

# FINAL TRANSCRIPT

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**PHGFF.PK - Q3 2010 Royal Philips Electronics Earnings Conference Call**

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Oct. 18. 2010 / 8:00AM, PHGFF.PK - Q3 2010 Royal Philips Electronics Earnings Conference Call

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## PRESENTATION

**Operator**

Welcome to the Royal Philips Electronics third quarter results 2010 conference call on Monday October 18, 2010.

During the introduction, hosted by Mr. Pierre-Jean Sivignon, CFO, all participants will be in a listen-only mode. After the introduction there will be an opportunity to ask questions. (Operator Instructions) Please note that this call will be recorded and is available by webcast on the website of Royal Philips Electronics.

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

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

Good morning, ladies and gentlemen. Welcome to the conference call on the third quarter results of 2010 for Royal Philips Electronics.

As usual, Philips' Chief Financial Officer, Pierre-Jean Sivignon, will take you through his introductory remarks on the business performance. After this, we will open up the line to take your questions.

Our press release and accompanying information slide deck was published at 7am this morning. Both documents can now be downloaded from our investor relations website. We will also make available a full transcript of this conference call on the investor relations website by tomorrow morning at the latest.

With that, I hand over to you, Pierre-Jean. The floor is all yours.

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**Pierre-Jean Sivignon** - *Royal Philips Electronics - CFO*

Thank you, Abhijit. Good morning to you all. I'm pleased to announce that, for the fifth straight quarter, we have delivered a strong earnings performance. Actually, we've delivered an adjusted EBITA of 10.6% for Q3 this year which is, of course, a significant improvement over the 6.8% we delivered last year.

Our reported net income increased to EUR524 million, which is up from the EUR176 million of Q3 '09, which is mainly resulting from A, higher EBIT across all sectors and, of course, higher financial income compared to last year.

Adjusting our net income for the one-time gain of EUR154 million on the sale of NXP shares to the Philips UK pension fund, our net income rose to EUR370 million for the third quarter of 2010. This is significantly higher than the EUR146 million for the same period of last year after having adjusted for the EUR30 million gain on the partial reversal of the TPV impairment loss which was actually booked in Q3 last year.

On the balance sheet front, the working capital increased from minus 1% of sales in Q3 of '09 to plus 5.7% at the end of the third quarter this year. But the main reason for this is a reduction in the pension liabilities. If you exclude the effect of pension, the working cap was actually lower than last year as a percentage of sales by 1 percentage point.

Our inventories are higher, and I will go into this into a bit more details a bit later.

Before going through the numbers in more details, let me highlight some of the developments that we see in our external markets.

In Healthcare in the US we saw hospitals focus on lowering their operating costs and managing their ROIC. For those with relatively strong balance sheets, the availability of credit there has eased. Some uncertainty around healthcare reform remains, especially [with the] taxes that healthcare equipment will attract.

As expected, we see the easing of pent-up demand which show large multiyear deals in the first half of 2010. Through all this uncertainty we see robust demand in the emerging markets as more investments continue to be directed at these markets.

The Lighting market saw growth across the board with the demand for LED products continuing to remain very strong. The Automotive sector continued to remain strong although, as production aligned itself to sales, the growth rates dropped to high single digits from the rates of the previous quarters.



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Professional & Consumer Luminaires, which were weak in the previous quarters, showed signs of getting back on a modest growth trajectory. The Lamp market remained resilient during the period, and the Commercial Construction market remains tough.

In Europe construction starts are, at best, bottoming out. In North America construction starts and the forward-looking architects' billing index remain weak. Significant recovery in these markets before mid-2011 is unlikely.

In the consumer markets, consumer confidence in Western Europe and in the US remain fragile. As a fallout of this, in some specific product market combinations we have seen consumers trading down in terms of their choice of products. We continue to see the home audio market shrinking, although this was partly compensated by growth in the area of relatively newer technology like Blu-ray.

Health & Wellness, Personal Care, Domestic Appliances markets were buoyant. Consumer Lifestyle sales in emerging markets remained resilient.

As mentioned in the last quarter, TV inventory post the World Cup football championships in the retail channels were high, as a result of which the television market remained soft in the quarter.

Let me now move to the Philips Group results for the third quarter. For Philips, sales in the third quarter were nominally up 10%, on which currency had an impact of 9%, resulting in a comp growth of 1%.

Comparable sales, excluding Television, were up 4% in the quarter. The post World Cup effect on the sales of Television was quite significant, as I said, and as we had indicated to you during the Lighting Capital Market Day.

We made a conscious decision not to push sales at any cost, and to maintain margins. On the geographic basis, our investments in emerging markets continue to pay off with strong growth, driven in particular by Healthcare & Lighting. Emerging markets represented over one third of sales in the third quarter; actually 34% to be specific. Sales in Western Europe declined by 4%. However if you exclude TV, sales in Western Europe were flat.

Strong growth in Healthcare was compensated by a stronger decline in Consumer Lifestyle. The US was flat where the increased sales in Healthcare & Lighting was compensated by the decline in Consumer Lifestyle.

Reported EBITA was EUR648 million. That is 10.5% of sales, which is significantly better than the first two quarters of this year, and well ahead of the EUR344 million of Q3 last year.

Excluding incidental gains and charges, adjusted EBITA reached 10.6%; a record for a third quarter. Adjusted EBITA profitability on the last 12 months for Philips improved to 10.8% of sales, calculated on a MAT basis.

Free cash flow was a negative EUR200 million compared to a positive EUR353 million last year. That negative free cash flow was mainly due to higher capital investments than Q3 of last year, and those investments were essentially in Lighting. And due as well to an increase of working capital compared to Q2 2010. And I will come back to that.

With that summary, let me now take a closer look at the performance of each of our businesses during the quarter, starting with Healthcare.

