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PHIA.AS - Q4 2013 Koninklijke Philips NV Earnings Conference Call

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OVERVIEW:

PHIA.AS reported 4Q13 comparable Group sales growth (adjusting for currency and portfolio changes) of 7% and net income of EUR412m.



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PRESENTATION

Operator

Welcome to the Royal Philips fourth quarter and annual results 2013 conference call on Tuesday, January 28, 2014. (Operator Instructions). Please note that this call will be recorded and is available by webcast on the website of Royal Philips.

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

Robin Jansen - *Koninklijke Philips NV - Head of IR*

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

In a moment, Frans will make his opening remarks, and will take you through our strategic achievements, as well as through our main financial performance highlights for the period. Ron will then provide more details of the financial performance during the quarter. After this, both Frans and Ron will be happy to take your questions.

As usual, our press release and the accompanying information slide deck were published at 7am this morning. Both documents are now available for download from our investor relations website. A full transcript of this conference call will be made available by tomorrow on our investor relations website.



Before I give the word to Frans, I would like to remind you of two things. Following a decision in Q1 2013 to sell the audio, video, multimedia and accessories business, or the AVM&A business, we reported the profit and loss on this business under discontinued operations; and the net assets for the business in the balance sheet on the line assets held for sale. The cash flow of the audio, video, multimedia and accessories business is reported under cash flow from discontinued operations. Therefore, all commentary that will follow, in terms of sales and earnings, at both the Group level, as well as at Consumer Lifestyle sector level, does not include audio, video, multimedia and accessories-related information.

As of October 25, 2013, the agreement to transfer the AVM&A business to Funai was terminated, as you know. Since then, we have received interest in the business from various parties, both strategic as well as financial investors; and we have been actively discussing the potential sale of the AVM&A business with potential buyers. Obviously, it is, in this phase of the process, not possible to provide further detail on these parties, or on the timing.

At the same time, we continue to run the AVM&A business as a standalone entity, called Woon Innovations.

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

Frans van Houten - Koninklijke Philips NV - CEO

Thank you, Robin. Welcome, and thank you, all participants in the call, for joining us today. We are pleased with this quarter's performance, and that we have achieved our 2013 financial targets.

In 2011, we articulated our path to value, including three mid-term financial targets to measure ourselves against. We targeted a compound annual growth for our comparable sales of 4% to 6% over the years 2012 and 2013, assuming real GDP growth of 3% to 4%. We delivered a comparable CAGR of 4.5%, even with a GDP growth for the period that was only between 2% and 2.5%.

We also targeted a reported EBITA as a percentage of sales in the range of 10% to 12%. We delivered 10.5%, despite slower market growth, currency headwinds, and changes in pension accounting.

Thirdly, we targeted to deliver a return on invested capital in the range of 12% to 14%, and we exceeded this target with an ROIC of over 15%.

We are pleased that we have achieved these goals, and I would like to acknowledge the contribution of our employees across the globe and the trust of our customers.

I have a rock-solid belief in the unlocked potential of Philips. And while there is more work to do meeting these 2013 targets, is a confirmation that we are taking the right steps to transform Philips and an important milestone on our multi-year transformation journey.

With respect to our performance in 2013, we expected our results to be back-end loaded, and that is indeed what happened. We ended the fourth quarter with a strong comparable sales growth of 7%, supported by all three sectors. Consumer Lifestyle and Lighting delivered comparable sales growth of 8%; Healthcare delivered a comparable sales growth of 4%.

Growth geographies performed very well across all sectors with 15% comparable sales growth at the Group level, while mature markets delivered 2% growth.

A comparable sales growth of 3% for the whole year, which is about 1 percentage point above real GDP growth, clearly indicates that the initiatives that we have launched to drive growth continue to deliver results in weaker than expected macroeconomic environment, as well as the headwinds related to US healthcare reform and the continued austerity measures in Europe.

We are also pleased with the improvements in or operational results, which increased in the fourth quarter by 20% to EUR915 million, or 13.5% of sales, compared to EUR765 million, or 11.3% of sales, in Q4 2012.



Our reported EBITA as a percentage of sales for the full-year 2013 improved by almost 6 percentage points to 10.5%, of which gross margin improvements contributed 200 basis points.

All sectors achieved a strong year-on-year improvement in operational results, enabled by our Accelerate program, which is driving growth, gross margin, and cost improvements all at the same time.

As you know, with Accelerate, we have put programs and initiatives in place that fundamentally establish operational excellence, enabling us to deliver innovation faster, at lower cost; with more predictability; better customer service; higher local market relevance; and eventually better profitability.

This is further enabled by a growth in performance culture that we are steadily developing, and which is centered around entrepreneurship, teamwork, operational excellence, and accountability for results.

As we progress with these Accelerate initiatives, we are capturing the new ways of working as part of the Philips business system; our repeatable system of value creation to ensure that we execute business plans and deliver sustainable results on our path to value.

Let me call out some recent important achievements and results. We have actively restructured and significantly improved the quality of our portfolio. Philips is now a diversified technology company, serving attractive markets, with a dynamic portfolio of around 40 businesses, and we have several growth initiatives underway.

We have also made great strides in putting our customers and consumers at the center of everything we do.

Where needed, we have increased the seniority of market teams to ensure that our markets are now led by empowered entrepreneurs.

We have also made significant progress across all three sectors to increase the local relevance of our product portfolios, with the aim to deliver higher value to our customers and consumers and to accelerate growth and gain market share.

We have developed granular plans to increase the number of business market combinations in which we are a market leader. Simultaneously, targeted investment plans have been defined to support and increase market leadership.

Strong progress has also been made in transforming our customer value chains in four lean business models, standard products, systems, software, and services, that will be enabled and supported by a standardized process framework and an effective real-time IT landscape.

This fundamental overhaul of these elements of our operating infrastructure is a key driver of the 300 basis points to 400 basis points of gross cost savings in the next 3 years that we announced at the Capital Markets Day in September. But it will also raise our growth potential through increased customer responsiveness, and improve time to market of our innovations.

And finally, it will set us up as a digital company, ideally suited for online marketing and sales in cloud-enabled value propositions.

When we launched Accelerate in 2011, we targeted a reduction in overhead and support costs of EUR500 million by 2013. By now, we have taken out EUR1 billion of cost; and as you know, we aim for about another EUR500 million more in the coming two years.

In addition, our Design for Excellence program, DfX, is building a strong funnel of opportunities to lower our cost of goods sold by an additional EUR1 billion between now and 2016 to further improve gross margins and enhance competitiveness in the market.

Let me now talk about innovations; the life blood of our Company. We will continue to invest in innovation that will drive future sales performance. We are focusing on innovations that matter to people, such as technologies that will make healthcare delivery systems more affordable, with better outcomes for patients. But also, all innovations that deliver energy-efficient LED lighting solutions that will improve peoples' wellbeing and make the world more sustainable, as well as locally relevant consumer appliances and services.



In 2014, we intend to invest approximately 7% to 8% of our sales in innovation.

