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PHIA.AS - Q4 2015 Koninklijke Philips NV Earnings Call

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OVERVIEW:

Co. reported 4Q15 comparable sales of EUR7.1b and net loss of EUR39m. Expects modest comparable sales growth for 2016.



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PRESENTATION

Operator

Welcome to the Royal Philips fourth-quarter and full-year 2015 results conference call on Tuesday January 26, 2016. (Operator Instructions). Please note that this call will be recorded and is available by webcast on the website of Royal Philips.

I will 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*

Thank you, operator, and good morning, ladies and gentlemen. Welcome to Philips' fourth-quarter and full-year results conference call. I'm here with Frans van Houten, CEO; and Abhijit Bhattacharya, CFO.

In a moment, Frans will make his opening remarks and will take you through our main [and] strategic financial highlights for the period. Abhijit will then provide more details on the financial performance during the quarter. After that, both Frans and Abhijit will be happy to take your questions.

Our press release and the related information slide pack were published at 7:00 AM CET this morning. Both documents are now available for download from our investor relations website. A full transcript of this conference call will be made available by tomorrow on our investor relations website.

Before I turn over the call to Frans, I would like to remind you of two things.

Following the decision in June 2014 to combine our Lumileds and automotive lighting businesses into a standalone company and to explore strategic options to attract capital from third-party investors, the profit and loss of these combined businesses is reported 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 combined Lumileds/automotive businesses is reported under cash flow from discontinued operations. Therefore, all commentary that will follow in terms of sales and earnings, at both the Company level as well as the lighting sector level, continues to exclude the performance related to the Lumileds and Automotive lighting businesses.



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.

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

Frans van Houten - *Koninklijke Philips NV* - CEO

Yes. Thanks, Robin, and good morning to everybody on the call.

Overall, 2015 was a solid year for Philips in which we delivered consistent performance improvements, notwithstanding ongoing macroeconomic challenges. Lighting delivered yet another year of operational improvements, and our HealthTech portfolio, which combines the Healthcare and Consumer Lifestyle businesses, achieved 5% comparable order intake growth, and 4% comparable sales growth and improved margins for the year, demonstrating our progress in capitalizing on opportunities in this large and growing market.

The commitment I see across the organization to our Accelerate! transformation program continues to be the main engine behind our operational and financial performance improvements throughout 2015. The culture of operational excellence has taken root, and it leaves me very optimistic about our ability to continue to improve operational and financial performance for the years to come.

We've also made good progress on the integration of Volcano during 2015. We are ahead of our plans in delivering on cost synergies, which has helped our results being ahead of plan. More importantly, we have been able to capitalize on more than planned revenue synergies in the interventional x-ray business, with Volcano's sales force providing actionable leads to our sales organization due to Volcano's highly frequent contact with customers.

In the last 12 months, we also made significant progress on our plan to separate Philips into two standalone companies, each one better positioned to capture the highly attractive opportunities in HealthTech and Lighting Solutions. I cannot stress enough the complexity of this task, and I'm pleased to say that the process remains fully on track.

Turning now to our fourth-quarter performance which reflects another quarter of fundamental improvement in the challenging macroeconomic environment. We delivered currency-comparable order intake growth of 15%, continued sales growth in healthcare and consumer lifestyle, and very solid improvements in the adjusted EBITA margin across all three sectors.

Let me provide you with some color on the performance of each.

In Healthcare, comparable sales grew 3%, and currency-comparable order intake, as said, increased by 15%. In the quarter, we signed three new long-term strategic partnership with Mackenzie Health in Canada, Granada's Clinical Hospital in Spain, and Hospices Civils de Lyon in France. These partnerships are based on a managed services model to optimize the delivery of care, and are expected to make meaningful contributions to healthcare's performance during their lifespan.

Let me provide a bit more detail on two of these partnerships.

The strategic partnership with Hospices Civils de Lyon is our first in France and is worth around EUR60 million over a 12-year term. The hospital will have access to state-of-the-art equipment and services under a single-payment structure. This includes procurement, installation, systems integration, maintenance, equipment updates, so to ensure that hospitals will be provided with the medical technologies that its radiology department requires for the optimal delivery of care.

And as a first for Philips in Canada, we have signed an 18-year agreement worth CAD300 million with Mackenzie Health that will advance Mackenzie Health's medical technology procurement and maintenance programs for the existing Mackenzie Richmond Hill Hospital, and for the future Mackenzie Vaughan Hospital which will be completed in 2019.

These latest strategic partnerships signal a growing trend within hospitals and health systems to better manage cost and handle the complexity of their technology investments, while expanding quality access to advanced medical care and improved medical outcomes.

In addition to these strategic partnerships, we are leveraging our wide range of capabilities to address specific customer needs such as our expertise and leadership in clinical informatics. In the quarter, we signed a multi-year agreement with the University of Colorado Health, an integrated delivery network or IDN in Colorado for the implementation of Philips' Intellispace Picture Archiving and Communications Systems, also known as PACS, across the health system.

We will consolidate and standardize UCHHealth's electronic health records, voice recognition systems and PACS on to specialized platforms for both radiology and cardiology. Together, we aim to optimize the delivery networks image sharing workflow, thereby enhancing patient care and driving projected cost savings of more than \$10 million for the health system.