Sales at Healthcare were nominally up 14% versus last year. And if you correct for currency on a comparable basis, sales were up 4% versus last year, with all businesses delivering higher sales in the quarter. Sales growth was strongest at Home Healthcare Solutions, showing high single-digit growth, and Patient Care and Clinical Informatics.



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Strong growth continued in emerging markets, particularly in China and India. Sales in Europe strengthened compared to Q2, with mid single digit comparable growth. And sales in North America were flattish.

We are encouraged by the continued growth of the order book and, in this quarter, equipment order intake grew by 7% on a currency comparable basis, and 20% for emerging markets. Currency comparable equipment order intake for the US showed a strong 11% growth, while emerging and international markets, including Europe, grew by 2%. Equipment order intake growth was mainly driven by Imaging Systems.

EBITA at Healthcare for the third quarter was EUR282 million or 13.6% of sales on a reported basis. If you now exclude restructuring and acquisition-related charges, EBITA increased to EUR288 million or 13.9% of sales, which is a substantial improvement versus the 11.8% profitability of Q3 last year. EBITA improvement was seen across all the board as all businesses delivered higher EBITA compared to the previous year.

Consumer Lifestyle, there sales grew by 1% nominally in the period, and on a currency comparable basis declined by 5%. This was mainly due to the post World Cup football effect on the TV business I already alluded to, as well as the impact on the brand licensing deal in China, which is currently being finalized, where sales slowed significantly in preparation for the transition.

This resulted in a comparable sales decline for the global TV business of 12%. If you exclude TV, the comp sales for the CL sector were down 1%. The sector saw some solid digit growth in the Personal Care and Health & Wellness businesses.

The Domestic Appliances business saw healthy mid single digit growth. This growth was compensated by declines in License revenue, as anticipated, as well as declines in the Audio-Video & Multimedia business, which showed some shrinking market in the third quarter.

The EBITA at Consumer Lifestyle improved from a profit of EUR129 million in Q3 last year to a profit of EUR149 million this quarter. Almost all businesses reported a higher EBITA compared to last year, except TV where the loss increased from [EUR26 million] (corrected by company after the call) in Q3 to EUR31 million in Q3 2010. But the main contributors to the additional loss was lower sales, but as well some currency headwind in the beginning of the quarter. And we actually saw the results of TV improving during the quarter as months went by.

Excluding restructuring and acquisition-related charges, EBITA for TV was a loss of EUR20 million. The team there, as already discussed, are heavily engaged in obviously trying to achieve the full year EBITA at close or at a break-even level, as already previously guided on.

As indicated in previous quarter, I would like to repeat that the License income for the first three quarters is ahead of last year by about EUR86 million. License income then, as a result of that, in Q4 is expected to be materially lower than the one of Q4 of last year.

At Lighting, sales grew by 16% on a currency comparable basis, which translates to a 7% growth once it's calculated excluding obviously the impact of currency.

LED sales was a star performer with growth of 68% on a nominal basis. And with this growth, LED sales now represent 14% of the sales of the Lighting sector. All the businesses in the Lighting sector grew in Q3 on a comparable basis which, of course, is very encouraging.

Professional Luminaires, which has been affected, as we know, and is still affected, by the construction market, delivered mid single-digit growth after 20 months. Geographically, strong sales continued in emerging markets, particularly in all the four BRIC countries. In mature markets as well, there was growth on a comparable basis.



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Reported EBITA at Lighting more than doubled from the EUR79 million in the third quarter of 2009 to EUR216 million, or 11.3% of sales, in Q3 this year. If you now adjust for restructuring and acquisition-related charges, Lighting reported an EBITA of EUR233 million, which stands at 12.2% of sales which, of course, is a significant improvement, versus a 7.4% equivalent amount for the third quarter of last year.

The reported EBITA for the third quarter at GM&S was significantly better than last year. There, the reported EBITA was a profit of EUR1 million. This quarter saw favorable impacts of EUR36 million, due to a pension plan change, as well as a EUR6 million impact due to a provision release. Q3 also benefitted from some tailwind caused by receipt of License income, which came a quarter earlier than what we had initially planned. We expect Q4 to be around the results announced for the GM&S sector for Q1 and for Q2.

Our reported net income increased to EUR524 million, which is up from the EUR176 million of Q3 '09, largely as a result of higher EBITA and higher financial income compared to last year. The higher financial income was a result of EUR154 million gain on the sale of the remaining stake in NXP to the Philips UK pension fund.

Despite higher earnings, income tax was at par with Q3 2009, mainly due, on the one hand, to the higher non-taxable income generated by the gain on the sale of the NXP shares, but there was as well the impact of a release of a tax provision.

While the year 2010 will obviously benefit from this effective tax rate reduction in the third quarter, going forward, and as already mentioned in previous calls around this table at quarter ends, we maintain the earlier guidance of clean ETR of 30% to 32% for full year and for the years to come.

Let me now look to cash and to the balance sheet. As mentioned earlier, our inventory is higher than last year. And there, there is work to be done in the fourth quarter in order to bring that back to the level we want it to be at.

Due to the effect of the World Cup football championship, sales in July and August were lower than planned, and that caused some build up of inventory in the course of the third quarter. Further, we were able to make some strategic purchases at significantly improved terms, which also resulted in a temporary increase of the inventory for TV.

Apart from these actions, and not related to TV, we have built some bridging inventory related to the closing of one particular factory, which, again, is a temporary event in nature.

Cash from operations of EUR8 million resulted in a negative free cash flow of EUR200 million in the quarter. The deterioration of cash flow compared to last year, where the free cash flow at Group level was EUR353 million, was mainly caused by the increased working capital as compared to Q2 2010. But there again, I would like to clarify that, if you exclude the impact of pension, the working capital for the Group at the end of Q3 2010 is 1 percentage point below what it was at the end of the third quarter of last year. So we continue to improve our working cap Q-to-Q on a consistent basis.

