

PHILIPS

Fourth Quarter and Full Year 2020 Results

Monday, 25th January 2021

Operator: Welcome to the Royal Philips Fourth Quarter and Full Year 2020 Results Conference Call on Monday, 25th January 2021. During the call, hosted by Mr Frans van Houten, CEO, and Mr Abhijit Bhattacharya, CFO, all the participants will be in a listen-only mode. After the introduction, there will be an opportunity to ask questions. If any participant has difficulty hearing the conference at any time, please press the star followed by the zero on your telephone for operator assistance. Please note that this call will be recorded and replay will be made available on the Investor Relations website of Royal Philips.

I will now hand the conference over to Mr Leandro Mazzone head of investor relations. Please go ahead, sir.

Welcome

Leandro Mazzone

Head of Investor Relations, Royal Philips

Good morning, ladies and gentlemen, welcome to Philips Fourth Quarter and Full Year 2020 Results Conference Call. I'm here with our CEO, Frans van Houten, and our CFO, Abhijit Bhattacharya. On today's call, Frans will take you through our strategic and financial highlights for the period. Abhijit will then provide more detail on the financial performance. And after that, we will take your questions. Our press release and the related information slide deck were published at 7.00 CET this morning. Both are available on our Investor Relations website. A full transcript of this conference call will also be made available today on the website.

As mentioned in the press release, adjusted EBITA is defined as income from operations, excluding amortisation of acquired intangible assets, impairment of goodwill and other intangible assets, restructuring charges, acquisition related costs, and other significant items. Comparable growth for sales and orders are adjusted for currency and portfolio changes. Finally, forward-looking projections exclude the domestic appliances business.

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

Fourth Quarter and Full Year 2020

Frans van Houten

CEO, Royal Philips

Thanks Leandro. Hi everybody. Good morning to you. I hope that you and your families are keeping safe and well. It's clear that COVID-19 pandemic is far from over and my thoughts go out to the caregivers and patients as we battle the virus all together. In this environment, we at Philips are proud of our role to support care providers and patients. I'm pleased with how we have performed under these challenging circumstances, as our teams remain focused on delivering against what we call the triple duty of care: meeting critical customer needs, safeguarding the health and safety of our employees and ensuring business continuity. The work we are doing to support healthcare providers, medical staff, patients and consumers is our top priority.

In close collaboration with our suppliers and partners, we've ramped up the production volumes of products and solutions to help diagnose, treat, monitor and manage COVID-19 patients throughout 2020.

We have also rapidly responded to the increased demand for telehealth solutions, like tele-ICU, tele-radiology, tele-pathology, tele-dentistry services, which aid virtual working among care professionals, as well as move care into the community. Very important, we have continued to deepen our engagement and relationships with customers through consultative partnerships, strategic partnerships, leading to a higher degree of recurring revenues, superior service, and stronger customer loyalty. As a result of these efforts, I'm pleased that we have recorded comparable sales growth of 7% in Q4.

Connected Care grew a very strong 24%, driven by the demand for patient monitors and respiratory care. Our Diagnosis and Treatment businesses delivered encouraging and sequential improvement and returned to growth with a 1% comparable sales increase. Sales for Personal Health grew a solid 5%. Comparable equipment order intake grew 7% in Q4 with double-digit growth in Connected Care and 3% growth in Diagnosis and Treatment. This was driven by strong demand for patient monitors, hospital ventilators, radiology informatics, computer tomography, X-ray and ultrasound systems.

Customer response to our innovative products and solutions remains very positive, resulting in market share gains and strong year-end order book in both Connected Care and Diagnosis and Treatment. Adjusted EBITA margin was 19% in the fourth quarter, which is 110 basis points higher than in 2019, and free cash flow increased to over €1 billion.

As a result of our strong performance in the second half of the year, for the full year 2020, we delivered 3% comparable sales growth and an adjusted EBITA margin of 13.2%. Quarter intake grew a further 9% in 2020. Moreover, we achieved a free cash flow of almost €1.9 billion in the year, ahead of our target of €1.5 billion.

Looking ahead, we continue to see uncertainty related to the impact of COVID-19 across the world. For 2021, as guided at CMD, we plan to deliver overall low single-digit sales growth driven by solid growth in Diagnosis and Treatment and Personal Health, but partly offset by lower Connected Care sales as demand in these businesses will normalise from the spike in COVID-19 generated demand in 2020. We also aim to deliver an adjusted EBITA margin improvement of 60-80 basis points in 2021.

Now, I would like to provide some colour on some of our initiatives to respond to customer needs and support healthcare professionals and consumers.

In the quarter, we expanded our range of patient-centric solutions for the home, with the launch of the BiPAP A40 non-invasive ventilator. With this introduction, we extend our respiratory care solutions with a new ventilation therapy feature to treat COPD patients with expiratory flow limitation, or EFL. Our unique Expira flow technology detects EFL more accurately and automatically optimises ventilation to the individual needs of the patient. This enables more effective treatment of patients at home and ultimately avoids hospital readmissions.

Highlighting our strengths in enterprise imaging informatics solutions, we created a single cloud-accessible system for all 12 hospitals of the region of southern Denmark for storing

retrieving and viewing radiology and nuclear medicine images and data. The unified imaging informatics ecosystem, which comprises Philips vendor-neutral archive and universal viewer, aims to improve collaboration and enhance patient care for a population of over 1.2 million people.

At the RSNA annual meeting in December, we also launched an industry's first vendor-neutral multimodality and AI supported radiology operations command centre to enable real-time remote collaboration between radiologists, technologists and imaging operation teams across multiple sites. This, with the aim to increase radiology productivity, minimises issues with image quality and expands access to MR and CT based diagnosis.

We also expanded our Image-Guided Therapy portfolio through the launch of major extensions to our industry-leading Azurion platform, as well as new diagnostic and therapeutic devices.

We are also excited that later today, the five-year ILLUMENATE EU RCT and Pivotal study results of the Philips Stellarex drug-coated balloon will be presented. Stellarex with its low dose and unique drug-coding composition is an important treatment choice for healthcare providers treating patients with peripheral arterial disease. And we have a lot of confidence in its potential. That's enhanced by the study that I just referred to.