We are also making steady progress with our quality optimization efforts in Cleveland. As we indicated last quarter, we will continue to invest in quality improvements during 2016 as we remediate the smaller remaining product lines and address the remaining outstanding issues. As a result, we expect that Cleveland will contribute around EUR100 million to adjusted EBITA in 2016, albeit it back-end loaded, and then the remainder to come in 2017.

Let me now turn to the Consumer Lifestyle business. Consumer Lifestyle continued to perform very well, driven by the continued strong demand for our innovative solutions, as well as successful new product launches, as the next generation VisaPure, which was successfully launched in both Asia and Europe.

The benefit of our focused approach continued to drive sales across the Health and Wellness, Personal Care and Domestic Appliances businesses, and was demonstrated in China, for example on Double 11 day, the country's biggest day for online shopping.

Philips was the top-selling brand in categories such as male grooming, beauty, garment care, kitchen appliances and oral healthcare, with some product ranges selling out within minutes. Male shaving products were particularly popular, with over 0.5 million shavers sold in just 24 hours.

Oral healthcare across the global experienced double-digit growth, with particularly strong performance in countries like North America, China and Germany. The Philips Sonicare 2 electric toothbrush range was cited by US retailer Target as one of the most popular items in their Black Friday pre-sale.

Earlier this month, we participated in the Consumer Electronics Show in Las Vegas where we had the opportunity to demonstrate our innovative approach to connected healthcare by demonstrating our HealthSuite Digital Platform. This platform can, among other things, connect consumers to medical devices that monitor and coach personal health and wellness, and can also connect patients to systems that allow them to recover from procedures in the comfort of their homes.

HealthSuite will also support professional healthcare solutions from both Philips and third parties, driving better outcomes, higher productivity, and enabling patient-centric population health management through the cloud.

It received an excellent response and we plan to announce a slate of health informatics applications based on HealthSuite at the coming HiMSS Conference. HiMSS is a healthcare informatics show in Las Vegas in end of February/early March in the United States.

Let me now switch to Lighting.

Lighting delivered yet another quarter of year-on-year operational improvements driven by sustained comparable sales and margin growth in the LED business and our ability to sustain our high level of adjusted EBITA margin in the declining conventional lamps market.



We have continued to strengthen our leadership in connected lighting, proving time and again that we can revitalize buildings with our connected LED lighting technology, such as the Cairo Opera House. We recently provided this iconic building with a stunning makeover. By using our latest LED lighting technology, the Opera House will reduce its energy consumption by up to 80% compared to conventional lighting previously used.

Philips' new lighting concept focuses on highlighting the importance of the building as a source of cultural pride; and with our new dynamic lighting, this landmark is visible from up to 0.5 kilometer away on the River Nile.

Los Angeles and San Jose in California are the first cities to benefit from Philips' LED street lighting, combined with wireless broadband transmission technology from Ericsson. Next to providing brighter and safer streets at night and a reduction in energy usage of more than 50%, the Philips SmartPoles enable seamless mobile wireless 4G LTE connectivity, increasing data capacity in the mobile network, ensuring that citizens, as well as the Internet of Things, IoT objects such as connected cars, get improved data coverage. It doesn't take much fantasy to see that this is the future.

We also entered into a global strategic alliance with Cisco, integrating Philips' connected LED lighting system with Cisco's IT network to save energy, improve building efficiency, and enhance employee wellbeing and productivity in the office.

Light points in the Philips' system equipped with sensors and software applications can be connected using Cisco technologies. This lighting network creates a pathway for information and helps enable new facility management services. Equipped with sensors, connected lighting becomes intelligent and is able to sense and measure the environment. For example, occupancy sensors in the system provide information on space utilization to help reduce cost.

Ladies and gentlemen, I began the call stressing the importance of our Accelerate! program to the strength of our fundamental performance improvement. Let me therefore now provide you with a couple of specific Accelerate! achievements in this quarter.

In Healthcare, for example, we saw the increase of ClarityIQ upgrades for interventional x-ray systems by 50% in 2015 compared to 2013 by actually automating our process for system upgrades. And in lighting, we delivered solid sales growth improvements in the Benelux and in Iberia, for example, by adapting our Consumer Luminaires portfolio to locally relevant value propositions.

Overall, our three productivity programs drove our operational performance improvements. In the quarter, we saved EUR140 million in cost of goods sold, and our end-to-end productivity program delivered incremental savings of EUR50 million. We also achieved EUR15 million of incremental gross overhead cost savings, which were offset by an anticipated increase of EUR45 million in IT cost as we roll out the Philips' integrated landscape and execute on the separation of the lighting division.

Let me also provide you with an update on several important decisions in our HealthTech organization to ensure that we remain ideally positioned to effectively capture an increasing share of the ever-growing HealthTech opportunities.

As you know, we announced four reporting segments for HealthTech at our Capital Markets Day in September, as shown on slide 53 of the quarterly IR deck. Since then, we have decided to keep Healthy Living and Prevention and Home Care together in one segment called Personal Health, which reflects the business scope as led by Pieter Nota.