Ladies and gentlemen, let me now conclude on the financials by saying that it was indeed another solid financial quarter for the Company. We will continue to drive growth initiatives and operational improvements to further exceed the targeted EBITA before restructuring and acquisition-related charges of 10% for full year 2010. If you were to calculate it for the first nine months cumulative, that number currently stands at 10.1%.

Looking ahead, it's worth reiterating that the first half-year benefitted from a couple of supporting factors that will not repeat, of course, in the fourth quarter, particularly the additional working days in Q1. That has impacted, as we mentioned at the end of Q1, our Lighting business and our Healthcare business. And as far as the CL business is concerned, the positive timing of the License income, which I have referred to earlier on in this introduction speech.

Given the uncertain economic climate and the fragile consumer confidence in some of our markets, we take a cautious view on revenue development in Q4. We expect it to be a seasonally strong quarter as our growth business, as well as our growth



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geographies, will continue to deliver. Albeit, this will be counterbalanced by some year-end channel inventory management among our distributors and, of course, the continued soft construction market which, of course, impacts Lighting.

On the M&A front, during the third quarter we strengthened our clinical informatics portfolio with the acquisitions of Wheb Sistemas, a leading Brazilian provider of clinical information systems, and CDP Medical, an Israel-based company which provides PACS.

Continuing our commitment to invest in emerging markets, we acquired Shanghai Apex, which is a leading manufacturer of ultrasound transducers in China. And that strengthens our portfolio of high quality transducers, specifically aimed at the value segments for our ultrasound portfolio.

In Lighting, we strengthened our outdoor lighting portfolio with the acquisition on the street lighting domain of a control business from a company called Amplex, which is based in Denmark. And we expanded our professional luminaire portfolio with the acquisition of Burton, which is a leading provider of specialized lighting solution for healthcare facilities in North America.

Last week, finally, we announced the acquisition of Discus Holdings, the leading manufacturer of professional teeth whitening products. And we believe that this acquisition will broaden our own Healthcare portfolio within Health & Wellness, and provides a strong foundation for growth in cosmetic dentistry.

As a final comment, let me take the opportunity to remind you that we will update the market on our Consumer Lifestyle business as it is done customary, that's early December, with our new CEO of Consumer Lifestyle, Pieter Nota, being there, as well as his management, at our Capital Market Day in Amsterdam. And that will be, again, on Wednesday, December 1st.

On that same day, Jan van Leeuwen, who is the Controller of the Group, will also provide, among other things, our yearly customary updates on the pension position on that very same day.

With all that, I would now like to open the lines to your questions.

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## QUESTIONS AND ANSWERS

### Operator

Thank you, sir. (Operator Instructions) There will be a short pause while participants register for a question.

Our first question comes from Martin Wilkie from Deutsche Bank. Please go ahead with your question.

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### Martin Wilkie - Deutsche Bank - Analyst

Yes, good morning. Martin Wilkie from Deutsche Bank. A question on Healthcare. The 7% order growth is, I think, the fourth quarter in a row now where we've seen order growth ahead of revenue growth, and I was wondering if you could just give us some guidance as to when we could expect that order strength to appear in revenue. Is that something we should see in Q4/Q1? Or are there other things happening in the non-equipment business that we should consider in terms of translating orders into revenue?

And then a follow-up on Healthcare is just, it seems that the orders in Europe were particularly weak, I think on my calculations they must have been negative 6% or 7%; just to tell us is there something happening in that area in terms of austerity impacting Government orders? Or is that just some lumpiness in the business? Thank you.



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**Pierre-Jean Sivignon** - *Royal Philips Electronics - CFO*

Okay, good morning. I think on the first -- your first question is on the 7% on Healthcare, and indeed the mismatch that we've had for a few quarters now between incoming orders and revenue. I think the answer is that we are continuing to rebuild our backlog.

I think your point is valid. We have studied our backlog carefully; it has clearly increased. We don't disclose a specific percentage, but it has definitely increased in comparable terms versus what it was a year ago, and it is continuing to increase. I think you will see the impact of that next year.

Some of those orders, of course, were a bit longer term. But all in all, indeed, we are reconstructing the backlog. And if you study carefully the pattern of backlog and revenue, you will see that late '08/early '09, we have actually eaten up a little bit in the backlog during three quarters. You will see that, for three quarters consecutively, we were having comp growth north of the comp growth of incoming orders. But now for the last, I would say, three, four, five quarters it's a reverse, which means, yes, indeed we are building a stronger backlog for future growth; that's absolutely clear.

Your next question was just now on guidance for Healthcare revenue for this year now, and not for future year. I think that the guidance, we are still shooting for mid single-digit guidance growth for Healthcare for the year. I think that's the kind of number we continue to shoot for.

In terms of the 7%, yes, the 7% is made of several things. It's made of a strong number, as mentioned, for North America; it's made of a very strong number for emerging market, 20%, I've mentioned that. If you talk about Europe, Western Europe was actually, I think, mid single-digit growth. So Western Europe was actually strong; Southern Europe and Eastern Europe was indeed weakish.

I think that's probably -- you have to distinguish Western Europe doing well and Southern Europe and Eastern Europe being, I would say, not so well and actually a negative. And I think that's a trend we have seen as well in the previous quarters, so there was nothing really new there.

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**Martin Wilkie** - *Deutsche Bank - Analyst*

Okay, thank you.

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**Operator**

Thank you. Our next question comes from Andreas Willi from JPMorgan. Please go ahead with your question.

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**Andreas Willi** - *JPMorgan - Analyst*

Good morning. My question is relating the inventory you speak about in your outlook statement in the channels; maybe you could give us some indication there. You see that potential inventory trimming, is that in relatively low margin Consumer Electronics products and, therefore, it's not going to matter too much? Or is this more widespread across some of your other businesses in Consumer, maybe also in other areas?