It's also important to emphasize that we are gradually shifting from a products to a solutions company as we partner with our customers to deliver better outcomes over multi-year engagements and leverage new recurring revenue models.

When we invest in innovation, we assess in a very granular way which business market combinations offer most long-term profitable growth potential. In this respect, Consumer Lifestyles' approach to locally relevant products is a great example.

In China, geographical expansion and localization of product innovations, including Philips rice cookers, noodle makers, drove strong growth in Domestic Appliances in the fourth quarter.

Another example is the Air Purifier portfolio, developed in record time to meet a fast-growing demand.

Within Healthcare, we introduced the EPIQ Ultrasound system, which has seen good traction in the markets where it was launched.

At the annual conference of the Radiology Society in North America, the RSNA, in Chicago, we introduced a new Vereos digital PET/CT system, which features a twofold increase in resolution, which leads to higher image quality and increased accuracy to improve diagnostics, treatment planning, and workflows.

We also introduced the IQon system, the first Spectral Detector CT that uses color to enable a more definitive diagnosis in a single scan for faster imaging results, especially of cancer tumors.

In Lighting, we are strengthening our leadership by focusing on products and solutions that are more energy efficient, while at the same time bring down the energy bill for our customers by 60%, or more. One recent example to illustrate this is the 10-year performance contract that we won to deliver, monitor, and service an integrated lighting system with 13,000 connected LED fixtures and adaptive management controls for parking garages in Washington DC.

And importantly, we will continue to invest in initiatives that we believe will fuel future profitable growth. In Consumer Lifestyle, we see a lot of opportunities in business adjacencies that fit with the focus on personal health and wellbeing. So we have set up a new business group, named Personal Health Solutions.

In Healthcare, we will realign our US sales teams at the end of Q1 2014 to better support a changing marketplace and respond to customer feedback. Philips will provide additional focus on independent delivery networks, IDNs, and the larger accounts, while continuing to support standalone hospitals and the non-hospital market.

A new coordinated account management approach will allow Philips' account managers to offer to our customers more comprehensive solutions across a wider broader portfolio than is possible today. These changes are made with considerable thought and detailed implementation plans. We are confident the new structure will provide more value and even better service to our customers.

As we continue to create the future of healthcare, we are developing innovative healthcare solutions across the Continuum of Care in partnership with our customers to improve patient outcomes, provide better value, and improve access to care.

Solutions of the future will be more patient centric and integrated, enabling better collaboration among healthcare professionals, and support the delivery of quality care at lower cost through the use of analytics and integrated clinical decision support.

To ensure that we are organized to improve our focus on customers and patients, we announced last week that we have set up a new business group in Healthcare, named Informatics Solutions and Services, which offers hospitals and healthcare systems customized clinical programs; advanced data analytics; interoperable cloud-based platforms; and world-class integration and consulting services, necessary to implement new models of care.

Finally, in terms of new growth initiatives, I would like to draw your attention to the IG&S sector, where we now hold several startups that have great promise, although they will be EBITA negative for the next few years because of investments in R&D and market development cost. Examples of these new business areas are digital pathology, point of care diagnostics, and horticultural and city farming solutions.

It's very good that Philips has now several new growth opportunities in the making. As I've often said, an entrepreneur invests with one hand and cuts with the other. Overall, these growth initiatives are expected to lead to additional investments of at least 50 basis points of sales in 2014, compared to 2013.

The main point for you to remember is that our self-help story will continue to be the key driver in reaching our 2016 targets. This is entirely driven by our multi-year Accelerate business transformation program.

We will maintain a strong focus on actions that will improve gross margins, like DfX; drive productivity; rationalize our industrial and distribution footprint in Lighting and Healthcare; speed up innovation; and improve customer service.

As mentioned, this year, we will also start with the rollout of our new integrated IT landscape, embedding standard business processes which will fundamentally simplify the way we work. This is a massive undertaking to weed out complexity, make us more efficient and effective, and enable us to respond to customers and partners in what is called real time.

The additional investments associated with the Accelerate end-to-end and IT rollout and restructuring programs amount to up to 50 basis points more for 2014 compared to 2013, as we indicated already at our Capital Markets Day in September.

With all these initiatives put in motion, we are confident that we are well positioned to achieve our 2016 financial targets; notably, a compound annual growth rate for comparable sales of 4% to 6% over the period 2014/2016, and 11% to 12% reported EBITA as a percentage of sales, and ROIC of more than 14% in 2016.

We also target to increase our market penetration as we aim to touch and improve the lives of 3 billion people a year by 2025 through our innovations in healthcare, energy-efficient digital lighting solutions, and consumer products that improve personal health and wellbeing.

In keeping with our dividend policy, and as a sign of our confidence in the future, we propose to increase our dividend to EUR0.80 per share, compared to the declared dividend of EUR0.75 of last year. Again, this year, shareholders will have the option to receive their dividend payment in cash, or in shares.

In terms of outlook for 2014, we are confident in our ability to further improve our performance by continuing the strong focus on Accelerate transformation.

Looking at 2014, we remain, however, cautious because of ongoing macroeconomic uncertainties, currency headwinds, and, of course, the softer order intake in Q4 2013. Therefore, we expect 2014 to be a modest step towards reaching our 2016 targets, especially taking into account restructuring to drive new productivity targets and investments in additional growth initiatives.

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

Ron Wirahadiraksa - Koninklijke Philips NV - CFO

Thank you, Frans. Good morning, and welcome to all of you on this call. Let me take you through a greater level of detail of our financial performance for the fourth quarter and full-year 2013.

Comparable Group sales in the fourth quarter increased by 7% when adjusted for currency and portfolio changes. On a nominal basis, Group sales increased by 1%, due to negative currency effects of 6%.



In our growth geographies, comparable sales increased by 15% in the fourth quarter and represented 37% of the Group sales, compared with 35% in Q4 of last year. Our growth geographies are defined as all markets excluding the US; Canada; Western Europe; Australia; New Zealand; South Korea; Japan; and Israel.

In Western Europe, all three sectors delivered comparable sales growth in the low to mid-single digit range. The other mature geographies also delivered a solid sales performance, with a comparable sales growth of 5%, supported by particularly strong performance in Consumer Lifestyle.

Sales in North America remained stable on a comparable basis in the quarter as US market conditions for healthcare remained challenging, with hospitals working through the implications of the sequestration and healthcare reform. This has led to delays in purchasing decisions and lower order intake.

Consumer Lifestyle sales in North America grew low-single digit in the fourth quarter, largely reflecting a reduced selling period of four weeks instead of five weeks; as well as stock reduction initiatives at some of the larger US retailers. US market shares for Consumer Lifestyle, however, sustained or improved in the period.

Lighting sales in North America remained flat, where good performance by LS&E was offset by a decline in sales in Professional Lighting Solutions.

In terms of profitability at the Group level, reported EBITA was EUR884 million, or 13% of sales, compared to a loss of EUR50 million reported for Q4 last year, which included, among others, the European Commission's CRT fine.

