

PHILIPS

Philips Q4 2023 Results

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Introduction

Leandro Mazzone

Head of Investor Relations, Royal Philips

Welcome

Hi everyone. Welcome to Philips' Fourth Quarter and Full Year 2023 Results Webcast. I'm here today with our CEO, Roy Jakobs, and our CFO, Abhijit Bhattacharya. The press release, investor deck and the Frequently Asked Questions on the Respironics field action were published on our Investor Relations website this morning. The replay and full transcript of this webcast will be made available on the website after the call.

Disclaimer

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

In today's call, we will discuss our results as well as the progress on the actions we are taking across different areas to drive performance improvement.

I would like to hand over to Roy.

Fourth Quarter & Full Year Highlights

Roy Jakobs

CEO, Royal Philips

Key takeaways

Good morning. Welcome. Great to be with you today. I want to start with the key highlights of this morning's release.

We delivered a year of strong sales growth, improved profitability, and very strong cash flow. The improved operational performance is a result of the solid execution of our plan to create value with sustainable impact.

We are making progress on all our three priorities: enhancing patient safety and quality; strengthening supply chain reliability; and simplifying our operating model, supporting significant productivity and margins.

Patient safety and quality remain our highest priority across the company. We agree with the FDA on the terms of a consent decree focused on Philips Respironics in the US, which provides clarity and a roadmap for us to demonstrate compliance and restore the business.

We are confident in delivering the previously stated plan for 2023 to 2025, which now takes the consent decree into account and remains unchanged, although recognising uncertainties remain in a volatile geopolitical environment.

Based on our ongoing actions to enhance execution, we expect further performance improvement in 2024.

Strong full-year 2023 results driven by solid execution of the plan to create value with sustainable impact

Onto the key financial highlights.

Comparable sales growth was 7% in the full year, excluding the impact of provisions charged to sales mainly in connection with the Respironics consent decree, which we will explain later in the call. Sales growth was 11% in D&T, 5% in Connected Care and 3% in Personal Health.

Improved operational performance across business segments

Group Comparable sales growth, including the impact of the provisions, mainly in connection with the Respironics consent decree was 6% for the full year. The adjusted EBITA margin was 10.5% in the full year, excluding the impact of the provisions mainly in connection with the Respironics consent decree. This is a strong improvement of 310 basis points versus 2022.

Adjusted EBITA margin including the impact of those provisions was 10.6%. Free cash saw a strong inflow of €1.6 billion in 2023, and we significantly strengthened our balance sheet in the year. Restructuring and other charges were high in 2023. This was a result of our focus on resolving the consequences of the Respironics recall, the consent decree and the important interventions we are making in the company as part of our plan to create value with sustainable impact.

Order intake was lower in 2023 due to the exceptionally high comparison base in the last two to three years, lower China and Russia, and longer order-to-delivery lead times. We saw sequential improvement in Q4, as anticipated, and we remain focused on implementing the necessary actions to reduce lead times and leverage our enhanced operating model and our AI-driven innovations to improve order intake.

It is important to note that our order book, which accounts for around 40% of Group sales, is 15% higher than when the global supply chain crisis started, and we will continue to support revenues with that order book as planned for 2024.

This morning, we announced that Philips agrees with the FDA on the terms of a consent decree, which is now being finalised and will be submitted to the relevant US court for approval. The decree is mainly focused on Philips Respironics in the US and will provide a roadmap of defined actions, milestones, and deliverables to demonstrate compliance with regulatory requirements and to restore the business.

In the US, Philips Respironics will continue to service sleep and respiratory care devices already with healthcare providers and patients, and supply accessories, patient interfaces, consumables and replacement parts.

Philips Respironics will not sell new CPAP or BiPAP sleep therapy devices or other respiratory care devices in the US until meeting the relevant requirements of the consent decree. Outside of the US, Philips Respironics will continue to provide new sleep and respiratory care devices, accessories, patient interfaces, consumables, replacement parts and services, subject to certain requirements.

Further details will become available once the consent decree has been finalised and submitted to the relevant US court for approval and we are not able to provide more information on the consent decree at this time.