And the follow-up question on the TV business. I know your position on that in terms of a strategic view longer term; has the fact that we've had this volatility again this year with World Cup boost and then back to negative growth and losses and all the old issues we have seen in the past, is that changing your view about this being still a part of Philips going forward?



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**Pierre-Jean Sivignon** - *Royal Philips Electronics - CFO*

Okay, I'll take them one by one. First of all, on the inventory in the channels, your question was on Lifestyle. Basically, when I refer to inventory, I refer to only inventory; I think inventory of Philips. And a lot of it actually had to do with TV; was high at the end of Q3 and we planned to dispose of that inventory in the course of the fourth quarter. So that's for the Philips inventory.

Now, if I move to the inventory in the channels, there I would like to say two things. First, I would like to talk about Lighting because the closing comments actually was related as well to Lighting. We've seen a little bit of destocking in the Lighting channels in the latter part of Q3, and we think it will continue in Q4.

So the first element of the destocking, I would say, is probably to be referred to Lighting. And as you remember, we have seen an enormous amount of restocking in Q1. So we are seeing, end of Q3, and probably we should expect that as well a bit in Q4, some destocking in the Lighting channels.

As far as the Consumer channels are concerned, there I don't have any particular information, because I haven't had access to inventory in the Lifestyle channels. The only thing I have said is that we expect, of course, that retailers, on the back of the lessons learnt at the end of last year, will be disciplined on their year-end inventory. And that's what we meant in our closing statement in the press release. But we don't have specific information. The only specific information, again I repeat, were more related to the Lighting channels.

Your next question was related to TV. Well, on TV, I'd like to give a few figures just to say where we are on TV year-to-date. Actually, our TV business year-to-date, that is to say at the end of September, grew 12%. If you look now at the adjusted EBITA of TV again at the end of Q3, we have a loss of EUR40 million this year, versus a loss of EUR150 million last year. And the guidance obviously remains to be as close as possible to break-even for the year.

I'll give you a few more elements, a few more color on Q3. One is that, in Q3, we obviously still had the losses on the back of our Chinese business, because that business still hasn't closed. The brand licensing agreement still hasn't closed, so that is obviously still impacting our Q3. And the other thing I want to say is that, in the early part of Q3, we took some front wind coming from currency. And with those elements, of course, improving [a lot] of the way in Q4, we expect to deliver on our commitment to be as close as possible to break-even for the year.

So the answer to your question is our TV business, as you know, is not one business model; it's a sigma of business models. And we continue, yes, to believe that it should be part of the Philips portfolio.

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**Andreas Willi** - *JPMorgan - Analyst*

Thank you.

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**Operator**

Thank you. Our next question comes from Gael de Bray from Societe Generale. Please go ahead with your question. Gael de Bray, your line is now open.

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**Gael de Bray** - *Societe Generale - Analyst*

Yes, hello. Gael de Bray from Societe Generale. I've got a few questions for you, please; the first one relates to your acquisition strategy. In your current pipeline for M&As, is there anything that looks potentially like Genlyte or Respiroics in terms of size?



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Or do you now consider that the Group has been successfully repositioned, strategically speaking, and that only bolt-ons will happen over the next few quarters?

Also, one question on the growth pattern in the Lighting business. Excluding LEDs, it seems that actually the Lighting growth was pretty soft, probably around flattish organically; is that right? And how confident are you that the business will deliver 7% to 9% growth, as you recently highlighted at your Capital Market Day, especially when the LED growth will gradually soften down from the 68% growth you've achieved in Q3?

And the third question would be about your capital allocation. Obviously, you will likely end up this year with a net cash position, so did you think now the timing looks really appropriate to reinstate a share buyback program as early as of next year?

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**Pierre-Jean Sivignon** - *Royal Philips Electronics - CFO*

Okay, I think let's take your question one by one. Acquisition strategy, I think you could see that this quarter we've [done] actually five small acquisition, largely in emerging markets. The acquisition in the domain of white teethening was slighter bigger in terms of size.

Could we have larger projects in the pipeline? Well, you mentioned Genlyte and you mentioned Respiroics; those two projects were of different size. But could we have larger projects in the pipeline? Yes. Doesn't mean that we will do larger projects, but we've always said that we are looking at projects continuously, small, medium. Do we look at transformational projects? No. Do we look at larger projects? Yes. But again, we've been doing that for quite some time, and we would only do that if that makes sense.

And since you ask that question, I want to emphasize that we had showed you. in the London Day. the ROIC at the end of Q2, and compared to the WACC. And you can see that at the end now of Q3 that ROIC has reached 10% versus a WACC of 8.1%. So those are numbers basically which shows that our acquisition strategy, all in all, is creating value.

On the Lighting growth, basically, the growth was -- yes, we had absolute a strong first quarter, 22%; Q2 was 13%; in Q3 we have 7%. So yes, we feel that the guidance which was given for the year will stand at the Lighting Day.

I think the one thing though I should mention on Lighting is two things. First of all, the perception you might have that the non-LED product categories didn't grow, I think is not correct. Actually, all the product categories grew. Lamps actually was, I would say, low single digit; Prof Lum was mid single digit; Lighting Electronics was double digit; Lumiled, we've mentioned that; Automotive was high single digit; and Professional Luminaires went back into positive territory with low single digit.

So, I think even if you exclude LEDs, the whole Lighting portfolio grew in that third quarter. And year-to-date, just to finalize the numbers, we are at 12% growth for the comp growth of Lighting.

I think the last question you had was related to the net cash position and share buyback. I think we have outlined or kept a reallocation strategy in London. I think there was a dedicated slide there; I think I want to stand by that slide.

So now specifically in terms of share buyback, definitely not this year, for a number of reasons, including the fact that if we were to do something this year it would have totally adverse tax consequences, and I think we've been open about that in previous calls.

Looking forward, we will have to see. It's one of the four elements on the capital reallocation strategy; it's on that slide. And it will depend on the amount of cash to be reallocated at the time. And I think that's all I can say at this particular point of time.