Next to his role as CEO of Personal Health, Pieter Nota has also been appointed to the newly-created position of Chief Marketing Officer. In this role, he will lead a nimble yet integrated and enhanced approach to marketing and communication to drive greater awareness and preference in the rapidly-changing world of health technology, characterized by the linkages between professional and personal health solutions, the consumerization of healthcare, and of course, the digital revolution.

We've also slightly reconfigured the Monitoring Informatics and Connected Care segment. First of all, we renamed this entire segment Connected Care and Health Informatics, and it will be led by Jeroen Tas.

Secondly, within this segment, we created a new business group called Population Health Management which combines our activities in Personal Health Solutions, Hospital to Home, and Home Monitoring. We expect this to speed up business growth in a very relevant growth market by creating



synergies across our consumer and hospital propositions, integrating architectures, strengthening software and cloud service capabilities across these businesses.

These organizational changes are depicted on slide 52 of the quarterly investor relations deck.

In conclusion, I'm pleased to deliver another quarter of improved operational performance, and with a full-year performance in which we delivered 5% currency comparable order intake growth and 4% comparable sales growth in HealthTech and an improvement of Philips adjusted EBITDA margin of 20 basis points, or even 120 basis points if you would exclude the negative ForEx impact.

Before handing over the call to Abhijit, let me provide you with an update around the strategic process to attract capital from third-party investors for Lumileds.

As you saw last Friday, we announced that GO Scale Capital and Philips terminated the agreement pursuant to which the construction led by GO Scale Capital would acquire a majority interest in Lumileds. Despite our extensive efforts to mitigate the CFIUS concerns, clearance was not granted for this transaction.

I'm very disappointed by this outcome as this transaction would have benefited all parties involved in the transaction. This outcome does not, however, impact the fundamentals of this business, nor does it impact the separation process of the remaining Lighting business. We will now engage with other parties that have expressed interest in exploring options for Lumileds to pursue more growth and scale, independent of Philips.

Let me also say a few words about Lumileds' current financial performance.

As you know, we have significantly improved Lumileds' fundamentals and operational financial performance over the last couple of years. Lumileds today has a strong customer base and a strong innovation pipeline. As a result, Lumileds was able to deliver a high single-digit adjusted EBITA margin in the quarter and for the full year despite the current pressure on the high performance LED components industry. And to secure this attractive financial profile, further cost measures have been put in place that are expected to take effect in 2016. We are confident about the opportunities to strengthen performance.

And with that, let me now hand over the call to Abhijit to discuss our financial performance and market dynamics in more details.

Abhijit Bhattacharya - *Koninklijke Philips NV - CFO*

Thank you, Frans. Good morning and welcome to all of you on the call. Let me start by providing you some more detail on our financial performance for the fourth quarter.

Comparable sales in Q4 increased by 2% to EUR7.1 billion compared to last year. On a nominal basis, total sales increased by 9% mainly driven by 6 percentage points of positive currency translation effects.

It's important to note that due to a change in our reporting calendar, Q4 this year had 3% lesser number of days compared to last year. Geographically, comparable sales in the fourth quarter was driven by our growth markets which grew 6%, driven by countries like China, India, Poland and Saudi Arabia.

Sector-wise, in the growth geographies, sales growth was driven by double-digit sales growth in Healthcare and Consumer Lifestyle, which was partly offset by low single-digit sales decline in Lighting.

In our mature markets, comparable sales remained stable in the quarter, where growth of 2% in North America and 1% in other mature markets was offset by a decline of 3% in Western Europe.



Sector-wise, in the mature markets, Healthcare and Consumer Lifestyle showed low single-digit growth, while Lighting declined in the low single-digit range.

Let's take a closer look at order intake.

Currency comparable order intake increased by 15% year on year driven by double-digit growth in Imaging Systems and in Health Informatics and Systems and Services. Currency comparable order intake in Patient Care and Monitoring Solutions remained stable. Geographically, North America, Western Europe and China all delivered double-digit order intake growth versus the same period last year.

Driven by the strong Q4 performance, we achieved currency comparable order intake growth of 5% for the full year, which is above market growth, and hence, we expect to have gained market share.

In Lighting, our performance reflects the sustained comparable sales and margin growth in the LED business and our ability to sustain our high level of adjusted EBITA in the declining conventional lamps market. LED lighting comparable sales grew 26%, and EBITDA margins of LED lamps continued to improve despite the technology-driven price erosion and are now in the high single-digit range on an annualized basis.

LED sales now represents 48% of lighting sales compared to 37% in Q4 last year. We expect LED sales to represent more than 50% of total lighting sales in the course of 2016, thereby enabling total Lighting comparable sales to return to growth in the course of 2016 following two years of decline.

Conversely, conventional lamp sales declined by 16% in line with industry trends. In fact, we have gained a bit on market share in conventional lamps. Notwithstanding this significant sales decline in conventional lamps, the Lighting leadership team has been able again to sustain the highly attractive double-digit adjusted EBITA margin in this business, which is also clear testimony to the strength of our Accelerate! program.

Moving on to the EBITA development for the fourth quarter, slide 37 of the presentation material that we posted on our website provides an overview of the main drivers of adjusted EBITA when compared to the same period last year.