Confident in delivering the plan for 2023-2025, with further performance improvement in 2024

Looking ahead, we remain confident in our plan and in the financial outlook. The previously stated 2023 to '25 Group financial outlook of mid-single digit sales growth, low teens adjusted EBITA margin, and €1.4 billion to €1.6 billion free cash flow in 2025, now takes the consent decree into account and the plan remains unchanged. This outlook excludes the impact of ongoing litigation and the investigation by the US DOJ related to the Respironics field action.

In 2024, we expect to deliver further performance improvement, with 3% to 5% comparable sales growth, building on the strong 2023 comparison base, and an adjusted EBITA margin of 11% to 11.5%.

We expect free cash flow of between €0.8 and €1 billion. This only excludes the expected remaining cash-out related to the previously announced resolution of the economic loss class action in the US.

While we continue to see hospitals and healthcare systems to exhibit some cautious buying behaviour, we expect this to develop positively in the course of 2024, driven by improving hospitals financials and more procedures.

In China, the government-imposed anti-corruption measures continue to impact short-term decision-making by hospitals, but this is not expected to impact fundamental demand. Our order funnel remains very active in the country, and we expect order growth to resume in China in the second half of 2024, following a very difficult comparison base in the first half of the year.

Overall, based on the gradually improving market environment and our ongoing actions to improve order intake, we expect to see positive order intake growth in the full year 2024.

Preferred strategic and innovation partner for customers

Let me now provide you with some of the recent customer and innovation milestones during the quarter.

We signed an eight-year, \$115 million agreement with NYU Langone Health in the US to provide patient monitoring, AI-enabled diagnostic imaging, digital pathology and enterprise informatics solutions to its latest hospital.

Our programme to expand access to maternal health through AI-powered ultrasound aims to address the shortage of healthcare workers by putting a diagnostic tool previously reserved for expert technicians in the hands of midwives. This programme also received funding of \$60 million from the Bill & Melinda Gates Foundation.

Our innovation empowers clinicians with Artificial Intelligence for deeper clinical insights, improved workflow and productivity

Our innovations are focused on empowering clinicians with Artificial Intelligence for deeper clinical insights, improved workflow and productivity. For example, we recently launched Philips HealthSuite Imaging, a cloud-based next-generation of Philips Vue PACS that offers AI-enabled workflow orchestration, high-speed remote access for diagnostic reading and integrated reporting.

In Personal Health, we launched premium S9000 shavers with breakthrough close shave technology in the US, Western Europe, and China.

In 2023, we were again recognised with a prestigious 'A' score for our climate action leadership by global environmental non-profit Carbon Disclosure Project, and as one of the top health technology companies in Dow Jones Sustainability Indices list.

I will now hand it over to Abhijit to take us through the financials in more detail, after which I will come back on our execution priorities.

Financial Review

Abhijit Bhattacharya

CFO, Royal Philips

Delivered strong sales growth, improved profitability, and strong cash flow

Thanks, Roy. Good morning, everyone, and thank you for joining us on the call. Let me start by providing you some clarification on the charges we took in the fourth quarter connected with the consent decree and explain its accounting consequences as well.

In the fourth quarter, we recognised €363 million in charges connected to the Consent Decree. This includes provisions charged to sales for field action activities mainly related to the ongoing remediation of ventilators, and provisions charged to costs for the remediation activities, inventory write-downs and onerous contract provisions.

Technically, this had a negative impact of around 100 basis points on comparable sales growth for the full year and 350 basis points for the fourth quarter. It also resulted in a positive impact of 10 basis points on adjusted EBITA margin for the full year and 40 basis points for the fourth quarter as the same absolute adjusted EBITA was divided by a lower sales figure.

I understand there can be some confusion about our operational performance due to these impacts and have noticed some headlines mentioning a miss compared to our outlook. I want to make clear that we came at the top end of our upgrade comparable sales growth outlook of 6% to 7%, and at the midpoint of the upgraded adjusted EBITA margin outlook of 10% to 11% provided in October.

And free cash flow was significantly above our outlook. I hope the above – aforementioned explanation helps to clarify.