Very important, we continue to drive market share in our core businesses through deeper, more comprehensive customer partnerships to enhance patient care and improve care provider productivity. During the fourth quarter, we signed 25 new long-term strategic partnerships with hospitals in the US, Europe and Asia, with the aim of helping them achieve their clinical and operational goals. For example, we signed a five-year technology and innovation partnership with the Reims University Hospital, one of the top hospitals in France with four sites and more than 1,800 beds. Philips will deliver integrated solutions to support precision diagnosis, image-guided therapies and patient monitoring and management. The partnership also includes consultancy services, informatic solutions and visualisation and analysis tools to drive quality and efficiency improvements, and enhance diagnostic confidence.

Moreover, I'm encouraged that our strategy to win with solutions continues to work very well. When we set out to increase focus on solutions in 2015, it represented about a quarter of the company. We ended 2020 around 37% and expect solution sales to continue to grow double digit and represent slightly less than half the company by 2025.

In Personal Health, we continue to invest in innovation and new product introductions to capitalise on recovery opportunities. In the fourth quarter, we broadened our leading male grooming portfolio with an exciting launch of the Phillip shaver series 1000 in China, a proposition that is customised to specifically address the personal care needs of young Gen Z men.

Also exciting, we took important steps in our strategy to become a leading solutions provider with the acquisitions of BioTelemetry Incorporated and Capsule Technologies in Q4. BioTelemetry has a market-leading cardiac diagnostics and monitoring solution, comprised of wearable, connected heart monitors, AI-based data analytics and state-of-the-art monitoring and services centre. The combination of our own leading patient monitoring position in the hospital with BioTelemetry's leading cardiac diagnostics and monitoring outside of the

hospital, will result in a global leader in patient care management solutions, with much potential for further expansion. Capsule is a leading provider of medical device integration and data technologies for hospitals and healthcare organisations. Its medical device information platform is comprised of device integration, vital signs monitoring and clinical survey and services. And it connects almost all medical devices to EMRs in the hospitals through a vendor-neutral system that captures streaming clinical data and transforms it into actionable information to enhance patient care management.

These acquisitions will further broaden, enrich and scale Philips patient care management solutions. Both acquisitions will be accretive to sales growth and adjusted EBITA margin in 2021. Upon completion of the transactions, which is expected to happen in the first quarter of 2021, BioTelemetry and Capsule employees will become part of our Connected Care business segment.

I'm also proud, very proud that we've delivered on all targets set out in our 2016-2020 Healthy People, Sustainable Planet programme, and that our products and solutions improved the lives of 1.75 billion people in 2020, including 207 million people in underserved communities. As shared with you last quarter, we also reinforced our commitments as a purpose-driven company, with a comprehensive new set of initiatives and 2025 targets across the entire spectrum of environmental, social and corporate governance activities.

Let me give you an update on the current status of the divestment of the Domestic Appliances business. The separation process is on track and expected to be completed in the third quarter of 2021. As planned, we have sent the information memorandum and started to engage with interested parties in the fall of 2020. Domestic Appliances is a strong business and has returned to robust growth with increasing margins in the second half of 2020, based on a strong portfolio with market-leading positions. We continue to see good interest for the asset and remain open to different divestment options to deliver the best value for the company.

To round off, I'm pleased with the way that we have handled the crisis. I'm very grateful to our employees and proud of the resourcefulness and hard work that they and we altogether have been able to put in to deliver to the plan in 2020. While we have been working hard on managing the business, we continue to progress on our strategic and performance roadmap for the coming years. Our journey to health tech leadership continues as we innovate to drive growth, improve operational excellence and become a leading health tech solutions company. We have a clear strategy to help transform care along the health continuum, combining smart systems, devices, informatics, data and services. The strategy strongly resonates with customers and has been further validated during the COVID-19 crisis. And I'm convinced that the growth and the margin profile of our company is well underpinned.

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

Financial Performance in the Quarter

Abhijit Bhattacharya

CFO, Royal Philips

Thank you Frans and thank you all for joining us today. Let me start with providing some colour on the fourth quarter comparable sales. Comparable sales for Diagnosis and Treatment businesses grew 1% in the quarter. Diagnostic Imaging sales grew high single digit, driven by double-digit growth in Computed Tomography and Diagnostic X-ray. Enterprise Diagnostic Informatic sales also grew double digit in the fourth quarter, as we continue to successfully roll out our world-class enterprise imaging platform, resulting from our R&D programmes and the integration of the Care Stream business. Ultrasound and Image-Guided Therapy sales declined mid-single digit in the quarter, mainly due to push-outs of installations in the US.

The volume of elective procedures was close to pre COVID 19 levels in October and November, but went down to around 80% of pre-COVID levels in December, mainly driven by the US. We expect that elective procedure volumes to gradually recover in the course of the first quarter.

Services sales for our Diagnosis and Treatment businesses grew a solid mid-single digit compared to the same period in 2019. Let me remind you that recurring revenues from solutions and services represent more than 45% of the total sales of Diagnosis and Treatment. For the full year 2020, sales for Diagnosis and Treatment businesses declined 2% on the back of 5% growth in 2019.

The sales for Connected Care businesses grew a strong 24% in Q4, driven by Patient Monitoring and respiratory care solutions. We were also pleased to see double-digit growth in our Therapeutic Care business and a solid sequential improvement in the sleep business, driven by growth in Patient Interface. In the full year, comparable sales for Connected Care grew 22% with double-digit growth in both Monitoring and Analytics and Sleep and Respiratory care. Order intake for Connected Care grew strong double digits in the full year.

For Personal Health, we saw solid demand in the quarter with a comparable sales increase of 5%. Domestic Appliances grew double digit and Personal Care grew mid-single digit. Oral healthcare comparable sales declined low single digit on the back of mid-teens growth in Q4 2019, mainly in China. In the full year 2020, Personal health sales declined 4% compared to 2019.