As you can see on the slide, the adjusted EBITA margin of 11.9% this quarter was 50 basis points higher than Q4 last year despite a stronger-than-anticipated negative currency translation effect of 50 basis points. This margin increase was driven by a margin improvement of 100 basis points in Healthcare, 180 basis points in Consumer Lifestyle, and 150 basis points in Lighting.

Our underlying operational performance, therefore, contributed 110 basis points to EBITA margin improvement in the fourth quarter as our Accelerate! program continued to improve operational performance and drive efficiencies.

More specifically, in the fifth bar, you see there a net contribution of EUR143 million from our Overhead and End2End productivity programs, a year-on-year Incremental Gross Overhead cost savings of EUR81 million in the quarter, and our End2End productivity program generated EUR48 million of additional savings year on year. These savings were complemented by EUR14 million of lower cost in non-manufacturing costs versus Q4 last year.

Design for Excellence, or DfX as we call it, which is aimed at reducing cost of goods sold, delivered EUR140 million of savings year on year. These cost savings more than offset the 80 basis points of wage inflation and negative price effect of 230 basis points in the quarter.

As I mentioned, 110 basis points in operational improvement was partly offset by currency headwind of 50 basis points. This can be explained in two main buckets. The positive impact of the dollar on sales was higher than the impact on adjusted EBITA, hence having a negative impact on the adjusted EBITA margin; and 2, the adverse swings in various emerging market currency, most notably the Russian ruble and the Chinese yuan negatively impacted the adjusted EBITA margin.

In the fourth quarter, we had tax charges of EUR152 million versus a profit before tax of EUR34 million. This was caused by a few things. A number of incidental items in the quarter that were not tax deductible; a write-down of tax assets in a number of countries largely due to the tax reductions



enacted in those countries in Q4; and thirdly, an unfavorable mix in this quarter of profits generated in high-tax countries and lower profits in low-tax countries.

The higher taxes, as well as the EUR345 million charge for de-risking our pension plans which we had communicated earlier, the EUR86 million of costs incurred for the separation of Lighting from the rest of Philips, and restructuring charges of EUR126 million, resulted in a net loss of EUR39 million. For 2016, we expect the effective tax rate to be in the low 30s.

The return on invested capital which was calculated on a five-quarter [net] basis, was 7%. Excluding one-off charges of EUR345 million related to the pension de-risking, the ROIC was 10.2%.

Inventories as a percentage of sales declined by 110 basis points to 14.2% year on year. Excluding the negative currency translation effects, inventories as a percentage of sales were down 40 basis points year on year, driven by all three sectors.

I'm also pleased that our focus on cash resulted in a free cash flow of EUR1.2 billion, excluding the outflow of EUR446 million mainly related to our pension de-risking initiatives in the US and UK in the fourth quarter.

By the end of the fourth quarter, we completed 74% of our EUR1.5 billion share buyback program. We anticipated separation costs for 2016 to be in the range of EUR200 million to EUR300 million, and we are currently expecting restructuring costs in 2016 to be around EUR250 million.

For IG&S in 2016, we expect to generate EUR400 million of net costs at the adjusted EBITA level -- sorry. Maybe I should repeat that.

For IG&S in 2016, we expect to generate around EUR450 million of net costs at the adjusted EBITA level, as we expect net-net to lose about EUR60 million of royalty income because of the expiration of licenses, and to incur around EUR40 million related to initiatives which will enable us to reduce our real estate footprint. These two factors are expected to be offset by EUR100 million of cost reduction across IG&S.

In addition, we continue to expect to incur separation costs in the range of EUR200 million to EUR300 million, as well as around EUR50 million of restructuring costs and other incidental items. At the reported EBITA level, therefore, this implies a net cost of around EUR750 million.

Looking ahead, we remain concerned about the global economic environment where it impacts our business, and in particular, about China, Russia, and Latin America.

In the US, the healthcare market experienced stronger-than-expected market growth in 2015 driven by procedure growth, a relatively strong economy, and improved financial performance for hospitals. These drivers have outweighed continual reimbursement pressure, payer mix changes, and adjustment to new payment models replacing traditional fee-for-service payment.

Key macro indicators point towards continued growth in 2016, although we expect overall growth to slow down in comparison to an exceptionally high 2015.

In Europe, the market was flat in 2015, with flat to low single-digit growth expected in 2016. We continue to see an uptick across Europe in multi-year solution-orientated deals.

In China, headwinds related to the government's anti-corruption measures, centralized tendering and price erosion, continued the overall slowdown across the healthcare market in 2015. Stabilization is likely in 2016, bolstered by the process of replacing of aging equipment which has been delayed during the multi-year slowdown.

We are, however, encouraged by the rebound of -- by the rebound in healthcare in China, where our commitment to deliver locally delivered innovations and operational improvements has resulted in double-digit currency-comparable order intake growth in the fourth quarter. While it's too early to say if this is a long-term trend, we view it as a positive development in what has been a challenging market for the entire industry.



Overall, and similar to 2015, we expect the global healthcare market growth to be in the low single-digit range for 2016.

For lighting, the market -- the outlook for the US market remains positive. The US construction market is expected to have grown by 11% in 2015, and is forecast to grow around 9% in 2016, of which non-residential construction is forecast to grow 7% in 2016. The Western European construction market is expected to have continued its recovery in 2015 with an estimated growth of around 1%.