For comparison purposes, during this call I will refer to the figures excluding the impact of these provisions as it will help to compare operational performance against the outlook provided earlier last year. In this morning's press release as well as the slide deck you will find the reconciliation between the metrics including and excluding the impact of these charges.

Let me now move on to our performance by segment.

Diagnosis & Treatment

In Diagnosis & Treatment, comparable sales increased by 11% in the full year, driven by double-digit growth in Image-Guided-Therapy and Ultrasound. In the fourth quarter, comparable sales growth was a solid 5%, on the back of tough comps in the previous year.

Full year adjusted EBITA margin for Diagnosis & Treatment was 11.6%, an increase of 210 basis points compared to 2022, driven by higher sales, pricing, and productivity measures, partly offset by cost inflation.

In Q4, the adjusted EBITA margin was 10.4%, impacted by an unfavourable mix, and phasing of production, as we reduced inventory, as well as the phasing of costs. This follows the strong adjusted EBITA margin in the first half that was driven by strong Ultrasound and Image Guided Therapy sales.

Connected Care

Connected Care comparable sales increased by 5% in the year, driven by double-digit growth in Monitoring. Q4 comparable sales were flat, as high-single-digit growth in Enterprise Informatics was offset by negative sales growth in Monitoring on the back of around 20% growth in the fourth quarter of last year.

Sleep & Respiratory Care sales grew low-single-digit in the quarter, driven by growth in sleep systems and patient interface, partly offset by lower ventilator sales. Additionally, a few days ago, we communicated to customers our decision to discontinue the manufacture and sale of certain product lines in the US primarily within Respiratory Care.

Full year adjusted EBITA margin for Connected Care improved 480 basis points to 6.9%, mainly driven by higher sales and productivity measures. In Q4, the adjusted EBITA margin improved 170 basis points to 13.3%, driven by a strong performance in Monitoring and improvement in Sleep and Respiratory Care.

Personal Health

Personal Health delivered a 3% comparable sales increase in the full year and a strong 7% in the fourth quarter, driven by strength in the Personal Care business. Geographically, growth in Q4 was driven by China, Western Europe and other Growth Geographies. Overall customer – consumer sentiment remains subdued but is expected to improve in the course of 2024.

Full year adjusted EBITA margin for Personal Health improved by 180 basis points to 16.6%, mainly driven by higher sales, pricing and productivity measures. In Q4, the adjusted EBITA margin improved 290 basis points to 19.9%.

Productivity initiatives delivered EUR 956 million in the year, with 271 million in the quarter

We have been very disciplined in cost management and our productivity initiatives delivered savings of €956 million in the year, of which the operating model savings were €496 million, procurement savings were €219 million, and other productivity programmes delivered €241 million. Productivity savings in the fourth quarter amounted to €271 million.

Adj. EBITA margin improvement driven by increased sales, pricing and productivity measures

The adjusted EBITA margin for the Group increased by 310 basis points, to 10.5% in the year. Wage and component price inflation was more than offset by operational leverage and by our productivity programme and pricing actions.

In the quarter, the adjusted EBITA margin for the Group increased by 50 basis points, to 12.5%.

Higher earnings and strong free cash flow resulted in significant improvement of leverage

We delivered significant cash flow improvement, with a free cash inflow of €1.1 billion in the quarter and €1.6 billion for the full year. This included a cash outflow of around €150 million related to the resolution of the economic loss class action in the US in Q4. Excluding this, the operational free cash flow was a strong €1.75 billion in 2023.

The strong free cash flow was driven by higher earnings and improved working capital. We saw a further sequential reduction of inventory in the fourth quarter, and accounts receivables were significantly lower due to strong performance in collections and favourable sales phasing throughout the year. This resulted in an improvement in our leverage from 3 times to 2 times on a net debt to adjusted EBITDA basis compared to the start of the year.

On capital allocation, we cancelled more than 15 million shares in Q4 2023, from the share buyback programme started in 2021, which resulted in a total reduction of over 1.5% of the outstanding shares in the quarter. We will submit a proposal to maintain the dividend at €0.85 per share, to be distributed in shares as part of our measures to further shore up our liquidity position.

Order book remains strong and will continue to support growth planned for 2024

Moving to our order book. As mentioned by Roy, it is significantly higher than the period before the global supply chain constraints and we expect it to continue to support sales growth in the coming quarters.