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**Gael de Bray** - Societe Generale - Analyst

Okay. Thank you.

**Operator**

Thank you. Our next question comes from Ilan Chaitowitz from Redburn Partners. Please go ahead with your question.

**Ilan Chaitowitz** - Redburn Partners - Analyst

Good morning. Thank you for taking my questions. Firstly of FX, there was quite a strong impact on the top line in the third quarter. I was wondering if you could give us some insight into how currency moves might have impacted your gross margin, which was very strong, and your EBITA margin.

And the second question related to Imaging Systems and some positive news we heard out on Friday with regard to pricing. Can you give us some indication how you are seeing pricing for Imaging Systems play out in the US and Europe, please?

**Pierre-Jean Sivignon** - Royal Philips Electronics - CFO

Okay. FX, yes, you are correct and it's totally disclosed in great details. There was, of course, I would say, some abnormally high impact in terms of currency when you calculate the difference between the nominal and the comp. And you have that all disclosed between the various sectors, so I won't come back to that. All of it is in the release.

The second part of your question on ForEx is -- because, indeed, you are absolutely right. We have significant increase of our gross margin, and that's almost true across all sectors expressed in percentage. That is gross margin.

Has that impact helped incentivized or else by currency? The answer is no. As we discussed in -- but I will make one exception to that, which is TV. And I'll come back to that in a second.

But for all the other product categories, the answer is pretty much no. And we are essentially, in terms of exposure versus currency, we are essentially balanced.

The one business where that is not the case is TV, and I mentioned that in my opening speech. There we were hurt by currency; in particular in the first half of the quarter it reversed. And one of the things we're looking at, we've almost made that decision, we might revise a little bit of ForEx strategy for TV in order to avoid that volatility in the quarters to come. So that is a problem that we will be addressing in the quarters to come.

But, with the exception of TV, I would say that ForEx did not have an impact on the improvement of the gross margin. And the improvement of the gross margin and of the EBITA, by the way you've seen, is totally genuine.

Your next question was on pricing and, in particular, on pricing in Healthcare and pricing in North America. I think the best way to essentially talk about pricing is to look at gross margin. Because this is the -- and I've said that on previous calls -- that is what never lies. Your gross margin will go up if you do a good job, of course, in cutting your costs and purchasing right. But if you don't do your homework on pricing discipline, your gross margin will not improve.

That gross margin is disclosed at the Philips level. It's not disclosed, of course, by sector. But you can see the improvement of the gross margin at the Philips level; it's reported. But if you could see the gross margin across the sectors you would see progress there.



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So I think that's a good indication that, in terms of pricing, there has been pricing discipline in Healthcare, including in North America. And obviously to make this even a stronger proposition we will be continuing to introduce products in the value part of the market and you'll see that, obviously, on the back of the RSNA in a couple of months from now.

One more thing now to give you because, of course, we've been talking a lot about the impact of currency on sales growth. But just for everybody to be absolutely in line, I'll give you the year-to-date comparable growth number per sector. I think those are important numbers.

Healthcare is up 5% on comps. That's excluding currency. Lighting is up 12%, again on clean comps excluding currency. And Lifestyle is up 7% with TV, as I previously mentioned, up 12%. So year-to-date Philips up 8% in clean comps, excluding the impact of currency.

I just mention those numbers for everybody expressed in clean comps, netted of the currency effect just for the sake of clarity.

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**Operator**

Thank you. Our next question comes from Olivier Esnou from Exane BNP Paribas. Please go ahead with your question.

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**Olivier Esnou** - *Exane BNP Paribas - Analyst*

Yes, hello. Good morning. A few questions, please. Maybe first on Healthcare. To better understand the different progress between orders and sales, could you please disclose by how much equipment and services grew organically in Q3 in Healthcare?

Second question on the Lighting part, do you have an assessment of the impact of restocking in the earlier part of the year and maybe the potential destocking effect in Q4? It sounds to me like organic growth in Lighting could be negative in Q4. Does that look a valid assessment for you? That's it, thanks.

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**Pierre-Jean Sivignon** - *Royal Philips Electronics - CFO*

Olivier, good morning. Just to clarify, the destocking you refer to in the latter part of your question is a destocking related to what sector?

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**Olivier Esnou** - *Exane BNP Paribas - Analyst*

Lighting.

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**Pierre-Jean Sivignon** - *Royal Philips Electronics - CFO*

Oh Lighting, okay.

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**Olivier Esnou** - *Exane BNP Paribas - Analyst*

This is all a question about restocking and destocking in Lighting.

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**Pierre-Jean Sivignon** - Royal Philips Electronics - CFO

Understood. Okay. Yes, I know, and to some extent even for us, there is -- and I've answered that question earlier on in the call -- there is, indeed, a disconnect, if I may call it like this, between the growth of the backlog and the growth of Healthcare.

The backlog, just to give you a number, has continuously grown in the last three quarters and Healthcare revenue year-to-date has grown 5%. So there is clearly a disconnect between the two, and the difference between the two, of course, is that we have increased our backlog consistently.

Now, as I said earlier on, is that we have booked a couple of multiyear orders in that backlog. So the good news is that those orders are there to stay and they will be there to help our growth in the coming quarters. But, of course, they are a bit more spread over time. And, as I said as well in a previous question, the guidance for the Healthcare growth for this year continues to be mid single digit.

In the second part of your question, you asked me specifically to disclose the split between service and equipment. So basically, they are mid single digit. One, the equipment sales is on the low side of mid single digit, and the service growth is on the other side of mid single digit. But there is not such a big difference between the two.

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**Olivier Esnou** - Exane BNP Paribas - Analyst

Okay.

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**Pierre-Jean Sivignon** - Royal Philips Electronics - CFO

So that's the answer to your second question.