Consumer sales through digital channels grew double digit in Q4 and represents 39% of total sales of Personal Health. Our shift to digital and adoption of new business models of direct to consumer resonate very well. Important to note that our current online market share is even higher than that in the traditional offline channels.

Moving to orders. As mentioned by Frans, ordering grew by 7% in the fourth quarter. This builds on double-digit growth seen in the first three quarters of the year, resulting in 9% growth in the year and a strong order book as depicted in page 33 of the presentation. Diagnosis and Treatment comparable order intake grew 3% in the fourth quarter, showing solid sequential improvement. Diagnostic Imaging orders grew mid-single digit, Ultra-sound

orders grew high single digits and enterprise digital informatics orders grew double digit in the quarter. This was partly offset by a mid-single digit decline in Image-Guided Therapy.

Order intake for Diagnosis and Treatment group mid-single digit in growth geographies, driven by double-digit growth in China, and was in line with Q4 2019 in mature geographies, with overall slow momentum in North America. Comparable order intake in Connected Care grew by 17% in Q4, and particularly encouraged by another strong quarter in Monitoring and Analytics and in our Therapeutic Care businesses.

Let me now turn to the profitability development in the fourth quarter. Adjusted EBITA for the Group increased 110 basis points to 19% of sales. In the full year, the adjusted EBITA margin was 13.2% in line with our guidance.

Looking at the business segments, Connected Care delivered an Adjusted EBITA margin of 27.2% of sales, compared to 19.4% in the fourth quarter of 2019. This was mainly due to operating leverage and the productivity programs. In Diagnosis and Treatment, the adjusted EBITA decreased to 14% of sales. This was mainly a result of unfavourable product mix, driven by lower growth of cardiac Ultrasound and Image-Guided Therapy portfolios. In Personal Health, Adjusted EBITA was 20%, in line with Q4 2019. Sales growth and cost savings were offset by planned higher investments in advertising. Adjusted EBITA in the fourth quarter was impacted by lower license income in the segment, Other, of around €30 million.

We continue to relentlessly focus on driving productivity and delivered close to €450 million savings in 2020, and over €1.9 billion savings for the overall 2017-2020 period, exceeding our target of €1.8 billion. At our Capital Markets Day, we provided the details around the productivity initiatives that will deliver additional cumulative net savings of €2 billion by 2025 through procurement programmes, supply chain productivity and overhead cost reduction.

Net income increased by 9% to €607 million in the quarter, and includes a charge of €144 million related to an impairment of goodwill, mainly due to revisions to the financial forecast of our personal emergency response system business due to lower demand. Financial income and expenses resulted in an expense of €20 million compared to €57 million in Q4 2019. This decrease is mainly due to the increase in value of one of our minority participations.

The adjusted diluted EPS from continuing operations increased by 13% in the fourth quarter and it was in line with 2019 for the full year. Free cash flow was an inflow of €1 billion compared to €959 million in Q4 2019. In the full year 2020, our free cash flow generation was €1,852 million as a result of strong working capital performance, notably in accounts receivable. This was driven by a significant reduction of overdue receivables and a shorter collection cycle in the Connected Care businesses due to the shift in product mix. Further, in the second half of the year, we saw a higher-than-normal proportion of sales in Q3 compared to Q4, which positively contributed to the cash flow generation for the year. Free cash flow also includes over €250 million inflow from the Domestic Appliances business.

Let me now provide you some guidance for certain areas of our business. In the segment, Other, we expect an Adjusted EBITA loss of around €120 million in 2021, an improvement of €25 million versus 2020, mainly due to higher license income. At the EBITA level, we expect a net cost of around €240 million for the full year compared to €262 million in 2020. This

includes €80-100 million of costs related to the separation of Domestic Appliances in 2021. For Q1, we expect a net cost of around €65 million at the Adjusted EBITA level, broadly in line with Q1 2020, and around €100 million at the EBITA level. Restructuring charges are expected to be 70-80 basis points and acquisition-related costs to be around 100 basis points in 2021. We expect one time EU MDR and consent decree related costs of around €40 million in the year compared to over €80 million in 2020. Financial income and expenses are expected to be a net cost of around €180 million in 2021, excluding incidentals.

On the topic of share buybacks, I would like to remind you that as of the end of 2020, we have completed over 50% of our €1.5 billion share buyback programme for capital reduction purposes that was announced in January 2019. The remaining 50% will be completed during the course of 2021.

To conclude, after a challenging second quarter due to the impact of COVID-19, our performance continued to improve through the second half of the year and we delivered a Q4 with 7% sales growth, 7% order intake growth, 110 basis points Adjusted EBITA margin improvement and a free cash flow of over €1 billion. For the full year, we delivered 3% comparable sales growth, 13.2% Adjusted EBITA margin, a strong cash flow of €1.9 billion. Moreover, driven by a 9% compatible order intake growth, we continued to gain market share in our healthcare businesses in 2020, and ended the year with a strong order book.

We will submit a proposal for dividend of €0.85 per share against the net income of 2019, in cash or shares at the option of shareholders. This is within the targeted pay-out ratio of 40-50% of continuing net income.

In 2021, we continue to see uncertainty related to COVID-19. We plan to deliver low single-digit comparable sales growth and an Adjusted EBITA margin improvement of 60-80 basis points in this year in line with the guidance given that the Capital Markets Day. We expect overall sales growth to be driven by solid growth in Diagnosis and Treatment and Personal Health within our guided range of 5-6%. This will be partly offset by a decline in Connected Care sales in the high single-digit range. Given the comparison base off 2020, we expect overall performance to be stronger in the first half of 2021.

With that, I'm happy to take your questions along with Frans. Thank you.

Q&A

Operator: Thank you, sir. If any participant would like to ask a question, please press the star followed by the one on your telephone. If you wish to cancel this request, please press the star followed by the two. Please limit yourself to one question with a maximum of one follow-up. This will give more people the opportunity to ask questions. If you are using speaker equipment today, please lift the handset before making your selection. There will be a short pause while participants register for a question.

And we can now take our first question from Veronika Dubajova from Goldman Sachs. Please go ahead.