It is important to note that orders and order book account for around 40% of our revenue. The remaining 60% comes mainly from recurring revenue streams, such as services and consumables, and the book to – book-and-bill businesses and from Personal Health.

Recent normalization of orders/sales ratio driven by strong sales conversion following severe supply chain constraints in 2021 – 2022

As you can see on the slide, absolute levels of order intake remain healthy, but we see a steep increase in sales levels in 2023 due to the enhanced order book-to-sales conversion following supply chain and execution improvements.

Continued improvement in operational performance in 2024, whilst acknowledging that uncertainties remain

Based on the strong order book, improving order intake, and the ongoing actions to enhance execution, we expect to deliver further performance improvement in 2024, with a 3% to 5% comparable sales growth and an adjusted EBITA margin between 11% and 11.5%, recognising that uncertainties remain.

We expect to see this growth of 3% to 5% and adjusted EBITA margin improvement across all our businesses. We anticipate order intake and sales growth to be slightly back-end loaded in 2024 due to the tougher comparison base in the first half of the year, resulting mainly from the strong China performance both on orders and sales, favourable Diagnosis & Treatment product mix and high royalty income in the first half of 2023. We also see consumer spending increasing gradually through the year.

Operationally, we aim to deliver a free cash inflow between €800 million and €1 billion this year, with higher earnings partly offset by higher working capital due to growth and consent

decree costs. This excludes the expected remaining cash-out related to the previous announced resolution of the economic loss class action in the US, as well as ongoing litigation and the investigation by the US Department of Justice related to the Respiroics field action.

Restructuring, acquisition-related charges

Restructuring charges are expected to be 100 basis points in 2024, driven by overall workforce reduction programme as well as the Sleep and – reductions in the Sleep & Respiratory Care business.

Acquisition-related costs are expected to be 30 basis points. Other costs are expected to be around 200 basis points and include 100 basis points of charges connected to the Consent Decree remediation activities and disgorgement payments and 100 basis points Respiroics field action running costs and other quality action-related charges.

Financial income and expenses are expected to be a net cost of around €290 million in 2024. The effective tax rate is expected to be within our medium-term range of 24% to 26%. We expect sales of €550 million to €580 million in segment Other in 2024, with a loss of €50 million at the adjusted EBITA level, which is €20 million better than in 2023, and €100 million at an EBITA level, which is €80 million better than in 2023.

With that, let me hand it back to Roy.

Delivering Value With Sustainable Impact

Roy Jakobs

CEO, Royal Philips

Execution with decisive action as key value driver

Thanks, Abhijit. I would like to continue with some of the progress we have made on our execution priorities and focus areas for the year ahead.

Patient safety and quality as highest priority

First, we are taking the learnings of the Respiroics field action to raise Patient Safety and Quality to the highest standards across Philips. A year ago, I elevated Patient Safety and Quality to the Executive Committee by creating a new leadership position to drive this priority across the company. We drove significant simplification of the way how we work by further reducing the number of Quality Management Systems, which is already 50% down since the inception of the programme, against our target of reducing them by over 65%.

We added significant capabilities and talent across the businesses, and continued to invest in our systems, capabilities and in training and education.

We also significantly improved CAPA closures, by strengthening processes, capabilities and governance around it.

Looking ahead, we will remain focused on driving the cultural shift to deliver the highest quality innovations and put patient safety and quality at the centre of everything we do, with a greater level of accountability within the businesses.

Towards a reliable end-to-end supply chain

With respect to supply chain, in 2023, we re-shaped our set-up and moved to customer-centric end-to-end team aligned to our businesses. We significantly reduced materials and component risks, resulting in a 20% increase in service levels, reduced lead times and improved sales conversion rates.

For example, we redesigned more than 75% of the planned PCBs and de-risked all high-risk components identified at the end of 2022. We will continue leveraging and regionalising our end-to-end supply chain and further reduce lead-times in 2024, enhancing reliability and service levels.