Restructuring and acquisition-related charges were EUR31 million in Q4 2013. As a result, adjusted EBITA amounted to EUR915 million, or 13.5% of sales, in the quarter, compared to EUR765 million, or 11.3% of sales, in Q4 2012. The 20% improvement in adjusted EBITA was driven by good sales performance, a gross margin improvement of 200 basis points, and productivity gains coming from the Accelerate program.

Net income amounted to EUR412 million in the quarter, compared to a net loss of EUR420 million a year ago.

We generated EUR608 million free cash flow in the quarter, which is EUR145 million lower than our free cash flow in Q4 2012, and can be mainly attributed to lower accounts payables and the creation of various provisions in Q4 of last year. This included the European Commission's CRT fine of EUR509 million.

Let me now walk you through the performance of each of our businesses through Q4, starting with our Healthcare business. Currency-comparable equipment order intake decreased by 1% in Q4 2013, compared to Q4 2012.

Imaging Systems order intake decreased low single-digit, while Patient Care & Clinical Informatics increased low single-digit.

Uncertainty in the US surrounding healthcare reform and its impact on increased demand for services continued in Q4 2013. Despite the Affordable Care Act resulting in approximately 2 million additional covered lives, no measurable increase was seen in the purchase of hospital equipment on a year-over-year basis.

In addition, healthcare construction declined by 2% in 2013, which was in line with estimates prior to the start of Q4. As a result, currency comparable intake in North America was up by only 1% in the quarter.

In Europe, the healthcare market remains soft. Southern Europe showed early signs of recovery in Q4, which was offset by market softness in Northern European countries.

Overall, European order intake declined by 12% in the quarter. Excluding two large multi-year deals we had mentioned in Q4 last year, comparable order intake in Europe is down by 5%.

The Asia Pacific region delivered strong double-digit order intake growth, fueled by strong double-digit order intake growth in the ASEAN region, Japan, and India. China and LatAm posted high single-digit growth in order intake.

On the other hand, we saw declines in Russia and the Middle East & Turkey, which brought the currency comparable order intake for the growth geographies down to a low single-digit. Middle East and Turkey markets remained challenging due to increased geopolitical risks in the region, while the Russian healthcare market continued to show weakness.

On a currency and portfolio comparable basis, Healthcare's year-on-year sales were up 4% in Q4 2013, supported by the good order intake in Q2. All four business groups contributed to the growth. Customer Services recorded high single-digit growth; Home Healthcare Solutions delivered mid single-digit growth; and Imaging Systems and Patient Care & Clinical Informatics posted low single-digit growth.

Comparable healthcare sales in the growth geographies increased 13% in the quarter, driven by strong double-digit performance in China, Central and Eastern Europe, Latin America, and Middle East & Turkey. A double-digit decline in Russia negatively impacted growth in the quarter.

Comparable sales in the mature markets were up 1%. Western Europe showed a bit of a mixed bag. Most of the Southern Europe markets experienced growth, while sales declines were mostly notable in some of the Northern European countries. Sales in North America were down 1% in the quarter.

Healthcare reported a third quarter EBITA of EUR541 million, which is 19.1% of sales. The adjusted EBITA amounted to EUR538 million, or 19% of sales; an improvement of 100 basis points versus Q4 last year, largely driven by Accelerate-driven overhead cost reductions.

Looking forwards, market uncertainty, especially in North America due to healthcare reform, and in Europe due to austerity, has resulted in an order intake pattern that has been lumpy throughout 2013, which we expect will continue in 2014; and hence, we expect a slow start in 2014 based on order book developments.

The outlook remains positive for Japan and China. The Japanese Government has identified healthcare as a key area for investment in 2014. In addition, the Chinese Government continues to invest heavily in healthcare, including upgrade to level 2 hospitals and primary care facilities.

Further, in our facility in Cleveland, Ohio, which manufactures advanced molecular imaging and some CT equipment, certain issues in the general area of manufacturing process controls were brought to our attention during an ongoing US Food and Drug Administration inspection. To address the identified issues, on January 10, we started the voluntary temporary suspension of new production at the facility, primarily to upgrade manufacturing process controls.

Currently, there is no indication of product safety issues, and our customers can remain confident in the safety of our products.

This action is estimated to have a negative impact on the sector's EBITA of approximately EUR60 million to EUR70 million in the first half of 2014, of which, we expect to recover a substantial part in the second half of 2014.

Consumer Lifestyle comparable sales increased by 8%, on the back of 10% growth in Q4 of last year. The growth geographies had a comparable sales increase of 15%, supported by virtually all markets and, most notably, China, Russia, and Brazil.

Sales in Western Europe were up 3%, while sales in North America were up 1%. As mentioned earlier, this largely reflects the reduced selling period and the stock reduction initiatives at some of the larger US retailers.

Other mature markets recorded a 12% growth in the quarter, with continued strong double-digit growth coming from Japan.

Consumer Lifestyle delivered an EBITA of EUR187 million, or 13.1% of sales, in the fourth quarter. Adjusted EBITA for the quarter was EUR192 million, or 13.4% of sales, compared to EUR157 million, or 11.3% of sales, in Q4 2012. The improvement of 210 basis points can largely be attributed to operational leverage and gross margin improvements across all businesses.



In Lighting, market growth picked up in the fourth quarter of 2013, driven by growth geographies and the continuing penetration of LED across markets.

Comparable sales in Lighting were up 8% in the quarter, compared to Q4 of last year. Light Sources & Electronics and Professional Lighting Solutions delivered mid single-digit growth, and Lumileds and Automotive achieved double-digit growth. Sales in Consumer Luminaires declined low single-digit.

We continued to see strong sales of our LED products with year-on-year quarterly growth of 48%. LED now represents 34% of total Lighting sales, compared to 25% in Q4 2012.

Excluding OEM Lumileds sales, the growth geographies showed a double-digit sales increase, which was driven by strong performances in China, Brazil, Taiwan, and Indonesia. In Western Europe, sales were up 5%, while sales in North America were flat compared to Q4 2012.

The reported EBITA for Lighting was EUR218 million, or 9.5% of sales, compared to a reported loss of EUR28 million in the fourth quarter of 2012, as restructuring and other charges were EUR185 million lower in Q4 2013 than in Q4 2012.

Adjusted EBITA was EUR240 million, or 10.4% of sales; a significant increase compared to the EUR179 million, or 7.9% of sales, in the fourth quarter of 2012. The year-on-year improvement was driven by better gross margins and overhead cost savings.

Reported EBITA for Innovation, Group & Services amounted to a net cost of EUR62 million, compared to a net cost of EUR560 million in Q4 2012, which included a EUR313 million impact of the earlier mentioned European Commission CRT fine; as well as EUR132 million of provisions related to various legal matters.

For 2014, we expect reported EBITA for IG&S to amount to [a cost of around] (corrected by company after the call) EUR380 million; an increase of EUR140 million compared to 2013 due to a reversal of one-offs of EUR75 million; an increase in restructuring expenses of approximately EUR30 million; a decrease in IP royalty income of around EUR15 million; and an increase in investments related to Accelerate and new growth adjacencies of around EUR20 million.