Veronika Dubajova (Goldman Sachs): Good morning and thank you for taking my question, and I hope you're both keeping well and healthy. Just wanted to dive in a little bit into the dynamics that you're seeing across the healthcare businesses, both for D&T and

Connected Care. Just curious, Frans and Abhijit, can you discuss a little bit where the backlog stands when you look at it at the end of the fourth quarter? And I guess in the context of the current trading dynamics, it would seem to me that there should be fairly healthy backlog for both of these businesses that might imply a bit more growth than what's assumed in the guidance. So just if you can walk us through your thinking on that, and what are some of the risks, but also the opportunities that you see for both of these as you think about 2021,

Frans van Houten: Yeah, hi Veronika, great to hear you. Let me start and Abhijit can complement if I forget something. Look, I feel quite encouraged about how hospitals are looking at the future. We have seen no cancellation of orders, only some postponements. We are getting new orders. The 7% order intake in fourth quarter is also a sign of confidence in the future. Those orders were partially related to Connected Care, but for example, precision diagnosis recorded an 8% order growth in the quarter, which is all looking at the future.

We know from hospital C-suites that they are interested to expand ambulatory surgery centres, [inaudible], but also invest in telehealth and remote patient monitoring. And I'm sure we'll come to talk about BioTelemetry later on. And that bodes well.

Also, you could say that to get 25 new strategic long-term partnerships is a validation of the Philips strategy. Hospitals want help, need help in transforming healthcare, as they need to do more with less. They need to support more patients with stable budgets, and they realised that they need to invest in technology to do so. And I don't recall a quarter where we had 25 agreements in a single quarter. So it is a bit of a signal for confidence.

So, and then on the backlog, Veronika, indeed the order book that we have is very high, partly because of the delays in installations in 2020, partly because of the new orders. And so if I were to sum it all up, then we expect a strong start of the year, a strong first quarter, strong second quarter. In the first quarter, of course, the pandemic is still raging but we will continue to deliver acute care equipment. We also expect that D&T, despite the pandemic, will still have a good start of the year, especially driven by Precision Diagnosis.

Elective procedures are a risk. I think this was also picked up by the JP Morgan conference in January where I was asked to comment on it. I think we should not take this out of context. It's pretty normal that elective procedures are rescheduled when hospitals are full of COVID patients. I would turn it around and actually say, we should take some encouragement that at this time it is only 20-30% down, while back in April, it was 70% down. So hospitals are much better able to cope with the pandemic than before. And I would also expect a quick rebound of elective procedures the moment, let's say, regions go from red to orange risk status. Therefore the IGT business is maybe a bit more later in the quarter, showing strengths the Diagnostics and Connected Care immediately now. We also expect a good start of the year for Personal Health.

Of course there are risks. Of course there are opportunities. Maybe I'll look now to my right. Abhijit, anything to add.

Abhijit Bhattacharya: No, I think it was very comprehensive. Just for the order book, the order book itself is double digit higher than the end of 2019. So that also is what gives us the confidence that we will start 2021 well and that growth is across, right? So Connected Care is up double-digit Precision Diagnosis close to double digit and Image-Guided Therapy is a bit

lower; it's still higher than the end of 2019, but it's a low single-digit growth. And that's primarily because of the US where orders have been slow in coming. But Frans, you will remember to the end of Q3, when we were thinking that the pandemic is going to abate, the discussions around IGT rapidly picked up, and then again, got pushed out with the second wave.

So we have a good confidence that when the pandemic does abate, IGT will come back strongly.

Frans van Houten: And as some analyst noted in the commentary, of course you then temporarily have a mixed change towards diagnosis versus treatment. And that of course has a little bit of impact on the profitability as such. But that's all temporary.

That should be a fairly comprehensive answer, Veronika.

Veronika Dubajova: I was going to say, I think we've covered pretty much everything. I guess, just a quick follow-up if I can. Just looking at your guidance – because obviously you guys gave that out in early November and the world has changed a bit since then. Just curious, at this point in time and given where the fourth quarter came in, your degree of confidence in that guidance; has it increased or stayed the same or worsened? If you can just briefly speak to that and then I'll jump back into the queue. Thank you both.

Frans van Houten: I think it's stayed the same and I think we talked about CMD also around risks and then I think I flagged that if pandemic second wave would happen, that you would probably see a bit more Connected Care sales early on at the expense of elective procedures. Now, that's exactly of course what we just discussed. But then, we all expect a strong recovery later in the year of the interventional procedures.

So, all in all, we confirm our guidance. I don't think that materially the risk has changed. And so, we're off to a good start of the year. I'm reminded here by Leandro to also mention that we would see the uptake of Sleep as the pandemic gets more under control because there's certainly a lot of unmet needs in the Sleep market. And Abhijit mentioned in his speech part that we saw good traction on the Patient Interface, which of course is a theme that is always high on your attention list as well.

Operator: Does this answer your question, Madam?

Veronika Dubajova: That's great. Thank you. Thank you so much.

Operator: And our next question comes from Patrick Wood from Bank of America.

Patrick Wood (Bank of America): Perfect. Thank you very much. I'll just ask my two up front, if I can please. I guess, the first one would be specifically around Personal Health and the Q4 exit rate, which seemed a bit better than certainly we were expecting. And when you think about the 2021 guide, I mean, that guide essentially implies that organically, revenues are still below 2019, even adjusting for FX. I guess, what is it that you're seeing this causing you to think about worries or issues? You've got a good full product pipeline. Everything seems to be going well. And the Q4 exit rates seems to imply a better result on that. I'm just curious some of the puts and takes you're thinking of when you think about the consumer for 2021. So that's the first question.

And the second question, obviously, even though you guys have done some interesting M&A very recently, the divestiture of DA, after that, the balance sheet should still be in very good shape by the end of this year. Just curious how you guys are thinking about capital allocation. Are you thinking about a similar balance between buybacks and M&A or is it more weighted one way or the other? I'm just curious. Thank you.

Frans van Houten: All right, Patrick, maybe Abhijit, why don't you start straight away with the Q4 exit rate and the PH discussion?