Simplified, more agile operating model

Finally, our new operating model, with prime accountability in the businesses, has been live for nine months now and we have fully completed the re-alignment of the workforce roles and reporting lines. This enabled more effective ways of working across the company, resulting in significant productivity improvements. It also included the difficult, but necessary reduction of over 8,000 roles to-date, out of the planned reduction of 10,000 roles by 2025 versus the plan of 7,000 roles in 2023.

At the same time, we started the cultural journey to drive impact with care and attracted over 900 talents with HealthTech background this past year.

Execution with decisive action as key value driver*2024 focus areas*

As you have seen in the results we have presented today, I'm pleased to see that the actions we have taken continue to positively impact our performance. We are very focused on our priorities and on executing with excellence to keep improving where needed to deliver our AI fuelled innovations to our consumers and customers.

We remain confident that our focused growth strategy for scalable innovation will further strengthen our business and results going forward. And we see huge potential to make a difference helping more healthcare providers help more patients, in an efficient and sustainable way, and making it easier for more people to take care of their health and well-being.

Key takeaways

Let me close out by repeating the key messages of today's announcement.

We delivered a strong year of improved operational performance as a result of the solid execution of our plan to create value with sustainable impact.

We are making progress on all our three priorities: enhancing patient safety and quality; strengthening supply chain reliability; and simplifying our operating model.

Patient safety and quality remains our highest priority across the company. And the consent decree provides clarity and a roadmap for us to demonstrate compliance and restore the business.

Looking ahead, we are fully on track with the plan for '23 to '25, although recognising uncertainties remain. The progress we are making reinforces our confidence to deliver further performance improvement in 2024.

I would like to thank you for joining the call. And we will now take your questions.

Q&A

Operator: Thank you, sir. If any participant would like to ask a question, please press the star followed by two times one on your telephone. Due to the time, please limit yourself to one question. This will give more people the opportunity to ask questions. There'll be a short pause while we - while participants register for questions. Thank you. The first question comes from the line of Hassan Al-Wakeel from Barclays. Please go ahead.

Hassan Al-Wakeel (Barclays): Hi. Morning. Thank you for taking my questions. I have three, please, if we can take them in turn. Firstly, can you talk about the portfolio pruning in Connected Care and why you've chosen to exit some of these businesses in the US? Was this directed by the FDA? And what is the combined revenue from these devices, and how should we think about 2024 revenue growth in Connected Care on a clean basis?

Roy Jakobs: Thank you, Hassan. Let me take that question. So we have been starting to prune our portfolio on an ongoing basis. We did that across the portfolio of Phillips, which we have seen in various products, but also businesses. We also did that in Sleep & Respiratory Care.

What is important to understand is that actually these pruning actually are aimed to accelerate our performance. And so far as you have seen also in 2023, that is actually what they do. So also for the Sleep & Respiratory Care business and also what you have seen in terms of the pruning that we take there, it's aiming at the same objective.

We see that Sleep & Respiratory Care bottomed in terms of the €1 billion of revenues and with the clarity that we have now with the constant decree and the roadmap to get to compliance and to restore the business, actually we are able to build from there. And actually that is also why we were happy to announce that actually we could now confirm that we remain on our plan, including any consent decree implication for 2023 to 2025.

And I think, as you remember, when we started last year with the plan and we said that we have a three-year trajectory, there were questions around what consent decree could still mean. Now we can take that unclarity of the table and we remain very committed. And based upon the first year where we actually over-delivered versus the first-year plan because then you also remember where we started, we said low single-digit growth where we did 7% growth. We said we would do high single-digit EBITA, we did 10.5% EBITA and we committed to €700 million to €900 million of cash. We did €1.6 billion cash. That actually was excluding insights of the consent decree.

Now we continue including the consent decree and we remain fully committed to the plan as we have.

Hassan Al-Wakeel: And sorry, just the combined revenue from these devices and the expectation for Connected growth - Connected Care growth in '24?

Roy Jakobs: So it's really immaterial. That's also why we would not disclose. We remain very committed to the 3% to 5% growth for 2024, and that includes any impact of any pruning that we did in 2023. And that was not only in SRC, we also did it in D&T, we also did some pruning in Personal Health. So actually we have been pruning across the portfolios, but

actually what we do is to focus our efforts on the innovations that we can scale faster and better, right? So that we have less fragmented portfolio and the portfolio that we have does make a better impact. And also that helps us to drive better margins because we said also, if you kind of consolidate your portfolio more, you will be able to get more leverage and that will support your margin trajectory as well.