Inventories as a percentage of sales improved by 40 basis points to 13.9% at the end of Q4 2013. Consumer Lifestyle delivered the biggest improvement with a reduction of 90 basis points. Healthcare and Lighting both recorded a reduction of 30 basis points.

Over 2012 and 2013, we lowered inventories as a percentage of sales by 260 basis points, thereby meeting our inventory reduction target of between 200 basis points and 300 basis points for the period 2012/2013 that we communicated in the beginning of 2012.

Return on invested capital improved to 15.3% for the year, compared to 10.7% (sic - see slide 4, "7.3%") excluding the CRT fine in 2012. The strong improvement in ROIC was largely driven by an increase in earnings in all sectors, as well as lower fixed assets and lower average net operating capital. The applied discount rate for the Group is 9%.

As far as capital allocation is concerned, we have commenced our new EUR1.5 billion share buyback program in October 2013. At the end of December 2013, 7% of the program was completed.

Ladies and gentlemen, let me briefly summarize, before opening up the floor to your questions. The performance in the fourth quarter of 2014 demonstrates further progress on our journey to make Philips a more agile, competitive, and innovative company. We are pleased that we achieved our 2013 financial targets, despite economic uncertainties and volatility in the foreign exchange markets.

As Frans said in his opening remarks, we are now highly focused on our 2016 targets, and believe that we have a strong set of programs and initiatives in place that will allow us to make additional progress.



Looking at 2014, we remain cautious because of ongoing macroeconomic uncertainties, currency headwinds, and, as I mentioned earlier, softer order intake in the fourth quarter. Therefore, we expect 2014 to deliver a modest step towards reaching our 2016 targets; also taking into account restructuring to drive the new productivity targets, and investments in additional growth initiatives that Frans alluded to.

With that, let me open the line for your questions. Also, correcting what I said earlier on the compare of ROIC in 2012, which was not 10.7% but 7.3%; so 15.3% this year, compared to 7.3% last year excluding CRT fine.

Thank you. And the floor is now open for questions.

QUESTIONS AND ANSWERS

Operator

Thank you, sir. (Operator Instructions). Andreas Willi, JPMorgan.

Andreas Willi - JPMorgan - Analyst

My first question is to clarify your guidance for 2014. You said you expect a modest improvement on 2013. Basically, does this mean that, given the 10.5% EBITA margin, reported EBITA margin in 2013, we should see a modest improvement from that level for 2014, as part of your guidance?

Second question on payables and the weak performance here in Q4. Maybe you could give us some explanation in terms of timing of payments you made, and whether we should get some recovery as we go through 2014.

And the third question on Healthcare. If we look at orders, you have now underperformed Siemens and GE for two quarters in a row on equipment order growth. Are you concerned about market share innovation there, or is that something you are confident is basically stable if we look through larger orders than the usual fluctuations? Thank you.

Frans van Houten - Koninklijke Philips NV - CEO

Thank you, Andreas. Let's share the questions between Ron and myself. I'll give you some color on the guidance of 2014. When we talk about modest improvement, we do not only talk about the overall profitability number, but we look also at the quality of our underlying businesses, which we expect can each improve.

Of course, in the mix, we also need to look at the guidance that Ron already gave in December around IG&S, so that goes also into the equation. And you need to take into the equation that we will make some step-up investments in growth, as well as restructuring. The sum of that will mean only a modest step on our trajectory for the 2016 targets in terms of profitability.

On Healthcare, in terms of comparability, we need to take into account that we had some big elephant orders in the previous year that influences the year-on-year comparison.

Also, we introduced a whole new product range in ultrasound, the EPIQ system. Our customers were anticipating on that. That product range was only coming available in Q4 in the US market; that represented a slowdown in the earlier quarters. And we saw a good pickup towards the end of the year and with more upside in 2014.

Also, the new PET/CT and Spectral CT, all these innovations were highly anticipated, but also make customers pause for a moment as they are waiting for that to become available.



Having said all that, of course, I'm not satisfied with a minus 1% order progress. And we will work very hard to turn that situation around as we increasingly target to become more of a solutions partner to hospitals and win larger deals. For example, the contract that we signed last week, on Friday, with the Medsi Group in Russia is another nice example of the direction that we are going.

So, work in progress. I underline, again, that there's a lot more potential in Philips to go after. And stepping up our efforts in big data in Healthcare certainly is another, let's say, proof point of our commitment to become a solutions provider.

Maybe, Ron, you can talk about development of cash flow and payables.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Yes, Andreas, your question was on the payables, where indeed we have seen quite a lumpy pattern over quarters. This is driven by seasonality, but also by the fact that we have our own calendar. As I many times say, payments go in and outside the quarter. And I know that's not a very satisfactory answer, and it's probably something that we are going to look at. If the holding of our Philips' calendar, which is a pattern of five weeks, four weeks, four weeks, if you break it up, is that influencing this too much, and we can think of further improvements.

But payments tend to come in lumpy; there is seasonality. And also, we've been working on better payment discipline over the past years. These are not an excuse, but these are just an explanation of why the pattern sometimes comes in erratic.

Of course, at the end of last year we had quite high payables, which were partly driven by the CRT fine, EUR509 million; and also, in the provision part by, but that's not payables, restructuring. So that influenced the working capital. And we've disbursed some of those restructurings, that I said, earlier in the year.

Maybe shed a little bit of light on the full-year free cash flow development. So last year we had EUR1.6 billion; this year it's at EUR0.2 billion if you round it off. And it's exactly what I've been talking about throughout this year, because last year had 600 million of good incidentals, High Tech Campus sales and the Senseo brand sales, and this year mainly the EUR509 million CRT fine that we paid out; and about EUR280 million, EUR 300 million in the restructuring provisions that we had an outlay for. So that is about the gap of EUR1.4 billion.

And, of course, we look forward to drive cash flow structurally every year between EUR1 billion and EUR1.5 billion.

Andreas Willi - *JPMorgan - Analyst*

Thank you.

Operator

Martin Wilkie, Deutsche Bank.

Martin Wilkie - *Deutsche Bank - Analyst*

A couple of questions. The first one on Lighting. Very, very strong organic revenue growth, driven by LED, but the margin on a clean basis just going up by about 20 basis points quarter on quarter. I'm assuming there's lot of moving parts in there with cost savings coming through, but just if you could let us know has that been tempered somewhat by mix with LED? Or is it foreign exchange? Or if you could just let us know a little bit more detail about that margin development in Lighting sequentially in the quarters. That was the first question.

And then secondly, just to clarify, on Healthcare you talked about a facility closure that could have an impact on EBIT in the first half of 2014. Just to clarify, was there any cost of that included in Q4? Just to understand that development. Thank you.



Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Okay, well thanks for the question. Yes, so if you look actually on a adjusted EBITA basis, the margin expansion has been the same; [10.2% and] (corrected by company after the call) 10.4%.

