to extend payment terms. So are you seeing any of those trends? Thank you.

Frans van Houten: Yeah. On the first question, look, we have said the consent decree proposal was just received last week and we can't really comment any further on it. I'd like to be as transparent as possible, but we really have to leave it at that. And Roy prescribed how we will gradually ramp up the business, but obviously we are not going to give a near-term forecast for 2023. So apologies, but we have to leave it at that.

Then for the second question, perhaps Adhijit, you would be willing to take that one.

Adhijit Bhattacharya: Yeah, sure. So when we talk about growth of inflation, we've given in the bridge separately that we expect 6-8 basis points of inflation over the years. So if you take 3% for this year and then gradually coming down, that's how you will see the net impact of productivity minus the inflation. And this productivity is part of the bridge that we've shown anyway. So, you have two blocks there, you have the non-manufacturing cost productivity and then some of it in the gross margin, because there you get on the cost of goods sold and in our manufacturing cost. That's how you should look at it.

Operator: The next question comes from Falko Friedrichs of Deutsche Bank. Please state your question.

Falko Friedrichs (Deutsche Bank): Thanks very much. Good morning, everyone. I have two questions please. The first one is on the margin headwind from the lockdowns in China, which were quite significant, it looked like. If there were to be another lockdown in China over the next few months, which, given the country's COVID policies, could be a possibility, were there any learnings or was there any way – is there any way to prepare you a bit better for potentially next COVID lockdown so that the margin impact would be a little bit less?

And then my second question is on your Personal Health business – it actually has two parts. So the first one, when I look at Q2, it was a pretty strong performance in North America while pretty weak in Western Europe. So I'm trying to understand the big difference between these two regions in Q2. And then thinking about the midterm, your midterm margin outlook doesn't imply much improvement in Personal Health. So just wondering why that is. Thank you.

Frans van Houten: Yes. Hi, Falko. Indeed, the margin headwinds from China in the second quarter were significant – twofold. On the one hand, a significantly reduced revenue base; on the other hand, factory closures and also impact on the global supply chain and, thereby, reduction of high margin products like ultrasound not materialising in the quarter. The lockdown in China in the first and second quarter was very strict. And I think in the meantime, the government has signalled what they call the dynamic COVID Zero policy, which is much more surgical and, let's say, geographically located versus broad based. But I

would be the last to say that COVID is over, and it still poses a risk, but I do think in China the kind of strong action has been moderated a bit. So, in that sense, I'm less worried that we would see this massive lockdown happening again.

Now, as to building supply chain resilience in the midterm, because it will take some time, we are diversifying our manufacturing into regional hubs – that was a strategy that we already had, but we are accelerating it – to make our dependence on one particular region less. I think that will then all help in the future to avoid these issues. Also, second sourcing, as we qualify ultimate suppliers, will help us a lot.

Now, maybe Adhijit, if you could take the PH guidance question.

Adhijit Bhattacharya: Yeah. So, I think couple of things you called out, strong demand in North America, that is a fact. I think with inflation that we are seeing in Western Europe, it comes – we saw sales slightly weaker, but you must remember that Personal Health compared to last year, where we had a 33% growth, the comparables are extremely difficult. So I think you will see further growth, but not as strong as in North America. And in the other growth geographies, be it, India, LATAM, Middle Easy, Turkey, that demand still continues to remain very strong.

Regarding the guidance, I think overall, as Frans has mentioned, we have tried to be a bit prudent because we are going to drive good growth and we need to make the investments in advertising and promotion to drive that growth. And if we get the leverage and if inflation comes down, there's a possibility that we go to the higher end, but you're right, that it's not a very stretch guidance. So we have been in that range before, so it's a very gettable range. That's how I would look at it.

Falko Friedrichs: Okay. Thank you.

Operator: As a final reminder, if you would like to ask a question, please press star one on your telephone. The next question is from Ed Ridley-Day of Redburn. Please state your question.