Your third question comes to destocking in Lighting. Do we think we could have negative growth in Lighting, all in all, in Q4? The answer is we don't think so, but it's a good question you raised because, of course, there are two things which are taking place in Lighting.

One is the destocking, which I mentioned earlier on in the channels. I said clearly that there I had information and we've seen destocking in the latter part of Q3 and we think this will continue in Q4 because those distributors will want, of course, to finish the year with a very clean balance sheet.

And the other thing, Olivier, you need to keep in mind, and you remember that in Q1 we had in Lighting a strong quarter, which came from the fact that we had more work days. And statistically, it's hard to translate that, of course, in terms of exact impact on revenue, and we didn't really do that in Q1.

But just be aware that the Q4 of Philips will have 3% to 4% less work days in the fourth quarter versus last year. And that has benefited, obviously, the first quarter because for the full year there is just about the same number of work days as last year.

But within the year 2010 there are obviously more work days comparatively in Q1 than in Q4. And if you compare, as I said, Q4 2010 to Q4 2003, the difference there is 3% to 4%.

So this will, indeed, have an impact on the Lighting growth in Q4. That's a fair point, but we don't believe that it will go negative.

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**Olivier Esnou** - Exane BNP Paribas - Analyst

Thank you.

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**Operator**

Thank you. Our next question comes from Sjoerd Ummels from ING. Please go ahead with your question.

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**Sjoerd Ummels - ING - Analyst**

Good morning. Two questions from my side, please. The first one is actually on the acquisition policy. You mentioned that Discus constituted a somewhat larger acquisition. I was wondering if you are in a position to share with us acquisition price multiples on this project.

The second question is on LED. I was wondering if you could shed a bit more light on recently observed pricing trends. Thank you very much.

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**Pierre-Jean Sivignon - Royal Philips Electronics - CFO**

Well, I want to correct your perception. I didn't guide on an acquisition coming. Please, I think for the record, I want to repeat that.

The question was, could you do large acquisition in the future? And I said that we've always looked -- historically in the last couple of years we've done small acquisitions. I've said as well that we had looked at larger projects and continue to look at larger projects, but those projects have to make sense.

But please, I just want to repeat for the record. I'm not guiding on a large acquisition just around the corner. I just said we are looking at larger projects, but I didn't guide on a large project round the corner. So just for the sake of clarity. So certainly then, I can't talk about multiples accordingly.

As far as LED pricing is concerned, I think we continue to see good pricing. On the Lumiled business we continue to see improvement year-on-year of the margin of Lumiled, and that is a trend which we expect to continue. But you have to realize that Lumiled is positioned in the high end LEDs, and there the pricing stays and sticks.

We are now introducing, just recently, in the domain of LED lamps the first 60 watt equivalent LED lamps in North America. You can start seeing them in the channel in the US. And this is a profitable business. Of course, these LED lamps, which are first of a series, are still sold in small quantities at high price and accordingly a good margin for us. So for the time being, we are seeing certainly the LED business being a good margin business for Philips.

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**Sjoerd Ummels - ING - Analyst**

Okay. Thank you. Maybe my first question wasn't sufficiently clear. Actually, my question was directed at Discus. So the recently announced acquisition.

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**Pierre-Jean Sivignon - Royal Philips Electronics - CFO**

I'm sorry. Apologies. Then I misunderstood your question; I apologize. No Discus, indeed we have done Discus. Discus is a slightly bigger acquisition, but no, we have not disclosed the terms. And I don't think we'll disclose them, by the way. And lastly, the deal hasn't closed. So I think that would be yet another reason not to disclose.

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**Sjoerd Ummels** - ING - Analyst

Okay. Thank you.

**Operator**

Thank you. Our next question comes from Marcel Achterberg from Petercam. Please go ahead with your question.

**Marcel Achterberg** - Petercam - Analyst

Hello, gentlemen. Could you explain a little bit more what the impact, and how it works out financially, of the pension fund on the working capital, as it wasn't quite clear, I think?

**Pierre-Jean Sivignon** - Royal Philips Electronics - CFO

Yes. I think it's a good question. I basically want to say that you will get a full update on this on the back of the Capital Market Day on December 1. It's rather complex because it has to do with, of course, the evolution of interest rates and expected return on assets, and it's governed by what we call the asset ceiling test.

So I don't want to go into those complexities. But if you go back to the balance sheet of last year, you will have seen that we took a severe hit in the equity of Philips in June 2009. And we saw then a reconstitution of the equity in the fourth quarter of 2009. And that was largely coming from the fluctuation of expected return of assets, what we call the prepaid, as well as fluctuation of interest rates in the interim.

So this swing obviously had an impact on our working capital in the course of Q3 last year when you calculate working capital including pensions.

I won't say more right now because we will give you excruciating details on this and the evolution that we currently see in the second half of 2010. And Jan van Leeuwen will go into great details on the 1st of December.

Now, on working cap, excluding pension, there I was very explicit, and I have expressed that we continue to improve. And the working cap of Philips as a whole, and if you were to look at it sector by sector, with the exception of Lifestyle, because of the TV inventory I alluded to, you would see that the working cap of Philips as a whole came down 1 percentage point.

And basically, you have to realize as well that this reduction of the working cap as a percentage is coming not only from discipline on the absolute amount of working cap, but it's coming as well from the fact that the sales have gone up.

**Marcel Achterberg** - Petercam - Analyst

All right. Just to be sure, so if you exclude the pension fund effect, both in Q3 this year and last year, then the working capital of sales was down 1 percentage point?

**Pierre-Jean Sivignon** - Royal Philips Electronics - CFO

Correct.

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**Marcel Achterberg** - *Petercam - Analyst*

Despite the higher CL investment?