We had good sales growth, as we reported. Also, there has been an influence of ForEx in that number in somewhat less of an operational leverage than anticipated. If you look at the reported EBITA number, actually, you see somewhat better number, 8.5% and 9.5%, which is also because last year we took quite some restructuring provisions. So, yes, it's a good point that the operational leverage could have been better, and it's something that we are increasingly working on.

But I would also mention that if you look, compared even excluding the big restructuring we took last year, that there's a significant quarter-on-quarter for the year improvement. Yes, so even though the quarter versus quarter progression it has not been that much, I would also say that we have been able to sustain the year on year performance and overcame quite significant headwinds, particularly also in currency.

Martin Wilkie - *Deutsche Bank - Analyst*

So it's not mix in LED? It's much more attributable to the currency side?

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

No, it's not the mix in LED. In fact, the mix in LED has gotten somewhat better as we are growing in volume and more of the operational leverage of the expenses we're making to develop innovation and go to market there pay off.

Robin Jansen - *Koninklijke Philips NV - Head of IR*

The second question on Healthcare.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Cleveland in Healthcare, yes, that's --

Martin Wilkie - *Deutsche Bank - Analyst*

So the question on Healthcare was you've mentioned about a facility closure impacting the outlook in the first half of 2014 by EUR60 million or EUR70 million. I just wanted to clarify if there was any cost at all in Q4 that would have impacted EBIT in Q4 2013?

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

No, that's not the case; this is a 2014 event.

Martin Wilkie - *Deutsche Bank - Analyst*

Okay, very clear. Thank you very much.



Operator

Gael De-Bray, Societe Generale.

Gael De-Bray - *Societe Generale - Analyst*

Two questions, please. The first one is on Healthcare. Given all the headwinds in terms of the negative FX impact, the softer order intake, and also now the manufacturing issues, so is there a chance that Healthcare sales and profit actually turns negative in 2014 in terms of development?

The second question is selling expenses dropped by 160 bps as a percentage of sales in Q4. I think that's been a common feature throughout the year now, so maybe what was driving this decline in selling expenses? Thank you.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Okay, on Healthcare, on the downward trend, we're not giving guidance. I agree with you that with the ForEx headwinds, which also will impact Healthcare, and the uncertainties in the economy, not the least also the ongoing uncertainties in the US healthcare, a hospital system that is reconfiguring itself, we need to see throughout the year how we will deal with this.

We also, as we have announced, are reconfiguring our sales organisation to have a better, more effective ratio of order intake and to become more efficient, and better geared to customer needs, serving these larger integrated delivery networks, I would say.

The FDA, as we said, this will be a EUR60 million to EUR70 million impact in the first half, but we expect to recover most of that through additional measures in the second half of 2014. And it's not all overcome -- over very hard to try to neutralize the full impact for the year.

On the selling expenses and 160 basis points, yes, bear in mind that last year also there was quite some restructuring in that number and that if you look at it on a comparable basis the trend is not a downward one.

A similar argumentation holds true for R&D. We are definitely not achieving our mid-term targets by cutting back on either go-to-market spend, or innovation. I would argue the contrary; since 2010, we have spent significantly more money in R&D and in go-to-market, so our selling expenses.

But, of course, it is also true that we will look at productivity there. And some of the overhead savings are also coming in, in that area; a normal pattern, I would say.

Gael De-Bray - *Societe Generale - Analyst*

Okay, thank you very much.

Operator

Olivier Esnou, Exane BNP Paribas.

Olivier Esnou - *Exane BNP Paribas - Analyst*

Yes, a few questions, please. First, maybe just to clarify the guidance again. Sorry, I'm coming back to that, but when you say that the margin will only moderately improve from 10.5% this year in 2014, you do actually include -- I mean it's an all-in margin. You include the restructuring, also the negative impact of the healthcare disruption in H1, and potentially recurring in H2? I just want to clarify that it's an all-in number.

Secondly, on your comment earlier about the introduction about healthcare RSNA feedback, maybe, do you have the number of product launch in 2014 that you have? I remember, you gave 2013 was about 50.

Third question on the -- coming back also on the FDA disruption. I remember this happened to one of your competitor in the past, and it could be -- sometimes it can last a bit longer than we think. So I was just wondering your level of confidence on the limited disruption for the year; if you have enough visibility at this stage to be really confident to recover.

Frans van Houten - *Koninklijke Philips NV - CEO*

Okay, Olivier, thank you. We will look up the number of new product introductions; I'm looking at my team here, whether we have that.

Let me start with the other questions. Yes, on the guidance on margin, obviously, we don't give specific guidance. Andreas also asked there that question.

My response was that when we talk about making another step is that we look at the underlying quality of the performance of each of our sectors. We would like to improve every sector performance. There's also IG&S to consider; the IT income to consider; the extra investments in innovation and restructuring. So we give a qualified statement that the underlying quality of the performance will increase, with a modest step taking all of that into account, and, therefore, we don't give guidance on exactly the profitability last year versus this year. Sorry, but I cannot help you there in a precise manner.

The FDA question, of course, we are very much aware of -- that these things can be severe. This is also why we take it very seriously. At the moment, as we observed the manufacturing control deficiency in Cleveland, we immediately took proactive action with a voluntary close of the manufacturing operation so that we can immediately remediate the efforts. This work has already started. We expect this to happen in the first half of 2014, and then recuperate significantly the effects of that in the second half.

At this stage, that is all I can say about it. We have full attention to it, and we look then with confidence to fix this. And let me --

Olivier Esnou - *Exane BNP Paribas - Analyst*

Thank you very much. Maybe just a quick follow up. On your introductory remarks you also said that Philips was gradually shifting from product to solutions. In your mind, is it something which is structurally positive, or negative, for the margin? It means different things to different companies, so I just want to have an idea of what are the implication for you, for Philips?

Frans van Houten - *Koninklijke Philips NV - CEO*

Well, first of all, I believe that hospital systems require a technology partnership. They are fed up with buying individual products, all of individual makers that make their life complex in terms of training and efficiency and integration. Of course, when you go to larger deals, customers may expect better terms. On the other hand, it's for us more efficient to have a multi-year deal in which we help each other.

Overall, I believe that by moving to solutions we will shield ourselves against competition on point solutions, thereby avoiding commoditization. And by adding the clinical informatics and the software and systems integration we can provide unique solutions to every individual hospital. Again, that adds a lot of value to our customers. That's in line with our ambition to be locally relevant and close to our customers.

Overall, to sum it up, we think it will have a positive effect on our margin potential.



Olivier Esnou - *Exane BNP Paribas - Analyst*

Okay, thank you very much.

Operator

Simon Toennesen, Credit Suisse.

Simon Toennesen - *Credit Suisse - Analyst*

Two questions from my side. A few people have asked already about Group margins in 2014, and I acknowledge obviously that you don't want to give any specific guidance. I'm just a bit more interested in the margins in Healthcare.

One of your key competitors in healthcare flagged in the past that they're seeing margins peaking in healthcare. You obviously have quite a lot of competitors in Japan, which have a substantial FX benefit. Your last CMD was, obviously, mainly about Consumer and Lighting, and not so much about Healthcare. I would just appreciate a bit more color how you think margins in Healthcare can improve, apart from just overhead cost savings, which you flag as a key contributor to this 100 basis point margin improvement in Q4.