Ed Ridley-Day (Redburn): Good morning. Thank you. Firstly a couple of questions for Francis. Thank you for the update on your quality control efforts, and for the disclosure. First of all, if we look at the 4,400 employees you have, could you give us some colour on how that's been added to in the last 12 months since the recall was first known? And also, in terms of the additions you've made, how many are permanent, what percentage are permanent, and what percentage are consultants? Any colour you can give us on that would be great.

And also, if I could say, I mean, really historically, Philips has not had issues with the product safety. The real concern's been obviously process and particularly as it relates to the FDA. So if there are any of those executives that you've hired or additional appointments that you've made specifically to the North American regulatory area, that would also be helpful.

Frans van Houten: Francis, would you have go at it?

Francis Kim: Sure. Thanks for the question. So we have added a significant amount of resources, additional horsepower. We added significant capabilities and competencies for the Respironics business. As you heard from in the presentation, we have added over 1,000 employees working on it. We continue to look at the overall strength and the complementary

efforts in adding those capabilities across the board. So we have, again, like you said, 4,000+ employees, we continue to make the appropriate level of investment and do the appropriate level assessment. So, I feel very confident about we are strengthening and we're absolutely also beefing up not only processes, as I mentioned in the presentation, the standardisation, as we're looking at both compliance and the product quality. So we're looking at that across the board.

Of course, we use sometimes consultants or contract employees where we need to bring additional resources to address these actions that we committed in addressing for the agencies. And we will deliver on those as we go.

As far as on the product quality and looking at the overall safety areas, as you saw, it's not a new focus for Phillips but we are further beefing up and enhancing that. And as you saw in my presentation, we looked at, of course, about the overall governance and the controls and anything[?] on the top of the list on any conversations and the prioritisations. So from a patient safety and quality point of view, again, the company is leading forward, everyone is excited, everyone is leaning in and got a tremendous amount of support.

So I think overall looking at the overall picture of it, where we're heading, I think we're going to be much more elevating and operating at a higher level. So hopefully that answers your question.

Frans van Houten: Yeah. And maybe a reference point, Ed, I recall that some five years ago, we came from the low 3,000 employee count. And so we have added over 1,000 people in the last, I would say, three to four years and much under Francis's leadership.

Francis Kim: So, let me, if I may add, also, as I mentioned in my presentation, we're also leveraging a number of independent, external advisors so that we want to make sure absolutely, as we go through this process, again, we're not missing anything and that we're doing it really, really a thorough job. So, again, appreciate the question.

Frans van Houten: Yeah. And Francis, you have also hired an external firm to audit ourselves, right, which, I think, is also something that should lend credibility to the improvement actions.

Francis Kim: That's correct. Yes.

Ed Ridley-Day: Thank you both. Francis, thank you very much for the additional clarity. Just a quick follow-up on China manufacturing. Again, thank you for the disclosures related to – for local manufacturing, the progress you're making there. Can I flip that round and can you update us on what proportion of your ex-China revenue is still reliant on China's manufacturing and maybe by 2024, 2025 where you hope to reduce that to?

Frans van Houten: Well, that's a more complex question than meets the eye because even when we shift final assembly to Europe and the Americas, then the underlying component makers still often are China bound and that may be all the way into resistors and capacitors, right? So I'm not sure that we have a percentage number off the top of our head here. Maybe we'll take that, Ed, and we will study it because I think if I would just give you a percentage of final assembly, it would not be as meaningful as perhaps the depths of your question would warrant.

Ed Ridley-Day: That's fine, Frans, thank you. And I think it's fair to say that as you've discussed with – whoever you are discussing in terms of sourcing, you are working towards reducing that dependence on third-party suppliers in China?

Frans van Houten: Yes. At least dual sourcing, right, because I think what all the geopolitics have taught us is that, yeah, risks can come from many areas and resilience means dual sourcing, regionalisation but also having one source in China and having another source, for example, in Europe or in the US, right? And then you build resilience and that's what we are after.

Ed Ridley-Day of Redburn: Great. Thank you.

Operator: The last question today comes from [inaudible] of Societe Generale, please go ahead with your question.