For 2016, the construction market in Western Europe is expected to see a continued recovery as year-on-year growth is forecast to increase to 2.7%. This growth is largely driven by a slight pickup in non-residential construction.

Nevertheless, overall sentiment and market expectations in Europe remain quite uncertain and vulnerable. Hence, we remain cautious.

The Chinese residential construction market remains weak, but shows signs of improvement.

During the first 11 months of 2015, floor space residential building started construction declined by 15%, although the floor space of residential buildings sold has started to recover as it increased by 8% compared to the same period last year.

Let me briefly summarize our financial performance, before opening the line for questions.

Our improvement programs continued to drive operational improvements throughout 2015, and the fourth quarter was another quarter in which we delivered year-on-year operational improvements across all three sectors.

Our strong focus on working capital improvement and cash flow have delivered strong results, especially in the fourth quarter. Importantly, we have kept the organization focused on delivering improvements, despite the tremendous workload our employees have put in to ensure that the separation will be completed on time and within the cost targets for lighting.

Looking forward, we'll continue to drive profit performance improvements, and will not back away from taking additional action to increase cost efficiencies across our businesses.

For 2016, we continue to expect modest comparable sales growth, and we will build on the operational performance improvement that we delivered in 2015. However, taking into account ongoing macroeconomic headwinds and the phasing of cost and sales, most notably the net loss of EUR60 million of royalty income which is heavily weighted towards the first half of the year, we expect improvements for the year to be back-end loaded, with Q1 being slower than last year.

Most notably, for Personal Health, I would like to remind you of two things.

Firstly, we had a very high growth last year in Consumer Lifestyle in 2015 that has created a comparable for Q1 which will be difficult. The second; the change in the US reimbursement for home ventilation that came into effect in January 2016 will impact volumes and average selling prices; and, therefore, expected to impact EBITA margin of Personal Health by about 100 basis points in Q1 2016 compared to Q1 2015.

With that, let me now open the lines for your questions which Frans and I will be happy to answer.

Thank you.

QUESTIONS AND ANSWERS

Operator

Thank you, sir. (Operator Instructions). Max Yates, Credit Suisse.



Max Yates - *Credit Suisse - Analyst*

The first question for me was just on the 11% margin target for 2016. Obviously, that was referenced at the Capital Markets Day. Wasn't in the press release today, and I just wanted to understand how you think about that going forward in to 2016.

Thank you.

Frans van Houten - *Koninklijke Philips NV - CEO*

Well, the target was communicated by us. We said around 11% margin on the adjusted level. So that target is there. It stays. We didn't see the value of constantly repeating a target. We now will focus on working hard to achieve around 11%. So there's nothing else to be read in to that messaging.

Max Yates - *Credit Suisse - Analyst*

Okay. And just one follow-up would be on the -- on FX. Are you able to give any indication of what your expectations are for FX impact in 2016 based on the recent moves in emerging market currencies, and also based on current spot rates?

Frans van Houten - *Koninklijke Philips NV - CEO*

Yes. Well, what you saw last year is that even though we have a lot of revenue in dollars, we also have a lot of costs in dollars. Right? And that made the net ForEx headwinds persistent through the year.

In the meantime, we have taken measures among which to move some of our procurement from dollars to, for example, Chinese renminbi. But emerging markets continue to weaken, so it remains a volatile environment where for the whole year, I think we are looking at a neutral outlook on currency. But as we all know, many things can happen in the world. What our strategic aim is to get to a more balanced footprint with regard to cost, thereby not having to repeat the situation of last year.

Max Yates - *Credit Suisse - Analyst*

Great. Thank you very much.

Operator

Daniel Cunliffe, Liberum.

Daniel Cunliffe - *Liberum - Analyst*

Main question just really on cash proceeds. If we can think beyond the imminent Lighting transaction, I don't know if you could give us some indication what your thoughts are; whether it was either additional buybacks, more M&A. But just use of the proceeds would be quite useful and how you'd think about that strategically as we head into I guess the back half of the year would be useful.

Thank you.



Frans van Houten - *Koninklijke Philips NV - CEO*

Well, there's this Dutch expression of not selling the bear's hide before you have shot it. Right (laughter)? So we should be careful not to get ahead of ourselves.

First of all, of course, we see the delay in Lumileds' proceeds, and we have refinanced the Volcano acquisition loan. I think we have also flagged that there may be more pension de-risking to follow, although we feel very good about the progress that we have made in de-risking our pension liabilities.

We are on track with the Lighting separation and we are seeing interest from private investors in -- in Lighting. Same time, we will prepare for the IPO, and we will evaluate the direction to go in the course of the first half.

Now you hear me talk carefully about it because we are aiming at value maximization versus hurrying into a conclusion, and that means that there is a lot of variables on the capital that we have at our disposal. Right? And we have communicated at Capital Markets Day last year that we will look at acquisitions as a potential allocation of capital, but that's not the only thing on our minds. As we said, the de-risking and so on is also part of it.

So I'd like to leave it at that and reassure you that we will not hasten into M&A, and we owe you an update in due course. But the amount of cash is actually clear versus where we are today.

Daniel Cunliffe - *Liberum - Analyst*

Okay. Thank you very much.

Operator

Ben Uglow, Morgan Stanley.