Just looking at consensus numbers, and obviously you don't need to comment about those, but looking at those, the consensus is implying almost 120 basis point margin improvement in 2014 on an underlying basis versus what you've just reported. It looks quite challenging, so I would just appreciate a bit more color around that.

The second question is just on FX. Maybe, Ron, if you could give us maybe a bit more guidance about -- for Q1, and maybe Q2, what we should think about the FX impact there. Thank you.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Okay, very good questions. Of course, in Healthcare, we've been, under the influence of Accelerate, working on more operational excellence. There is much more potential, I would say, with the 1% growth and strong margin improvement in Healthcare.

We have, as we mentioned also, DfX initiatives. Now there's a ramp in there to 2016. We are looking at our industrial infrastructure, how to rationalize that further.

Of course, we haven't given you the number yet on the question earlier, how many new product introductions. We think it's similar than last year. If it's very different, I will come back to you on that. So, with those, also all good areas.

Of course, we have also a few things to deal with. One is the FDA in the first half, which will hit. We expect a recovery of most of it in the second half with a hit. Then, the ForEx impact in Healthcare, I think I keyed that also in earlier conversations, will also particularly influence the first half of the year.

So we keep working on operational improvements, and we keep working towards our 2016 stated ambition of 16% to 17% reported EBITA. Now, the trouble is not exactly a linear (inaudible) but more a gradual improvement with -- and the influence over also of what I just said.

I also would like to make note of the fact that the 19.1% on adjusted EBITA that we have just reported is a very, very, very high achievement; a record in the past 12 quarters.

So, yes, there is caution on Healthcare, like the story of self-help in Healthcare is really at work; there are also some clouds, as I said, but we need to overcome these and work towards our progressive goals for 2016.



Yes, on the ForEx, just kind of implied it already in what I said earlier, but it's a good point, Frans. ForEx, of course, this year we've been, of course, impacted a little by ForEx. You've seen the 600 basis points, and there's been an impact in the results. We overcame that. First of all, we were partly hedged, and I say partly because these things roll on and off, so it's if you're 100% immune to it. That's why we've also been working on cost out in the areas where it hits, on improving, of course, on further intimacy in customer relationships. We make sure the business is ongoing. And where we could, we have increased prices.

With all of that, and also, of course, with Accelerate, we've been able to overcome all these headwinds. We mention them, but we don't excuse the results for it. That's been an achievement, I think.

Now, go forward for 2014, even at today's currency rate, the ForEx headwind will get stronger. And that is not only because there is pressure on exchange rates, but also because more of these hedges are going to roll off. We'll work towards overcoming them. That is exactly why we mention that there is ongoing currency headwind, particularly in the first half of the year.

Simon Toennesen - *Credit Suisse - Analyst*

Okay, thanks very much.

Operator

Fredric Stahl, UBS.

Fredric Stahl - *UBS - Analyst*

I just -- actually, I wanted to start with a fairly detailed question. I'm just curious on the Air Purifier. Could you give us an indication how big that is as a part of your Consumer business, and how fast it's growing?

And then the second question, again more detail. On the Professional Lighting Solutions growth, it accelerated compared to last quarter. Could you give us some color on what geographies drove that growth? Thank you.

Frans van Houten - *Koninklijke Philips NV - CEO*

Thanks for that question on Air Purification. It's nice how Philips benefits from the unfortunate environmental issues in the world. The Air Purification business is a business that has been started three years, or so, ago, and from zero grew to EUR100 million in that timeframe. So it's a nice example of entrepreneurship.

It may not move the needle for the totality of Philips, but it's an example of what I like to see more. It's a spirit that we encourage in the rest of Philips, and the growth rate is fantastic. So we can hopefully continue and see more of that. I'm confident that we can.

And, by the way, air purifiers will now connect to smartphones, and then through your smartphone you can remotely monitor the air quality in your apartment. Who doesn't want to have that?

Then, Professional Lighting Solutions, as you know, we are dealing with a transformation in PLS North America, where we are finally consolidating the various brands coming from our Genlyte acquisition, and the sales force integration, and the manufacturing footprint. Arguably, we should have done that earlier, but we have made a major progress in 2013. We have lost a little bit of ground in 2013 versus our competitors; we aim to get that back in the next period.



We saw very good traction in both Europe and in the emerging markets. The premise, the value proposition of PLS is very, very strong. Energy efficiency becomes increasingly the theme.

I was in Davos last week. As you know, we have this deal with the city of Buenos Aires where we do 125,000 city lights with our CityTouch. We were in a gathering of city mayors last week. The city mayor of Buenos Aires stood up and gave a glowing story on how Philips is helping turn around the financials of Buenos Aires. Many other city mayors after the meeting came to us and said, can we please also do this? So you see that Davos is not only about high-level talk, but actually we go there for business leads.

I'm quite optimistic that PLS is on the right track to become the future of Lighting. I mean, strategically, that is where we want Lighting to end up. And LED part in PLS is more profitable than the conventional part in PLS, so also structurally it is a highly attractive segment to operate in.

Fredric Stahl - UBS - Analyst

Very nice. Thank you.

Operator

Aaron Ibbotson, Goldman Sachs.

Aaron Ibbotson - Goldman Sachs - Analyst

I have two questions, if I may, both on Lighting. The first one was just I was curious that you experienced slower growth in the US than Europe overall in the Lighting division. I was just wondering if you could comment a bit on that, and if this was something general, or anything specific related to more intense competition on the LED side, for instance, in the US.

And secondly, also on Lighting, I was hoping that you could potentially give some update on the gross margin development in LED versus non-LED. And specifically, if it's okay, I'm very curious to hear your thoughts on Automotive LED, which is both growing fast and expected to continue to grow faster, whether that is dilutive to Lighting margins overall. Thank you.

Frans van Houten - Koninklijke Philips NV - CEO

Okay, well, let's start with the first one. The slower growth in US versus Europe, I think that's specifically also a Philips issue. I've just explained to Fredric that PLS North America is undergoing quite some change and, therefore, was not growing, whereas in Europe we have good traction.

I would also point out to the fact that energy efficiency in Europe is high on the agenda, and we play into that opportunity. Energy costs in Europe are much higher than in the United States and, therefore, we see good chances to advance our energy-efficient lighting solutions in Europe. And the same applies to emerging markets.

To the gross margin comparison, I think we have talked about this at the Capital Markets Day several times. I've already just now said that PLS is comparatively better. Overall, LED margins are up from 2012 to 2013, reflecting the good work that we are doing to improve profitability of LED.

Differentiation of the value proposition makes, of course, a big difference, so connected lighting, and all the features that we bring out help us in that respect.

We do the same in Automotive, where your question is. In Automotive, we see strong interest in higher level assemblies of LED, including the light guides and similar points. So, versus selling just a naked light bulb, we see actually that we can supply a simple assembly that, from a margin point of view, is also good. We have very good traction, even though the said overall proportion of LED sales in Automotive is still very, very small.