Abhijit Bhattacharya: Yeah, we guided for 5-6% growth in PH for next year, which I think is a pretty good growth rate actually. And the last two quarters versus Q3 we had very strong growth because of Q2 decline. So, we are not, let's say, going above that at this stage, it would not be wise. And also, the longer the pandemic continues, there will be economic impacts on people and their spending ability. So I think if we end next year with a 5-6% growth, that's a very healthy growth for PH, although we expect to start the first half a bit stronger.

Frans van Houten: And, then perhaps also we can link there, the China performance. So we were not very happy with the China performance in 2020. And we are off to a good start in 2021.

Abhijit Bhattacharya: Yeah. So we had mentioned that in Q3, we had some work to do. I think most of it is now dealt with, so we will return to growth. And then that gives us the confidence for full-year growth. Yes, we don't catch up to 2019, but maybe a bit longer. And, if things are all very good, then maybe there is a chance, but for now 5-6% is a good guidance.

Frans van Houten: And then Patrick, on the M&A question, well, we are indeed proud of a good cash generation. I think it was also about time that we were generating more cash. And yes, we have a healthy balance sheet, but that's also our policy. I mean, we think that that is the way to go. So we, now with BioTelemetry and Capsule, will have a significant cash outflow in the first quarter. And then as we are on schedule with DA, Domestic Appliances, then that gets replenished later in the year, expectedly in the third quarter. So then we are indeed a healthy company with a healthy balance sheet. And I like it like that.

The capital allocation strategy remains unchanged in the way we have discussed it also at Capital Markets Day. So it will be combination of organic growth, M&A, continuing our dividend strategy as well as capital buybacks – or share buybacks.

So we have, I think, a healthy balance at the moment. We continue to be active on the M&A front but the plan of the 5-6% growth is all on the basis of organic growth. Therefore, we will be selective on M&A; only when it strengthens our core business, and it has a good return pass will we consider it. On the two examples that we discussed earlier, BioTelemetry and capsule, will both be accretive to growth and EBITA in 2021. Of course they are not part of the comparable reporting because Abhijit always takes everything out for a 12-month horizon.

Patrick Wood: Thanks.

Operator: The next question comes from Michael Jungling from Morgan Stanley. Please go ahead.

Michael Jungling (Morgan Stanley): Thank you. And good morning, everyone. I have two questions. I'll ask them upfront, if you don't mind. Firstly, on Domestic Appliances, are you able to provide some more insights into the cost synergies coming from the sale of Domestic Appliances? You threw a lot of numbers at us in the call, and I think I missed some, apologies for that, but just a reminder of the magnitude of these cost synergies and how you will treat them in terms of are they recurring costs in the way that you will disclose them, or are they going to be recorded as ongoing restructuring costs for a number of years until you're able to somehow get rid of them?

And then secondly, on the marketing and sales budget, in light of the COVID 19 restrictions that are continuing at a high level, are you intending to rework your budgets, giving a 2021 opportunity to over-deliver on your margin expansion targets of 60-80 basis points – less travel, etc. That's perhaps a different situation than when you first guided for 2021 back in November. Thank you.

Abhijit Bhattacharya: So hi, Michael, let me take the first part on the synergies coming from DA. In the past, for lighting and other businesses, we don't adjust it out so that remains part of the P&L. We expect that to be – over a two year period, normally between two to two and a half years, we reduce that cost because that's the time it takes also to wind down that activity. So again, it remains part of the adjusted EBITA and will be dealt with or removed over two, two and a half year period.

Moving to the sales and marketing maybe, Frans?

Frans van Houten: Yeah. So, let's say, we have a marketing transformation ongoing. That marketing transformation is aimed at raising our advertising budget and proportional spend, which we think is a structural matter because of the higher proportion of online sales and our desire to have a deeper consumer engagement.

So, we think that investing more in advertising is a good thing. Now, we are, at the same time, transforming our fixed selling expenses. We will reduce that as we are more targeting the online market where there is a higher customer concentration and we can leverage more online B2B portals for what you can call the long tail of traditional retailers. So, altogether marketing and sales will become more efficient, also more effective. It should help us generate a higher growth rate and eventually then the operating leverage. So then eventually you will, I think, see that margin expansion, but it is not just by cutting the budget. It is more by changing the budget mix.

The travel expense is an interesting question. We are striving to keep travel lower than the 2019 levels. Of course, at this time nobody is traveling, but anyway, structurally. If we succeed in that longer term, then it will disproportionately benefit our health systems businesses more than only the Personal Health business, because the travel rate in health systems was certainly more intense than on the Personal Health side. At this time, we are not changing our guidance of the 60-80 basis points, right? I mean, you can definitely identify opportunities to save, such as in travel, but there's also areas where we may need to adapt.

So, and that may be an interesting comment related to the area. And that is how we engage with customers. We do that increasingly through virtual means, not only for marketing and sales, but also for service. We find that the remote service works very well and that we can

also then do data analytics on all of that. So it's also something to stay. So also on that area, on the service area, we expect eventually productivity gains. Michael, I –

Michael Jungling: Abhijit –

Frans van Houten: Yeah, go ahead.

Michael Jungling: Can I just ask Abhijit, just on the 60-80 basis points of margin improvement this year. Is it more likely that we'll see upside than downside from lower spend on sales and marketing? Is that the right way of looking about it, or will you just reinvest whatever is on top because of the restrictions that we're facing today, meaning less travel, etc.?

Abhijit Bhattacharya: Michael, the guidance is 60-80, right? We have today on the 25th of January, we have 11 months and more to go in a fairly turbulent time. So I think we are not going to now start speculating whether it's upper or lower. In terms of our overall plan, it is to drive growth from 2022 onwards. So whatever we need to invest to drive that growth, we have planned for that. If things turn very positive, it doesn't mean that we will – whatever extra margin we make, we are going to simply reinvest. So we have plans to make our growth for next year. And that's all well-funded within the 60-80 basis points profit improvement.

Michael Jungling: Thank you very clear. Thank you.

Operator: Our next question comes from Hassan Al-Wakeel from Barclays. Please go ahead.