Hassan Al-Wakeel: Perfect. And then, secondly, so another on the consent decree. Could you help us understand the timeline of your return to market in the US given you talk about a multi-year process? And the duration of profit disgorgement and whether you see any risks to selling OUS?

Roy Jakobs: So, on the first piece, so we have and will not be provide to kind of give a timeline on that. I think we are committed to work through the constant decree as soon as possible. We're also taking all measures needed. We have a team lined up to do that. We will come forward with the details of the consent decree once it's court approved. So then you will also have further insight in the - in what it means.

But I would say the following. Recall, as of when we come back, we will deliver on our plan. So actually we have been taking charge of the rest of Phillips. The - you know that kind of we have €18 billion of revenue, €1 billion is SRC, but actually we will drive all of Phillips to deliver on our commitment and actually that therefore also gives us the opportunity to work through this and comply as we need to do. And there's no dependence on that trajectory for delivery of Phillips.

Outside of US, as you have seen already in 2023, we started to resume and come back into the market. Actually, that will continue because we got the regulatory approvals. We already started to sell new CPAP and BiPAP devices, and we were continuing already earlier to service the market with the consumers, the patient interface. And we saw actually in the patient interface also some good performance.

So actually we will continue that track. But what for me is the most important piece is if you look to the totality of Phillips, in 2023, we have been growing every single segment, D&T, Connected Care, Personal Health. We have been pulling growth out of every geography, China, Europe and Americas. And we will continue to drive that total performance in 2024.

And especially also based on a strong cash performance that we showed in Q4 and for the full year, that of course gives also very strong base to move forward in kind of investing in the business, but also be prepared for anything that comes.

And the margin improvement of 310 bps in 2023, we of course need to continue. We said also we have a target now of 11% to 11.5%, and that's also underpinned by further growth momentum, but also the productivity measures that you saw. We have - we took almost €1 billion of productivity that we realised in 2023.

Now we take another 1,000 roles out in 2024, and we continue to work also on wider productivity because we see also some market easing on, for example, the procurement side that will help us to also drive further productivity to support the margin step up.

Hassan Al-Wakeel: Very helpful. And then finally on guidance, can you help us understand the breakdown and the rationale for 3% to 5% growth, given the provision had an additional

1 percentage point drag in 2023? Is there anything driving caution here, or are you trying to retain your more conservative approach to guidance?

And then on the margins how, should we think about the 50 to 100 basis point margin levers by business segment?

Abhijit Bhattacharya: Hi, Hassan. Good morning. This is Abhijit. No, I - yes, while there is a bit of benefit because of the provision that went against sales this year, but we also over-delivered. So we came at the top end of our guidance for 2023. So if you net the two, it's a few tens of basis points. And given the wide range of 3% to 5%, I think there was no need to further change that range. That's one.

I think on the profit improvement, you will see that across businesses like you've seen that this year. So we will continue to drive margins up in Diagnosis & Treatment, of course, Connected Care as well, but also Personal Health. And - yeah, I think we leave it at that.

Operator: Thank you. The next question comes from the line of David Adlington from JP Morgan. Please go ahead.

David Adlington (JP Morgan): Hi guys, hope you can hear me okay. So first question really is just on the consent decree. I know it's a bit difficult, given the fact you're still watching the court decision. But maybe if beyond this year, just wondered if the ongoing costs particularly related to profit disgorgement will still be recognised below the line? I just want to get an idea of how much the headwinds we're going to see below the line in terms of one-off costs beyond this year?

And then secondly, you put towards productivity initiative savings of about €960 million so far this year, but your overall EBITA is only up €600 million. So just wondering if you could point us towards the underlying headwinds, please? Thank you.

Abhijit Bhattacharya: Yeah. Hi, David. Couple of points. So regarding the guidance, we said the 100 basis points will be below-the-line this year for the whole remediation, including the profit disgorgement. Details of how much is for what we will come with only once we have the signed court order.