Ben Uglow - *Morgan Stanley - Analyst*

I had a few questions just about the healthcare trends. I expect you'll get plenty on China so I actually wanted to focus a little bit on the US.

Frans, can you give us a sense of how you see just the underlying market development in US diagnostic imaging at the moment? I can see, obviously, that the orders are double-digit strong in North America, but that's obviously off the low base. And what I wanted to get a sense of from RSNA in terms of activity, in terms of customer conversations, is the sequential trend low growth, moderate growth? How significant is the upturn in the overall market?

Secondly, specifically, could you talk about the CT business? I'm not sure if I've got the numbers right, but it looks as though the Cleveland EBITA impact in the quarter was a bit lower than we'd expected. Is that correct? And can you give us an idea on how you saw the CT business specifically developing in the US in the fourth quarter?

And then finally, I see the patient monitoring business is basically flattish again. I may be incorrect, but I think we had one or two similar quarters last year. Is there something -- I don't want to say going wrong, but is there something in your patient monitoring business which is not picking up in the way that you would like?

Frans van Houten - *Koninklijke Philips NV - CEO*

Let's talk about the healthcare trends first and Abhijit will help me if I don't cover it well. Overall, the healthcare trend in the US, we see ongoing consolidation of hospital systems. Every week, something happens there. And I expect that trend to continue for the foreseeable future, all the way that will be maybe 300 IDNs left.

What these IDNs then -- Integrated Delivery Networks then do is they focus first on integration. So IT gets attention; then they focus on cost productivity in order to justify the consolidation. And much of the equipment investments are actually at a lower priority level.

Nevertheless, we see areas of strength. Our healthcare informatics business saw very nice orders in the fourth quarter. Indeed, we saw higher orders on diagnostic imaging. But that was versus a lower compare. All in all, we expect to have gained market share in the fourth quarter in the United States.

Patient Monitoring, that market has been slow. For example, the government does not every year buy the same order of magnitude in patient monitoring, and of course, the government is a very large healthcare customer for us. So I've no concerns about our market position and strength. I see it more as a function of the market.

And overall, maybe the last comment about diagnostic imaging. The installed base in the United States is fairly old, so I do expect that over the next few years, at some point in time, we will see an uptake there.

Now in the CT business, you are quite perceptive and right that the EBITA impact in the quarter was not as much as what we had originally planned. Now I look at my neighbor here. Abhijit, can you help?

Abhijit Bhattacharya - *Koninklijke Philips NV - CFO*

No. I think that's a fair comment, Ben. I think in terms of the sales and supplies out of Cleveland, we are on track, so that's the good news.

We have maintained our remediation resources a bit longer which, of course, therefore structurally keeps the cost base there higher for a couple of quarters more because we really want to embed the changes that we are putting into Cleveland so that they remain sustainable over time.

So we will see a recovery going into next year, but you're right that the cost levels that -- in Q4 were higher, and that primarily is related to remediation.

Ben Uglow - *Morgan Stanley - Analyst*

And just one follow-up on that, Abhijit. I'm not sure. I'm trying to recall from memory. But I seem to recall a number of EUR175 million given on the third-quarter call, of which roughly EUR60 million was going to be collected during 2015 and the balance in 2016. And it now sounds as though an additional EUR100 million will be coming in 2016. Are those numbers broadly correct?

Abhijit Bhattacharya - *Koninklijke Philips NV - CFO*

Yes. So basically, the EUR175 million, which we said will now be EUR100 million next year and then [EUR75 million] the following year.

Ben Uglow - *Morgan Stanley - Analyst*

Okay. Now I understand. All right. Brilliant. Thank you very much.

Abhijit Bhattacharya - *Koninklijke Philips NV - CFO*

That's linked to the cost base which we said we will keep for a couple of quarters more.

Operator

Philip Wilson, Redburn.

Philip Wilson - *Redburn Partners - Analyst*

I have two questions, please. I'll just do the first one and then come back on the second.

But on the European healthcare market, the fourth quarter was clearly very strong, but you've also had some very good growth for two of the previous three quarters of 2015. Can you comment on how sustainable that is and what your expectations are for 2016, European healthcare demand?

Frans van Houten - *Koninklijke Philips NV - CEO*

Yes. I think we see a recovery in the European market after a couple of years of decline. That improvement is not spectacular. Through the year, I think we have seen a healthy increase but nothing going through the roof.

I think it's sustainable as long as a financial crisis does not happen. Economically in Europe, we see a fragile recovery with low single-digit growth numbers. If that continues and governments do not have to intervene in spending, many health systems in Europe are government led, so in the current outlook we are cautious about 2016 with a low single-digit growth rate on orders.

Arguably, that's where we are, and I hope that nothing happens with regard to the macro environment or the stability of the region.

Philip Wilson - *Redburn Partners - Analyst*

Thank you. And we haven't talked about it much, but can you comment on the organic sales growth and the EBIT margin you're now achieving in Volcano; and perhaps the fourth quarter for 2015 as a full year, how that compares to 2014; and how you expect Volcano profit and sales to develop in 2016?

Thank you.