**Pierre-Jean Sivignon** - *Royal Philips Electronics - CFO*

No, [that's not true]. Thank you; you've said it exactly right. And as you know, we've put an enormous effort in this Group to manage working cap, and we have actually, in the pack, introduced a quarterly disclosure of the working cap sector-by-sector. And you will see that it continues to improve. The only blip was indeed Lifestyle basically, and that is essentially on the back of the surplus inventory we had in TV at the end of Q3. But I've said earlier on in the call, we will address that in Q4.

But even ignoring that high inventory in TV in Lifestyle, all in the working cap of Philips at the end of Q3 is expressed as a percentage of revenue, calculated on a MAT basis, is 1 percentage point down lower. And as I said, we'll continue to work on it because, certainly on inventory, we can do better, essentially on the back of the TV situation I just referred to.

**Marcel Achterberg** - *Petercam - Analyst*

Okay, thank you.

**Pierre-Jean Sivignon** - *Royal Philips Electronics - CFO*

Thank you.

**Operator**

Thank you. Our next question comes from Ludovic Debailleux from Natixis Securities. Please go ahead with your question.

**Ludovic Debailleux** - *Natixis - Analyst*

Good morning. It's Ludovic Debailleux at Natixis. I have two questions, please. First of all you, stated that at GM&S EBITA in Q4 should be in line roughly with Q1 and Q2, but this is despite lower License income than usual. Do you confirm the EBITA guidance of minus EUR300 million on a full year basis? Or you think that you can do better looking at Q3 2010 results and looking at what you did in terms of restructuring? That was my first question.

Second question; it's a follow-up on the working capital. Could you share with us where you think that the level of inventory will be at the end of the year? Will you be able to fully offset the negative Q3 effect in Q4, or it could take longer? Thanks.

**Pierre-Jean Sivignon** - *Royal Philips Electronics - CFO*

Okay, yes, I think on GM&S we've given you -- I think in my opening text I gave you pretty much full guidance. I think just to repeat, on the Q3 we have reported plus EUR1 million, but the plus EUR1 million really adjusted is minus EUR41 million. The minus EUR41 million, including the EUR36 million really actually one-off gain on the UK Pension, and there was a EUR6 million gain on the restructuring provision release. And we were helped as well by a [couple of tens] on basically some royalty that we thought we would collect in Q4 and came in Q3. And the other thing which helped us as well in Q3 was the Assembleon business, which is the only business left in GM&S, did better.

Now on Q4, I think that we've guided you on the level which will be, of course, cleaner and which should be at the level of Q1 and Q2. So that basically should enable you to recalculate what's the guidance for the full year. Okay?





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**Ludovic Debailleux** - *Natixis - Analyst*

Okay, thanks.

**Pierre-Jean Sivignon** - *Royal Philips Electronics - CFO*

Now your second question was on working cap, and essentially I translate it on, is the high inventory that we have in TV, could that have an impact on the cash flow of Q4? No, we expect Q4 to be our customary strong cash flow quarter, and we think that you will see strong cash flow in Q4; you will see a reduction of the inventory of television. And no, I cannot guide you on the balance of inventory at the end of Q4 because I don't have that number. But again, count on a strong free cash flow and definitely on a reduction on the inventory of television.

**Ludovic Debailleux** - *Natixis - Analyst*

Thank you.

**Operator**

Thank you. Our next question comes from Frederic Stahl from UBS. Please go ahead with your question.

**Frederic Stahl** - *UBS - Analyst*

Yes hi, it's Frederic here at UBS. Just a quick question. If you could tell me, or tell us, what the losses were in the Chinese TV business in the quarter?

**Pierre-Jean Sivignon** - *Royal Philips Electronics - CFO*

No, for a number of reasons I would not disclose this because, as you can imagine, there is a negotiation ongoing so that's not something I will disclose. But once transaction is closed, I think maybe -- let's discuss that at the end of Q4, if I may?

**Frederic Stahl** - *UBS - Analyst*

That's very good, thank you.

**Operator**

Thank you. Our next question comes from Philip Scholte from Rabobank. Please go ahead with your question.

**Philip Scholte** - *Rabobank Equity Research - Analyst*

Yes, good morning. A question on the margin performance at Lighting, it is down sequentially and I know there could be some seasonality in there, but the product mix, you would expect that to have a positive effect on margins as well. Are there big mix effects? Is there huge pricing pressure? Could you give some more details on that?

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**Pierre-Jean Sivignon** - *Royal Philips Electronics - CFO*

Yes, actually you are correct. If you do it sequentially because, of course, if you do it year-on-year you have an enormous improvement, but if you do it on a sequential basis, we had a 13% margin adjusted in Q2, which is now I think 12.2% in the third quarter.

To be absolutely transparent, and we didn't want to disclose it in the release, but since you ask, there was a one-off which we don't want to disclose, but there was an element of a one-off nature in the Q3 numbers, which we have not disclosed which is not meant to be repeated. So there is more consistency than it looks, on the face of things, between the margin of Q2 and the one of Q3.

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**Philip Scholte** - *Rabobank Equity Research - Analyst*

Okay, but you're not willing to share an amount with us?

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**Pierre-Jean Sivignon** - *Royal Philips Electronics - CFO*

No, we don't, because if we start disclosing all our one-offs -- we tried to be disciplined there. We disclosed to you the one-offs related to restructuring, the one-off related to the acquisition integrated charges. The positive one-offs we disclose as well so that you guys can see exactly where we are. And the small negative ones we tend to keep them for ourselves because they have to be part of the business. But it happens that in Q3, this quarter, there was one of those one-offs in Lighting and I will leave it at that.

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**Philip Scholte** - *Rabobank Equity Research - Analyst*

Okay, but it's probably still down sequentially if we correct for that?

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**Pierre-Jean Sivignon** - *Royal Philips Electronics - CFO*

Yes, but I would say much more marginally than the 13% -- well, first of all 13% to 12.2%, that is not a big decline. That's only 80 basis points and, as I said, a good chunk of that 80 basis points would be taken care of by what I just mentioned.