To your second part of the question, yeah, of course, we delivered, like we said, the €1 billion-odd of productivity. But of course, there was also inflation in cost wages, etc., etc. So the net is what you see back in the P&L. So that's - you will see that also in our bridge.

David Adlington: Thanks, Abhijit. Just to follow up on consent decree. Should we expect some below-the-line items in '25 and beyond?

Abhijit Bhattacharya: Sorry, see what?

David Adlington: On the consent decree.

Abhijit Bhattacharya: Yeah.

David Adlington: Should we expect some one-off items in 2025 and beyond?

Abhijit Bhattacharya: Yes. But we will come to - we provide more clarity later as we get more information. And the other thing may be important to understand is the 100 bps that we talked about, the additional cost. That's all included in the cash outlook for 2024 and

2025. So we are not changing the cash outlook for 2024 or 2025, so this is all included in that.

David Adlington: That's helpful. Thank you.

Operator: Thank you. The next question comes from the line of Richard Felton from Goldman Sachs. Please go ahead.

Richard Felton (Goldman Sachs): Thanks. Good morning. Two questions from me, please. The first one's on D&T margin in Q4. So can you provide maybe a little bit of colour around the mix impact in the quarter? I know strong growth in ultrasound had been a tailwind through the year, which I don't think was the case in Q4. But can you maybe help us quantify that impact, please?

Then the other driver that you called out in D&T margin for Q4 was the phasing of production and costs. Can you maybe explain what the phasing actually was related to and quantify the impact? Just trying to get a sense of the underlying margin trajectory for that part of the business.

Then my second question is a little bit more of a medium-term one on Sleep & Respiratory Care margins. Look, now that you have a little bit more visibility on the consent decree, and I see more detail on what remediation activities are going to look like, what level of profitability do you think is achievable for that part of business in the medium term? Thank you.

Abhijit Bhattacharya: Yeah. Hi, Richard. Let me take the first one on the Q4 impact on Diagnostic Imaging. So couple of things. One is the mix is not just on ultrasound, but it was a combined mix of a few things. So we had not only the mix of lower ultrasound because last year, we had, let's say, the backlog that we cleared, but also the geographic mix. So we sold more this year outside the US and China. So that was another impact. And then also the mix between equipment and services was also slightly adverse compared to the year ago because we sold - we had good sales in MR, etc., so there's equipment sales, which comes at a slightly lower margin. So that was the mix impact.

Now regarding the phasing of production that was - we have also brought down inventory big time. So as you do that, you taper off production so that we start next year with a healthy inventory, but not too high, and that results in a slightly lower coverage of our factory costs, so that impacted the margin in the fourth quarter.

And then there was some phasing of costs between - through the year and more significantly, in 2022. The annual incentive payments were very low because - or non-existent because of the poor performance. That, of course, comes as a cost this year. So that's the difference between the two years. So those are the three big buckets that impacted the margin in the fourth quarter.

Your second question on SRC outlook. Look, for sure, we will get back to profitability, but we are not giving separate guidance on every business. I think you should see a significant step-up in the overall Connected Care profitability that we have given in our guidance and as part of that is also the improvement that we will drive in Sleep & Respiratory Care.

Richard Felton: Thank you.

Operator: Thank you. The next question comes from the line of Veronika Dubajova from Citi. Please go ahead.

Veronika Dubajova (Citi): Hi. Good morning, Roy, Abhijit, Leandro. And thank you so much for taking my questions. I will keep it to two, please. One, would just love to get your take on China and your current expectations as far as your installations in China are concerned, and what's embedded in the guidance for D&T, both from a sales and a profitability perspective? Obviously, China is a very important and highly margin accretive market. So I'm just curious how you're thinking about the anticorruption activity and how that plays out in terms of the China revenue impact this year. Your commentary in order has been very clear. I'm really just curious about the P&L and what you've kind of factored it in there. And then I'll have a follow-up after that, if that's okay, but let's get this out of the way first.