Abhijit Bhattacharya - *Koninklijke Philips NV - CFO*

This is Abhijit. We, of course don't give specific numbers related to Volcano, but I think Frans provided color on it. We are ahead in our cost synergies, which is good news. So the results for this year are ahead of what we had in our RFA, or in our own plan, so to say.

For me, what is more encouraging is actually the cross-selling opportunities, the orders that we are getting in our interventional x-ray business, because that was one of the reasons why we also acquired Volcano and the synergies that come with it.

The sales force of Volcano has daily contact with people in the hospital, and that allows us to uncover many more leads, and we have actually seen that translating to orders in the order book. And I think -- so those are the two main positives that I would take out of the Volcano acquisition so far.

Philip Wilson - *Redburn Partners - Analyst*

Thank you. May I ask, because it was quite a large acquisition relative to your history, just in terms of the profit level perhaps a bit of detail there? It was break even, I think, when you acquired it. I think that's correct. Is it fair to say it's now making a mid-single-digit EBIT margin given that growth you talked about?

Abhijit Bhattacharya - *Koninklijke Philips NV - CFO*

Yes. The profitability level is above our plan, so that's what I mentioned. Like I said, we are not giving specific ranges on Volcano figures.

Philip Wilson - *Redburn Partners - Analyst*

Okay. Thank you.

Operator

Andreas Willi, JPMorgan.

Andreas Willi - *JPMorgan - Analyst*

My first question is on clarification on your guidance and what are you saying about Q1. You said you expect Q1 to be slower. Is that negative organic revenue growth? Is that year-on-year decline? Is it on adjusted EBITA? What do you mean with slower?

The second question, professional luminaires. Your business there is still declining. I think most markets there are growing. So it doesn't seem like we have reached stability at the market share. Maybe you could give us an opportunity there mainly also on the US.

And the third thing on the earnings bridge. The contribution in Q4 from volume mix has been quite low at the EUR25 million EBIT contribution given you had about 4% volume growth year on year, if I take your organic sales growth and the pricing number you give. What was going on on mix then in terms of negatives in Q4 that resulted in that re-contribution from volume growth?

Thank you.

Abhijit Bhattacharya - *Koninklijke Philips NV - CFO*

This is Abhijit. So let me clarify on the first one.

We've said that next year is going to be more back-end loaded than traditionally. We are anyway more weighted towards the second half, but next year will be more back-end loaded.

In terms of slower than last year, I mentioned a couple of areas which will of course impact performance in Q1. One is the big chunk of license revenue which simply drops through to the bottom line. That would have an impact in Q1 I think roughly about 70 basis points or so. We will have an impact of the slower sleep and respiratory care which I said was about 110 basis points, or 100 basis points in Personal Health.

So these are the two areas where you will see a lower or slower performance compared to Q1. Of course overall, we will get operational improvements that we are driving, but the start to the year will be, let's say -- or the year will be much more back-end loaded than we have been in the recent past.



On the PLS situation, I think we have been in decline in North America for a few quarters now. We see that slowly beginning to turn. That's the good news. I think we were flattish in Q4 to -- so that is a good trend.

What is most encouraging about North America PLS is that the backlog that we have end of this year is about one-third more than what we had last year. So there you see the backlog increasing; you see the sales declining, the declining sales being arrested. So we are kind of what we believe at the bottom where we now start turning.

They have also done quite some extensive cost actions. So from an overall profitability, we have seen both PLS North America and PLS improving this year, which has, of course, helped the overall lighting results to improve.

The last question on the volume mix for Q4. I think -- let's say the overall growth that came was more in the HealthTech side where you see quite a significant increase in profitability, both in Healthcare and in Consumer Lifestyle. There was, of course, if you look at it totally, including Lighting where you had a volume decline because you mentioned the 4% but it's 2% overall, so that probably diminishes the impact of volume because lower volume in lighting, of course, eats into that number.

Andreas Willi - JPMorgan - Analyst

Yes. But I'm still a bit surprised at that 4% volume growth you get no drop-through in your bridge, because the margin difference between the three different businesses is not that big.

Abhijit Bhattacharya - Koninklijke Philips NV - CFO

Yes, it is. So lighting is lower. Right? And the volume growth is 4% in HealthTech but 2% overall.

Andreas Willi - JPMorgan - Analyst

Okay. Thank you.

Operator

Ian Douglas-Pennant, UBS.

Ian Douglas-Pennant - UBS - Analyst

Just on the Lumileds sale, could you give us any indication on a new timeline perhaps for that, similar maybe to the H1 timeline you've given for the sale of the main part of the lighting division? And do you need to completely restart the auction process, or could we see something well before June for that? And could you comment on the possibility that we'd see that combined with the rest of the lighting sale? And if you say no comment to all of that, I've got another question instead.

Frans van Houten - Koninklijke Philips NV - CEO

(laughter) No. I'm not going to say that. I'll answer your question.

Ian Douglas-Pennant - UBS - Analyst

Thank you very much.



Frans van Houten - *Koninklijke Philips NV - CEO*

Yes. So it's disappointing. I see a timeline getting us into the second half of 2016 with regard to a transaction, and that it does imply our assumption that we will restart the process completely. Right?

So rather than rushing into a deal, we want to do a good preparation and give parties an opportunity to engage, perhaps parties that were not in the prior process but would like to get in now. And therefore, laying that process out between now and the second half of the year I think feels reasonable.