Hassan Al-Wakeel: Thank you for taking my questions. I have a couple, please. You talked about gaining share in the healthcare business. Could you expand on the dynamics within D&T and which modalities and products you feel are the most significant drivers of this? And then secondly, on the Sleep business, can you talk about the performance here and the degree to which you have seen an improvement in new patients? Thank you.

Frans van Houten: Yeah. Hi, Hassan. Yeah, in our calculations and data sources, we have gained market share in Diagnosis & Treatment and in Connected Care. So that's good news. And in Connected Care it was partly our ability to ramp up in acute care equipment, but also structurally in – especially, in monitoring, you see hospitals standardise on one architecture or one standard and increasingly we see enterprise-wide agreements coming through. And where given our strengths of the portfolio, we are often the winner. And now that we are further strengthening the out-of-hospital monitoring, which will seamlessly integrate with the in-hospital monitoring architecture, I think you can expect – or at least we target to further drive those kinds of share gains.

If I then pivot to Diagnosis for a moment. I feel that, thanks to the renewal of the portfolio, that we have a very strong portfolio. We have – of course the MR market was down last year, but in that downmarket, we gained share, basically in all geographies. And it comes on the back of innovation such as the sealed magnet, the helium-free operation, but also innovations like Compressed SENSE and the in-bore camera function to apply AI to the image acquisition. The speed of our MR, thanks to Compressed SENSE, whereby you can reduce the scan time by 40-50%, is a very well-received innovation.

On the CT side, I'm really pleased to see that from a reputation point of view and a competitive point of view, we are fully accepted now, so the Cleveland era is behind us. We

see market share gains ranging from the United States to China where we are performing very well with our CT portfolio.

Ultrasound, we go from strength to strength. In cardiovascular, of course, where we are the market leader, it is going very well. We did see a bit of dynamics in 2020 from the mixed shift between point-of-care ultrasound and general ultrasound versus cardiovascular that was obviously less prioritised by hospitals. But we expect also in 2021 that our strong portfolio will be having a lot of traction. Also there, applying AI is very well received, which aids the confidence of the sonographer, and even allows for less trained sonographers to still do a very confident diagnosis.

If I then switch to enterprise informatics, the Carestream acquisition is really doing fantastic. We saw a strong order growth in the fourth quarter. The integration between our traditional eyesight packs and the Carestream packs, we have a very good evolution path for our existing customers, whereas we are also winning net new names into the franchise. So that looks good.

And then finalising with Image-Guided Therapy, we continue on our strategy to innovate the procedure. This resonates very well with the interventionists. Doing more patients in a day, doing it more confidently, doing it more efficiently is exactly what they need. Azurion's upgrades are helping us to continue to gain market share. And then on the devices side, we are running very well with differentiating devices.

I made a passing statement with regards to the safety study that has now completed its fifth year. We are on the NDA and the results will only be published at 13.00 today. But I am authorised to tell you that they are very positive for us. And that also lends us to make the statement that we expect, relative to competitors, that Stellarex will continue to gain in traction. I also see intervention is becoming more comfortable, regardless of what the FDA publishes, to use Stellarex and the longer balloon makes it also an economically attractive or more attractive solution.

So if that's basically a view of the horizon, Hassan, I think, these are all drivers for continued market share gain. And maybe finishing off on China, because there, it's not just innovation that plays a role, but also geopolitics. Last year we talked a couple of times about what about the locals, but the fact that we had strong double-digit order growth in China in the D&T area just also shows that are navigating that local presence thing quite well.

Then on the Sleep business, you asked, are new patients coming in. Well, the sleep centres are still mostly closed. And therefore, patient diagnostics in the sleep centres is difficult. However, we have launched remote diagnostic and home sleep tests. We have also launched the remote fitting of the mask using mobile phone photography, which is then interpreted through AI to recommend a perfectly fitting mask. Then, it gives us confidence that we can compete well in Sleep. We also feel that we are now at least on par with our competitor on the Carestream orchestrator, the informatics ecosystem for sleep. And so we feel that we are well set up for Sleep in 2021. Abhijit, do you want...?

Abhijit Bhattacharya: Yeah, maybe – we see the pickup coming. So, Q2, Q3, we had double-digit decline. So we have now, Q4 was flat year on year. So procedure volumes or new patient volumes are around 70-80% of what they were pre COVID. But as Frans mentioned, the masks, or Patient Interface as we call it, has shown good growth, which

brings us to flat for the quarter, which is pretty good. And in terms of share, we believe also in North America and international markets, we have made good progress in gaining share.

Hassan Al-Wakeel: That's helpful. Thank you.

Operator: We will now take our next question from David Adlington from JP Morgan.

David Adlington (JP Morgan): Morning guys, I just wanted to get your thoughts on the pricing environment, both across your hospital-exposed franchise and your personal healthcare franchises. Just wondering if you're seeing or expecting any change to the pricing environment.

Frans van Houten: We expect it to be the same. And in the investor deck, you have the standard page, the bridge that talks about the normalised... Abhijit?

Abhijit Bhattacharya: Yeah, we normally talk to about a 1% price erosion in a year. And as Frans said, we don't expect anything different from that.

Frans van Houten: And then of course there already occasional bulk contenders, whether it's Russia or China, where people buy higher volumes but then, that is offset by add-on sales afterwards, and/or let's say the efficiency of serving those customers. And therefore, it would not lead to a stronger or an impact on profitability. So overall, I feel confident that we should not expect anything extraordinary on the pricing front.

Now, on the Personal Health side, we basically have not experienced price erosion there because it's always offset by new product introductions that keep us whole on the margin. We are now adding, both in male grooming and in oral care, also products in the lower price segments, like the shaver 1000 that I referred to in the introductory speech, or the Philips one by Sonicare, which is entry level. But those are all add-ons to the existing portfolio and lead us to bring new users into the franchise. And also there, it's not a pricing effect on the existing portfolio, it's just a product line extension. And it leads to new customers coming in. So it will also not have a negative effect on all margins.

David Adlington: Great. Thanks so much.

Operator: The next question comes from Scott Bardo from Berenberg.