So even though a lot of people talk about it and it is highly aspirational to have these sexy LEDs in your car, the vast bulk of cars is still on conventional; and that will stay for at least the next 10 years as the mainstream of the Automotive business. I think that is about as much as I can say about it right now.

Aaron Ibbotson - *Goldman Sachs - Analyst*

Okay, thank you. I have one quick follow up, just on Healthcare in Europe. It has been asked quite a bit in relation to GE and Siemens, but I was also curious if you believe emerging market competitors is having an impact on pricing, and potentially on your volumes on order intake in Europe. Is that something you're seeing? Or is that still basically a non-event, in your view?

Frans van Houten - *Koninklijke Philips NV - CEO*

Yes, that is something that is not very prevalent. And I don't see that as a big risk, especially given the fact that there is a trend towards larger deals, more holistic partnership deals, and less opportunism on individual single product sales. So, overall, this is not a big threat to us at this time.

Aaron Ibbotson - *Goldman Sachs - Analyst*

Okay, thank you.

Operator

Philip Wilson, Redburn.

Philip Wilson - *Redburn Partners - Analyst*

I have three questions, if I may. Firstly, on FX, Siemens talked today, for the first time, about 40 basis points and margin dilution in the quarter from FX as the hedges wore off. Can you help, perhaps, of what you saw as the margin impact of FX for the fourth quarter for yourselves, and how that impacts on 2014 as the hedges roll off?

Secondly, on G&A, G&A expenses, if I look on an annual basis, increase from 3.6% of sales in 2012 to 4.0%, despite the EUR500 million overhead savings in the year. Can you explain why this increased?

And you've given some commentary today on R&D and selling expenses, so can you help with how G&A will trend in 2014 as a percentage of sales? And should we expect this to come down, given the further overhead savings?

And finally, on Lighting, obviously very strong growth, but within that Consumer Luminaires has been in decline for the past two quarters now, and relatively low growth for the past two years. Can you outline what growth expectations you have for Consumer Luminaires for 2014, and what the strategy is to improve the growth here? Thanks.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

On the ForEx, as I said, there's been a significant impact. I don't believe we have quantified it in the way you articulate. But definitely, in Q4 there's been a significant impact in the margin, as I said, that we overcame.

I can only tell you that, go forward, as I said earlier, in the first half this will be a further headwind for the whole of 2014, but particularly in the first half, for reasons mentioned.



You asked why the G&A increases, and how this would trend. Bear in mind that we are still doing restructuring in a number of areas, also in our so-called global service units, and that it ends at some point; plus a number of other restructurings.

And also, the IT aggregate investments come in that line. They're the ones that we do to create the Phillips integrated landscape away from the legacy systems around the four standardized business models that we have outlined that we want to operationalize by 2016/2017, for which we will do the first implementation in the second half of 2014.

The part --

Frans van Houten - *Koninklijke Philips NV - CEO*

With regard to your Consumer Luminaires question -- you were still on the other one?

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Yes. On the G&A, bear in mind that in 2012 there was also a pension gain in G&A, so we alluded -- elaborated on that also at that time.

Philip Wilson - *Redburn Partners - Analyst*

Yes, okay.

Frans van Houten - *Koninklijke Philips NV - CEO*

Okay, then your last question on Consumer Luminaires, we have made a lot of progress in 2013 in improving the profitability; still not totally there yet.

What we see in the world is that the traction in Asia with Consumer Luminaires is very, very strong, and also well profitable. In Europe, we see very weak consumer demand for Consumer Luminaires, and we are still seeing the effects of the adaptation of our business model. Nevertheless, we are confident that we can make further progress on Consumer Luminaires in 2014.

Philip Wilson - *Redburn Partners - Analyst*

Okay, thank you.

Operator

Peter Olofsen, Kepler.

Peter Olofsen - *Kepler Cheuvreux - Analyst*

Three questions, if I may. First of all, on the comparable sales growth in Lighting, the 3.2% that you reported for the full year, could you provide a split between volume and pricing/mix?

And then on the Home Healthcare business, Respironics, I think one of your main competitors there reported quite weaker quarterly results. I think they were impacted also by competitive bidding. Could you shed some light on the market circumstances and pricing environment in that particular business? Also, because your competitors seem to suggest that they might become a bit more aggressive on pricing.



And then finally, on the Dutch pension plan, the EUR600 million that you will contribute, can you shed some light on how much of this amount will be cash, and how much will be non-cash?

Frans van Houten - *Koninklijke Philips NV - CEO*

Let's start with the third question on the pension plan. Ron, if you would take that, please.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Yes, the EUR600 million contribution, we don't give out the specific details on that usually. But we think about half, a little less than half, will be in cash, okay?

Frans van Houten - *Koninklijke Philips NV - CEO*

Then on Respiroics versus competition, a couple of things at play. I think, first of all, the implied message of our competitor was that somebody else was gaining traction; I think that was us, because we are gaining traction on the patient interface on the mask.

So new products are doing very well, and we are pleased that we have been able to come with some very attractive patient masks that allows us to gain some market share back in that place.

Competitive bidding is changing the landscape. The DMEs are consolidating; it creates a massive transformation of the marketplace. We also see that there's an opportunity to move into a more direct to consumer play.

Pricing is challenging. So far, we are managing margins. And we believe that structurally we continue to regard this business as a very good business (multiple speakers).

Peter Olofsen - *Kepler Cheuvreux - Analyst*

And the breakdown for the Lighting sales?

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Yes, so the Lighting sales, it's mostly volume. We've seen price erosion, still quite manageable. And go forward, for the LED lamps, particularly the price erosion will somewhat increase to drive it to a better price point, but that is something that we have still anticipated. We are working, of course, in the costs of goods to drive that to a good margin. So, that's on the Lighting split.

Peter Olofsen - *Kepler Cheuvreux - Analyst*

And when you say that it will accelerate on the price side, to what kind of levels?

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Well, as you see that subsidized form now in the US, it's about \$5. So it will gravitate to that point at some point in other areas, and, of course, then it has to become non-subsidized. So we've always said around EUR5 in our case, that's a good data point to think on; and from then onwards it probably will erode a little more.



Peter Olofsen - *Kepler Cheuvreux - Analyst*

Okay, thank you.

Operator

Andrew Carter, RBC.

Andrew Carter - *RBC Capital Markets - Analyst*

I had two questions, please. The first was just regarding some of your growth geography. I wonder if you could just talk a little bit more about what you've been seeing.

I thought it was particularly interesting that, given we've obviously had a couple of quarters where things have been a bit more difficult, at least in a macro terms, you've actually just had, I think, a record quarter in terms of sales growth out of those growth geographies. So I just wondered what you were seeing, and whether you thought that, that was sustainable as we go into 2014.

And the second question was just a very quick one, I guess, on Lighting. One of the things that people have been looking out for is starting to see some construction activity picking up, particularly I think in Western markets. I was wondering if you had any comment as to whether you've seen that yet, and whether you've got any lead indicators that it might be coming.