We will not combine the Lumileds business with Lighting. We remain convinced that the upstream components market has a different dynamic and will require eventual consolidation, whereas Lighting's value profit pool is shifting towards applications and services, something that I think we have demonstrated that we are quite successful in. So we will not mix the two up but run them separately.

Does that answer your question, Ian?

Ian Douglas-Pennant - *UBS - Analyst*

Yes. That's perfect, actually. Thank you. And if a semi-follow up, if you don't mind, on Cleveland to I think a question that was asked previously.

Can you give us an update of exactly where you stand with FDA at the moment? It seems like -- might they have some more --? Might we be able to speculate they have some more problems with what's going on in that plant than you originally thought and that's why you've kept that team in place for longer?

Frans van Houten - *Koninklijke Philips NV - CEO*

I can tell you where we stand. We have originally, in 2014, in good dialog with the FDA, voluntarily shut down the plant and then started a remediation, also leveraging external consultants; and we have kept the FDA abreast of progress on a monthly basis. The report from the external consultants have also been shared with the FDA. So the FDA is completely aware of what's going on and where we stand.

We are now, as you know, back in production for a year. That is working well. Through the year, I have told you that we have seen some supplier issues and, therefore, we have extended our remediation efforts into the supplier base. That is one of the explanations why cost levels of remediation and quality improvement have stayed at an elevated level and did not go down; and that's then the reason why the profitability improvement, which was originally slated for EUR100 million last year, did not happen and only was a small amount. Much of that has then shifted into 2016 and even part of 2017.

But overall, I think we are making excellent progress there. At some point in time, the FDA, rather than relying on third-party reports, will probably come back themselves to do a full audit. And we don't know when that is, but I look at that with confidence.

There is also some other sites that I've flagged last year also where we are doing improvements, structural improvements in quality. Basically, throughout the old healthcare division, we are running a massive upgrade program. So some of the elevated costs on quality are also applicable to other sites. I've always said not of the same magnitude as Cleveland, but nevertheless, now that we have the taste of it, we go a wall-to-wall improvement on quality.

So good progress; more to do. But I do want to conclude that the interventions that we have taken in 2014 are showing the desired outcome. We see that customer confidence is restored. We see that back in the high order intake. Margins are on the way up. But of course, obviously, still much more to do to get to the margins where we originally stated that we wanted to go. So it remains a journey, but a lot of improvement down the pike.



Ian Douglas-Pennant - UBS - Analyst

Thank you.

Operator

Philip Scholte, Kempen.

Philip Scholte - Kempen & Co - Analyst

A short question then. I was wondering if you can already provide some insights into your pensions cash out for 2016, maybe also compared to the expected cost level taken in the P&L.

Abhijit Bhattacharya - Koninklijke Philips NV - CFO

I think for -- there is a plan, of course, for further de-risking, but the exact timing depends on when we pull off this transaction. So I think we prefer to update you as and when these things happen through the press releases as we have done, because at this stage, the exact timings are not yet known.

We would engage in a transaction at a time when we feel timing-wise we are okay, but it will be significantly smaller than what you've seen in 2015.

Philip Scholte - Kempen & Co - Analyst

Right. But maybe apart from additional top-ups or risk reductions, just as a going concern, cash out, is there also a number you can provide us?

Abhijit Bhattacharya - Koninklijke Philips NV - CFO

Let me come back to you on that. Maybe we'll take another question and then come back. I just need to quickly check. Or, Robin, if you have that number already, maybe you can jump in.

Robin Jansen - Koninklijke Philips NV - Head of IR

Yes. I don't know if I am exactly answering your question, Philip, but because of the pension de-risking, we expect a somewhat lower impact on the P&L because of the de-risking that we've done, and that should translate into a positive effect of about EUR40 million to EUR50 million.

Frans van Houten - Koninklijke Philips NV - CEO

Was that your question, Philip?

Philip Scholte - Kempen & Co - Analyst

Yes. Well, that's the cost part, indeed, and I was actually wondering whether the cash out of that part, what will happen there.



Frans van Houten - *Koninklijke Philips NV - CEO*

Well, we've said two things. Let me try to elevate the discussion.

So we said we will likely do some pension de-risking. It is dependent on the deals, the transactions that we make, and the amount of the de-risking will be lower than the amount that we did in 2015. And then the second point that Robin mentioned is that the de-risking that we have done will have some positive impact on the results of 2016.

Philip Scholte - *Kempen & Co - Analyst*

All right. Thanks.

Operator

Alok Katre, Societe Generale. Mr. Katre seems to have withdrawn from the polling process. That was the last question.

Frans van Houten - *Koninklijke Philips NV - CEO*

All right. Well, then we are going to conclude.

Look, guys, thank you for attending. Thank you for sharing through 2015 our journey of improvement. It was a good ending of 2015. We will now work hard to continue on this path of gradual improvement. We have flagged a slow start in Q1, but that, of course, does not deter us from overall striving for the results that we have discussed and pursued.

Look forward to meeting you soon, and in the meantime, thank you and goodbye.

Operator

This concludes the Royal Philips fourth quarter and full-year 2015 results conference call on Tuesday January 26, 2016. Thank you for participating. You may now disconnect.

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