Speaker (Societe Generale): Thank you very much. Hi. I was just wondering regarding your inflation assumption for 2023-2025, wondering on what is the reference for the 6% to 8% that you are targeting over the period. And when you say you're going to make already a 5% increase in PH and probably later on into D&T next year, some of the products, so how do you think about your pricing mix, COGS impact and action you are going to put in into play for the next two years? Because we are ahead of a big wave of inflation probably not ending very soon. So just wondering how you see the future exactly.

Frans van Houten: Yeah. The bridge that Adhijit presented shows 6% to 8% of inflation. We have already said this year, about 3% and next year, we would likely see something like 2% to 3%. If that's going to be higher, we will raise prices further. I don't think anybody knows how long an inflationary period will be with us. But we have quickly redeveloped the muscle of price increases as opposed to price declines.

The fact that it takes some time actually goes back to a relative strength, right? We have an order book that has a 1.17 book to bill. It's at the highest point since I remember and the coverage is still increasing. Now, of course, the implicit point of that strong order book is also that you have prices coming out of last year, right? And that is why on the Health System side, it will take some time to work the price increases forward.

Now, we have price indexation on service contracts. We are increasingly putting in price clauses also on freight and on other materials so I feel that we are going to be better geared to handle subsequent inflation. And the productivity measures will certainly also contribute to bottom line improvement.

Anything to add, Adhijit?

Adhijit Bhattacharya: Yeah, but also as the supply situation eases, right, you will get a bit of a benefit. So right now, the impact that we have of spot buys, etc., we expect that to ease more into the second half of next year. And then going into 2024, 2025, we expect, especially from a bill of material point of view, that we can start seeing decreases again. So quite heavily built in, as well as the automation plans for our factories is something that is going to drive our – or at least help us to compensate for that impact. And then whatever else remains on top of, into our guidance to improve overall company profitability, that we will address through pricing, as Frans mentioned and we've clarified multiple times in the call.

Operator: Thank you, gentlemen. That was the last question. Please continue.

Concluding Remarks

Frans van Houten

CEO, Royal Philips

Okay, well, look everybody, thank you for joining. We wanted today to give you a more comprehensive overview, and this is why we are all here together, and we took a bit longer to present to you insights.

So the key takeaways, we are getting a handle on the results of 2022. I call it, in fact, a pivot point, a hinge moment from a negative first half to a resumption of growth in the second half, and where cost productivity and pricing and supply chain actions underpin a 6% to 9% growth for the second half year. We are laser sharp focused on near-term improvement of results.

Secondly, our innovations continue to be in good demand. I spoke to the strong order book, the order growth. We also talked a bit about CAPEX environment. We continue to expect good momentum, also looking at the opportunity funnel of all the propositions and the quotations that we have outstanding for the second half of the year.

Then, we are working diligently through the recall. It takes time but at least with the 3 million units now produced and the repair kits underway, we have a handle on it. We will go to 4X capacity as of this summer and we will be reaching the 90% point towards the end of the year.

So also that is in hand. I understand concerns and questions around consent decree. But I think we flagged before that this was going to come, this enforcement action, and we now need to dialogue with the FDA and the DOJ to conclude on that. So we are, let's say, taking issue after issue; we solve them, we move on. Litigation, similar discussion. We have comprehensive testing. I have to stress that the results of the testing are very encouraging. I know that that it is heavily being debated, but the case for dealing with the litigation is getting stronger from our point of view.

Now, the final piece of the testing is going to become available in the coming months. But also there, we are confident that that will lead to a good outcome. It all takes time. I realise that it's frustrating, but we need to be thorough because we only get one shot at the defence line on the litigation. And we are taking that very thorough approach.

And then we have given you an updated guidance for the midterm that is arguably less ambitious than the previous guidance. We take into account macro, we are raising prices, we have a gradual step up of performance, also very much helped by productivity actions as we have stepped up cost savings by €100 million already this year. And we'll do that for every year for the coming years. And we'll make sure that it lands into the bottom line so that gross savings are also net savings.

With that, ladies and gentlemen, I very much want to thank you for your attention. And we will take the company forward from this point onwards.

[END OF TRANSCRIPT]