Frans van Houten - *Koninklijke Philips NV - CEO*

Thank you. Yes, let me give some color on the growth geographies. We are very happy; record 15% sales growth in the fourth quarter. At the same time, the order intake in the fourth quarter was a little bit weaker because of the uncertainty in those markets, so growth markets are not invulnerable for the effects that we have been talking about.

Structurally, Phillips is well-positioned for growth markets, and that has to do with our strategy. We are addressing the healthcare needs in those markets. Most emerging markets need more light. There is urbanization. There is demand for energy efficiency, and we play into that.

By choosing different business models, such as selling light as a service, and making it a multi-year recurring revenue deal rather than an upfront investment, we can also overcome the hurdle of a big investment. Regional development banks are also supporting us in that in order to do different deals.

So, all in all, I think we can continue to be cautiously optimistic, even though I hasten to say that social unrest, like in the Ukraine, or in Turkey, as well as the currency movements, like in Indonesia, of course, in the near term are not helping us.

Your second point on construction in Lighting, actually, we see the retail market in the US pick up a bit, but there the lighting content is very, very low. The professional construction, or the commercial construction, is still very low and we do not really see a pickup.

So far, the success in the Lighting has a lot to do with the renovation or the retrofit market, where (technical difficulty) -- so building owners are interested to upgrade their existing buildings with LED lighting. Okay?

Andrew Carter - *RBC Capital Markets - Analyst*

Thank you.

Operator

Hans Slob, Rabobank.

Hans Slob - *Rabobank - Analyst*

Two questions. The press release states that you saw higher IP royalties related to one-time patent settlement for Blu-ray and TV. Could you disclose the impact of this one-time settlement?

Secondly, could you shed some further light on the performance of the Lumileds business, the underlying performance, and if you see room to improve that further in 2014?

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

Yes, thanks for the questions. The higher IP one-off settlement is EUR75 million.

Hans Slob - *Rabobank - Analyst*

Thanks.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

The Lumileds has increased its performance over the year. As you know, last year, we were close to breakeven for Q4 -- in Q4, we were breakeven. This year, for the full year we have increased our profitability; that's on the back of good business development.

As you know, Lumileds does more than only general illumination. The other parts in the portfolio, like flash and automotive, these have also performed very well.

We're looking to improve Lumileds further for this year. It will be mostly geared towards the second half of the year, that improvement.

Hans Slob - *Rabobank - Analyst*

Okay, thanks.

Operator

David Vos, Barclays.

David Vos - *Barclays - Analyst*

One more question, please -- or actually, two maybe, if I may. The first one on Lighting, could you, perhaps, talk about the license income part of the portfolio there, and how you see that developing? I think you've added about 100 licensees to the program, and recently a couple of high profile ones, so it would be interesting to hear a bit more about that.

And then secondly, just a housekeeping; what do you see in terms of tax rate and financial charges for next year, please?

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

The license income, as we said earlier, and it also [plans out] that way, as I said earlier in my speech, we have expected that in about four years' time license income would come down structurally by EUR15 million a year, so it's about EUR60 million, so about EUR15 million per year it will come down.

And then the second question -- the financial charges, sorry, about that.

David Vos - *Barclays - Analyst*

And the tax rate, please.

Ron Wirahadiraksa - *Koninklijke Philips NV - CFO*

The tax rate guidance is for 30% to 32%, go forward. On financial income and expenses, we expect to be within the same bandwidth as this year. If you take the financial income expenses, our total average gross debt of [7.7], there's, of course, a little bit more in that than just interest costs. Base interest costs on the loans are between 5% and 6%. Yes?

David Vos - *Barclays - Analyst*

Okay, thank you very much.

Operator

Mark Davies Jones, Agency Partners.

Mark Davies Jones - *Agency Partners - Analyst*

Could I just go back quickly to the reorganization of the sales infrastructure in US Healthcare business? A little bit more on the rationale for that would be great; but also, any financial implications for that. Are you actually reducing related headcount, or increasing headcount? Is there restructuring cost associated with that process?

Frans van Houten - *Koninklijke Philips NV - CEO*

Yes, okay, I'm happy to take that question. You have heard me talk about a trend of hospital consolidation, and also that we are moving more from a product sales company to a solutions sales company, a partnering company.

The two trends go together, obviously, and give us an opportunity to engage more at the enterprise level with large hospital chains, and also make a different pitch. So whereas in the past we would make a pitch just to sell a more efficacious scanner, we now are making the pitch that we can drive productivity for the entire hospital.

Obviously, that requires different setup, different skills, different also reporting lines in the sales organization, so we are creating teams; hunting teams that will support hospitals in their quest for driving productivity and efficiency.

So that is behind the transformation. So it's not a transformation that is driven out of cost, but much more a transformation in the light of a changing healthcare landscape.



Of course, as we are focused on competencies and capabilities, there can always be some consequences for individuals. But then again, that's not the driver of this change.

In terms of financial implications, I would consider that to be minor and not really influencing the results. Of course, there can always be some turmoil as you implement these changes, but at this moment I don't expect that.

Mark Davies Jones - *Agency Partners - Analyst*

Thank you.

Operator

Andreas Willi, JPMorgan.

Andreas Willi - *JPMorgan - Analyst*

I just wanted to clarify on your guidance, again. Sorry to have to come back to that, but it's clearly also affecting your share price during the conference call.

In the statement, it clearly reads that the improvement is targeted on a reported basis, because you mention that you take into account restructuring and investments, and on the call you say it's underlying. And I think that if you could just clarify that, once again, because it's clearly a material difference here on what you're trying to say. Maybe you're not trying to say much on what you expect for 2014, but there's clearly an issue here.

Frans van Houten - *Koninklijke Philips NV - CEO*

Okay, no, clearly, Andreas, thanks, first of all, to coming back on it; I know you want to have clarity. Obviously, we strive to improve the profitability on a reported basis overall for the Company.

I thought I was helping you by talking about the underlying effects because that is what makes a business go better. As you wrote in your own piece, there were some one-off effects in Healthcare last year, in 2013. We want to drive the operational results better every year and that is why I gave you color on what is happening, and then, of course, some of the investments that are happening, so that you can form a more balanced and integrated picture.

But, of course, we are committed to drive towards our 2016 targets; those targets are higher than our achievements in 2013. And we will make step-by-step progress on that journey, no doubt about it.

Andreas Willi - *JPMorgan - Analyst*

But your target's on a reported basis, so if you say we want to make progress the market assumes it's on a reported basis.

Frans van Houten - *Koninklijke Philips NV - CEO*

Exactly, that's what I'm just saying, on a reported basis. We are fully in agreement.



Andreas Willi - JPMorgan - Analyst

Thank you.

Operator

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

Frans van Houten - Koninklijke Philips NV - CEO

Thank you very much for attending. I look also forward to seeing some of you on the roadshow that both Ron and I will do in parallel over the next few days.

Operator

This concludes the Royal Philips' fourth quarter and annual results 2013 conference call on Tuesday, January 28, 2014. Thank you for participating. You may now disconnect.

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