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**Philip Scholte** - *Rabobank Equity Research - Analyst*

Right. Thank you very much.

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**Pierre-Jean Sivignon** - *Royal Philips Electronics - CFO*

Okay.

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**Operator**

Thank you. Our next question comes from Matt Williams from HSBC. Please go ahead with your question.

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**Matt Williams** - HSBC - Analyst

Good morning. It's Matt Williams at HSBC. A quick question, if I may, on Consumer Lifestyle. You mentioned you're seeing some evidence of trading down. Is that something you saw a lot of in Q3, or are expecting in Q4? And specifically, I suppose I'm wondering whether you're expecting to be able to keep people still within the range for those products, or do you think you -- or what the potential is for people to actually step out of the range, right below your lowest entry point?

**Pierre-Jean Sivignon** - Royal Philips Electronics - CFO

No, thanks, it's an important question, you're right, especially in the context of Q4. No, we always track trading down because that's obviously something you have to. But as you know, in the vast majority of the products where we are, we are the category leader, certainly, definitely in Lifestyle, and that means that we are number one or number two. And in most of those categories we are present at the various price points.

So I think that enables us not to lose the customer if the customer wants to trade down. And the one thing I want to add just for the sake of thoroughness, is that that trade down was essentially a US matter. I didn't say that in the opening text, but since you've come back to that point, I just want to say that the trade down was essentially a US affair.

**Matt Williams** - HSBC - Analyst

And as a follow-up, therefore if we're seeing trading down in the US, which way are customers going in the emerging markets?

**Pierre-Jean Sivignon** - Royal Philips Electronics - CFO

No, actually in emerging markets there it's booming. Actually our Lifestyle business did very well in China in particular, and there it's not essentially an issue of trading down. There it's an issue of making sure that you have the products which are properly customized, because what the customer wants is not to trade down. The customer wants a product which, at times, might have to reflect the particular taste and colors, and that's what is much more relevant these days in emerging markets.

I want to mention as well that, because I mentioned BRICs, the growth in Russia were spectacular. We've mentioned Russia at times, but in the case of the emerging markets, growth in Russia in Q3 was spectacular.

So the trading down, I want just to clarify that that's essentially and that was actually structurally there a US subject.

**Matt Williams** - HSBC - Analyst

Thank you very much.

**Operator**

Thank you. (Operator Instructions) Thank you. Philip Scholte from Rabobank. Please go ahead with your question.

**Philip Scholte** - Rabobank Equity Research - Analyst

It's Philip Scholte again. A question in general about the organic growth rate you are reporting; even correcting for the TV sales, you are up about 3%. Related to your Vision 2015 target, is that something that disappoints you? What do you think should change in the global economic environment to get to this GDP plus 2%? What are the issues here?

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**Pierre-Jean Sivignon** - *Royal Philips Electronics - CFO*

Okay. Two things; on TV I think I want to clarify, the comp growth on TV year-to-date is 12%, so I just want to make sure that you have the right figures. And the growth of Philips for the quarter, excluding TV, is not 3%, it is 4%. And if you now look at the growth of Philips year-to-date I think that number, I'll come back to you, I gave it to you a minute ago, it's actually 8%, just to put things in perspective.

Now you're asking me, do we feel comfortable about the 2% spread versus GDP? The answer is yes. I think that's the guidance we gave in London a couple of weeks ago. We absolutely stand by it. The only caveat, I don't know if it was in your question or not, but this is, given the volatility of Television and even though TV indeed grew, as I said, 12% year-to-date, but it has been a volatile number as we've seen in Q3, the 2% spread versus GDP which we gave in London for the next five years a couple of weeks back was to be understood, excluding TV, given the volatility that there is in that particular business.

**Philip Scholte** - *Rabobank Equity Research - Analyst*

Right. Just one remark on that; the Television sales were obviously so good because the Dutch played so well in the World Cup, but so just a small side step.

**Pierre-Jean Sivignon** - *Royal Philips Electronics - CFO*

Yes, okay. As a French person I am sure you will understand that I will refrain from commenting on the World Cup.

**Philip Scholte** - *Rabobank Equity Research - Analyst*

Thank you.

**Operator**

Thank you. Our last question comes from Ilan Chaitowitz from Redburn Partners. Please go ahead with your question.

**Ilan Chaitowitz** - *Redburn Partners - Analyst*

Thank you for taking the follow-up question. Just on the effective tax rates, can you give us some guidance what you expect for full year 2010 and then for full year 2011? Thank you.

**Pierre-Jean Sivignon** - *Royal Philips Electronics - CFO*

Well actually no, I can't guide and we usually don't guide for the year, but we've guided for next year and the year beyond. I think, even though you have continuously seen numbers which are a little bit better than that, but actually I am told right next to me, that I should guide you, so I will correct. Actually, I can guide you for this year at 27% to 29% for this year. I said I would not, but I am told on my right that I should, so I will be a little bit more then specific for this year, 27% to 29%. That's the guidance for this year.

Now what I have said in the past, and I've said on this call is, even though we might do better, I prefer to stick to a 30% to 32% clean ETR for the years to come. Historically we've done better than the ETR we've guided you on, but I prefer to be conservative there so that I keep the flex. So 27% to 29% for this year, 30% to 32% for the years to come with a chance to do better than that.

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**Ilan Chaitowitz** - Redburn Partners - Analyst

Thank you very much.

**Operator**

Thank you. Mr. Sivignon, there are no further questions. Please continue.

**Pierre-Jean Sivignon** - Royal Philips Electronics - CFO

Okay, I think to all of you, and I think there was a number of you who were on this call, we want, for me and the team around me, to thank you for your time, for your questions. And I'm sure we will meet quite a number of you on the road in the next four days. Thank you very much and goodbye.

**Operator**

This concludes the Royal Philips Electronics third quarter results 2010 conference call on Monday October 18, 2010. Thank you for participating, you may now disconnect.

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