Scott Bardo (Berenberg): Yeah. Good morning. Thanks very much for taking my questions. Two upfront then, please. Obviously, pleasing to see some strong dynamics for your long-term enterprise partnerships this quarter. Our own survey work suggests that appetite for these sorts of contracts has been growing throughout the COVID crisis. I wonder if you could share your views of whether you think that's the case or whether this is simply a one-off or company-specific phenomenon that we see in the fourth quarter. So I'd be interested to hear your thoughts there please Frans.

And second question for Abhijit, please. Free cash flow of close to €1.9 billion, very good this year, particularly in light of your 2025 guidance of over €2 billion. So I wonder, Abhijit, can you help us understand, throughout 2021, is it likely that we see some correction or some lower free cash flow dynamics of the Group as compared to what seems a relatively high watermark in 2022?

Frans van Houten: Hi, Scott, I would agree with you that there is growing appetite, or let's call it a growing realisation by hospitals, especially the larger chains that are run by a C-suite,

that they need to make a change to their procurement strategies. Historically, many suppliers, all with point solutions or that are not integrating, and that doesn't lead to the breakthroughs in results that these hospitals need. I mean, yes, they can put pricing pressure by that approach, but they cannot get the necessary support in their transformation. And I think they realised during the crisis that their largest suppliers were much better able to take them through the crisis.

For example, I've been receiving compliments from hospitals' CEOs on how we have stood up during the crisis. We're creative with solutions. For example, we realised remote COVID patient monitoring so that patients could be discharged faster while the hospital kept them into sight. So that agility and that resourcefulness doesn't come through if you have a classical procurement strategy, because you don't even get to the activity necessarily of the solution.

So I would agree with you, there is, across the board, a general growing appetite and I think that's a good thing. Within that, I think Philips is better positioned than our competitors, because we have been going at this for four, five, six, seven years. And we have a clear strategy of integrating technology across the different functional silos of a hospital. We are strong in healthcare informatics. We are strong in workflow optimisation. We are strong in analytics of care processes. We have now fleet management solution, so we can bring a whole arsenal of weapons to the game. Whereas some of our competitors are still much more traditional in their equipment focus as opposed to a solutions focus.

So let the results be the judge of this, but I feel good about the ongoing strategy. In fact, today we are going to send out the first win of the year already with regards to the next LSP that we have just signed. So, it's going to be good.

On your cash flow question, Abhijit, over to you.

Abhijit Bhattacharya: So, Scott, on the cash flow, so we have a €1.85 billion – let's say about more than €250 million of that is for DA. So, if you take that out, because that's not going to be there going forward, we will be around the €1.6 billion. Then I mentioned a few things. We have reduced our overdue this year with many, many actions by about €150 million, so that of course will not repeat every year. And then we had a phasing benefit as well as a benefit because we had much larger Connected Care sales where the receivables came in earlier or has a shorter payment cycle than the Diagnosis and Treatment part. That's another couple of hundred million.

So, as I had mentioned right at the start of 2020, between 2020 and 2021, there will be flux. I think we did well that we did a big collection this year. So excluding DA, around €1.6 billion and we are still aiming to be, let's say, around €3 billion cash flow over the two years of 2020 and 2021. So, this year a bit higher, next year a bit lower, but overall still on an average €1.5 billion, excluding DA, which is a very, very strong performance.

Scott Bardo: Thanks very much guys.

Operator: The next question comes from Lisa Clive from Bernstein. Please go ahead.

Lisa Clive (Bernstein): Hi, two questions. Just first, Abhijit, thanks for the detailed guidance on the Other category. Just given your comments that the cost of synergies for the sale of DA remain in your adjusted EBITA figures, can we assume that the specific items you

mentioned, that will add to the costs in the Other category for DA for the separation are fully one-off in 2021, and that the costs thus in the future years will be lower, obviously borrowing and a future one-off costs? And then also just a small follow-up on that. The weaker performance in the Other category in Q4, is this just a timing issue where Q1 will be higher?

And then second topic just on China, can you remind us of the impact of the current tariffs, excluding DA, and if the tariffs were reversed, would all of this come back or are some of the mitigation strategies that you put in place more permanent? I suppose just giving us a net impact would be helpful.

Abhijit Bhattacharya: Okay. The first one was the cost in Other for the DA separation. That is a one-time. So, once the separation is done, that cost will stop. The second was in health tech Other license, the license income that moved from Q4, yeah, that is a timing issue. So there were a couple of deals that we were hoping to settle in Q4, which didn't happen, so that should come this year.

Frans van Houten: But not necessarily in Q1, right?

Abhijit Bhattacharya: No, no.

Frans van Houten: Just to be clear, it's not a miss of a week, it will come later in the year.

Abhijit Bhattacharya: Exactly. And your third question, could you repeat that?

Frans van Houten: China tariffs. So, the gross impact of the tariffs were substantial. We have mitigated that down to a level of around €25 million. If tariffs are rolled back, then that should be a net positive for us. However, I don't see that happening anytime soon. So, it's an area to continue to watch. And we have now made the changes to the supply chain to mitigate some of this. There's no expectation that we would roll back those measures anytime soon.

Lisa Clive: Okay, thank you. Great. Very clear.

Operator: The next question comes from Julien Dormois from Exane. Please go ahead.

Julien Dormois: Yeah. Hi. Thanks for taking my question. I also have two. So the first one is a broad question. You've mentioned that most people will need to do more with stable budget but based on the discussion with the C-suites, do you get any anecdotal evidence or early signal that people are actually becoming more optimistic about getting higher budgets in the future? And then obviously, in the context of the stimulus money, that could be spread in the coming years in Europe and in the US.

And the second question is on the oral healthcare business. If I'm right, you've seen broadly flat sales in absolute terms in that business since 2015, and you've seen pretty significant channel variations in that line of business. So, how do you see the division going forward? Is it still part of the core business of Philips? And do you see that as a potential drag on your ambitions to accelerate sales growth of 5-6%?

Frans van Houten: Yeah, hi Julien. The sentiment in hospitals, I would say yes, it has become a bit more optimistic because in many countries in the world, there is a backstop for the losses that they have incurred as they focused on COVID. Of course, the scheme in which that is done differs by country. Sometimes, it's the insurance companies, sometimes, it is the governments themselves but I think largely, you will see that hospitals are going to be

compensated for the cost that they have incurred. That would then also suggest that in many countries, the hospitals are not impaired for future investments. And I think that statement would then correlate with the higher order intake already in Q4 for, for example, diagnosis.

I do think that there will be some shift in priority. What I hear is that the word productivity is very high on the priority list of hospitals. So, unlocking that and having a business – every investment needs to have a business case that generates that return. I think you will see less capital expenditure just for, 'Oh, I need to have this state-of-the-art piece of technology, and it doesn't matter what it costs.' I think that is going to be under pressure, but that is not our business. Our business is very much where we can provide the health economic evidence, that results can be obtained.

The hospitals are also talking about doing more on care management, care orchestration, both in and outside of the hospital, because that's what they need for productivity gains, for remote patient engagement. Telehealth will become structurally much more on the forefront, also because reimbursement is now in place in more countries on a structural basis. So I think you will be able to see that evolve. So that is, I think, what explains the somewhat higher optimism.

On oral care, look, we have had a tremendous ride with oral health care. We are not completely satisfied with our performance in the last quarter where we saw a negative growth in China, but that was on the back of strong double-digit growth in Q4 2019. And with the new product launches, with the expansion into other price segments, we expect to see strong performance in 2021. We see oral healthcare as core of our portfolio. We have absolutely no intentions whatsoever to even think about not having that in our portfolio. And we see also an increasing interest from insurance companies, from integrated delivery networks, in what consumers do at home because behavioural health –personal health and the behaviour, it all correlates. And in fact, Philip's strategy to be both in professional healthcare and in consumer or personal health, is something that is increasingly recognised as very important. It's a skill base that I value that I would admit that we can still build further integration as we go forward. But it's certainly something that we are working very hard.

Julien Dormois: Very helpful. Thank you.

Operator: Our next question comes from Falko Friedrichs from Deutsche Bank. Please go ahead.

Falko Friedrichs (Deutsche Bank): Thank you. And good morning, everyone. I have two questions, please. Firstly, have you been able to secure all the service contracts for all the new ventilator sales you realised last year. And then secondly, on BioTelemetry and this overall trend of moving monitoring outside of the hospital, now, that appears to be a pretty interesting space for the bigger technology companies of this world as well the Apples and the like. What is your view on the developments here? And could those big technology companies become a threat over the next few years, or is there even a possibility for some early partnerships? Any thought here would be appreciated.

Frans van Houten: Yeah. Hi Falko. We are working very hard to secure service contracts for this vast installed base that is now in place. We also are working with governments who have stockpile programmes to remind them that just having it in a stockpile is not a recipe for success; you need to maintain it. I think this was a lesson also observed in the United States.

I would say still some potential there to do more but definitely possible. Now, in any case, it usually takes a year between a delivery and a service contract to have an impact on Philips because the first year is like warranty and everything else. But we're working on it.

And then on the BioTelemetry side, so first of all, let's indeed confirm that it's going to be a very important space to manage vast cohorts of patients that have chronic disease. Remote patient monitoring and remote patient care is the way to go. And I emphasise that this is very often about chronic patients and not only, let's say, behavioural health or health coaching in the preventive space. And I would position the tech companies foremost in that lifestyle segment of preventative care. Very important, by the way, and I would encourage them to be in it but it gives assurance and feedback to people who are generally healthy. Whereas the healthcare systems require more information, deeper analytics and also more services around this. And I see BioTelemetry not just as a company with exciting devices. I see BioTelemetry as a services platform company that engages with referring doctors, that rolls out these diagnostic services to individual patients that then digests and analyses the data and comes with a confident diagnosis. So, it's a much wider game than just a smart device.

I could eventually also see that data from other devices will be complementary to what we do. Our data architecture is designed to be open and to take the data from anybody's device into the equation. To that extent, we can also expect collaboration. Already today, the data from health watch, if you put the privacy settings to allow that, then the data can be uploaded into the Philips health suite architecture and made available to your doctor. And I think increasingly in the future, that will be rather the norm than the exception. And therefore having a platform play where we are the data integrator and that where we are able to provide services and not just a clever gadget, is the way where the business is going.

So, you should also expect that we use BioTelemetry as a platform play, where we will expand it beyond the long-term holter. I'm very pleased that BioTelemetry is also in the outpatient monitoring business. And with their recent ePatch launch, we also expect to gain share against some of the competitors in the space. And I can also anticipate that over time, we will expand BioTelemetry to other disease profiles beyond cardiovascular.

So, lots to do, lots of excitement. We expect strong double-digit growth. And we also expect for profit enhancement and we are very happy that we were able to buy the market leader.

Falko Friedrichs: Okay. Thank you.

Operator: Due to time, the last question will come from Scott Bardo from Berenberg.

Scott Bardo: Thanks very much for the quick follow-up. Yeah, I just wonder if you could help us, Abhijit, in understanding the potential royalty flow that should be expected from the exit from Domestic Appliances. I suspect that's mis-modelled. And I wonder if you could help confirm then that given your guidance excludes Domestic Appliances, if any way your margin improvement of 60-80 basis points this year include any benefit from additional royalties from the exit of DA? Thank you.

Abhijit Bhattacharya: Yeah, I think Scott, the way you should look at it is the royalty income initially will be used to offset the standard costs that we will have. And then, let's

say, in the future years would be a potential benefit, so the 60-80 basis points profit improvement includes potential license revenue from DA.

Scott Bardo: Okay. Thanks guys.

Frans van Houten: All right. I'd like to thank everybody for your contribution and questions. And I'd like to summarise that we look with confidence at 2021 and that the year for us is already in full swing, being four weeks in. And we look to already delivering a very good first quarter. Thanks very much everybody. Bye-Bye

Operator: This concludes the Royal Philips Fourth Quarter and Full Year 2020 Results Conference Call on Monday, 25th January 2021. Thank you for participating. You may now disconnect.

[END OF TRANSCRIPT]