Roy Jakobs: Sure, maybe - thank you, Veronika, for the question on China. I think China has been always an important part of our business, also will remain an important part of our business. I think it's fair to say that we know that China is going through a difficult phase macro-economically from a growth perspective, where the growth is lower with around 3% to 5% for the country as they have normally been kind of customised to that has a consumer impact, but it also has an impact in healthcare. And there, in particular on top, we have seen, of course, the anticorruption measures.

Now what we know is that on the anticorruption, they're working through a country programme to actually go state by state. So what we have seen is that they have partly finished that programme or at least they made a lot of progress on that in 2023, but we do expect that to continue into 2024. And therefore, actually we are seeing that China is back-end loaded for 2024. We see gradual improvement in China. It will continue to contribute to our total plan and also embedded in the guidance of 3% to 5%.

I think what is important from an order perspective, it's only 5% of our global sales, mainly in D&T. And also, that on the consumer side, we have seen them coming back to growth, but we expect that to surely but slowly come further up. So China will strengthen throughout the year is our expectation. The government actions are not finished, and they will still need to complete that programme.

Veronika Dubajova: Okay. That's helpful. And Roy, would you expect China for D&T to be flat to grow or to be down for the full year?

Roy Jakobs: No, it should grow. So we expect -

Veronika Dubajova: It to grow, okay.

Roy Jakobs: Yes, it should grow.

Veronika Dubajova: Okay. That's great. And then my second question was - and I think, Roy, you alluded to this in your prepared remarks, some of the geopolitical risks, obviously, thinking about shipping and freight costs. Obviously, you have some very localised manufacturing in the Middle East for the CT business. Just kind of curious how much of your wiggle room, if I can say that, very highly technical term, have you embedded around those risks when you've given the 2024 guidance? And I guess what is for you the single most

significant area of concern that you have? Maybe Abhijit can chime in also on the freight side of things there. Thank you guys.

Roy Jakobs: Yeah, I think we alluded to the uncertainty because we just learned that the world around us is - and remains volatile. I think the guidance that we have been giving the 3% to 5%, we are very confident in based upon the execution improvements that we have been putting into 2023 because that gave us more agility, also to adapt to situations like we see today. It gave us productivity to absorb some of potential cost increases.

And I would also put into perspective kind of, yes, there is Red Sea, for example, developments. But if we look to the total freight cost that we have, this is a kind of immaterial impact that we currently foresee. There might be some kind of delivery times challenges, but actually, that will - we're also overcoming because we are kind of pre-empting that, and we're working already through mitigation.

So we are vigilant of what would happen to the world. So far kind of we are on top of the developments, both in Middle East. And I think the bigger concern that, I think, and you alluded to it earlier, is that we need a strong global economy, and we need all the geographies to contribute. And therefore, China getting stronger, I think, is something that, of course, we all welcome. But also rest of world, we see some strengthening in 2024. North America should be a bit stronger than in 2023. And we see also a focus of growth that we go after in Asia, for example, with Indonesia and Japan. And also Saudi, we see some good opportunities.

So we watch the world carefully, I think by adjusting our operating model. We have become more agile to adapt to situations, if they would occur. Currently, we are dealing with any known issues well and they are taken into the guidance, as you have seen.

Veronika Dubajova: Thanks guys.

Operator: Thank you. The next question comes from the line of - one moment, please - comes from the line of Lisa Clive from Bernstein. Please go ahead.

Lisa Clive (Bernstein): Hi. Thanks very much. Just a question on your order book and the match up of inflation and cost increases. I know fairly early on, as inflation picked up, you did manage to put through price increases. And just wondering if you could just remind us roughly what quarter that started and when that started coming through your backlog and after that initial round of price increases, have you been able to continue moving prices up as inflation has not yet abated?

Abhijit Bhattacharya: Yeah, I think what we did was we saw first small bit coming into Q3 and then Q4 a little bit more, but I think most of the, let's say, price increases you will see coming in, in 2024. That is what we had planned. So in PH, we don't see further strengthening of prices. So we are where we are. Our margins are at a good level. We are driving productivity, etc., to drive costs down.

In selected areas in Health Systems, we continue with the price increases that we've had, but we are also seeing component pricing and other things coming down. So we will manage that as a mix into the pricing strategy for 2024.

Lisa Clive: Okay. And then just a question on your sleep apnea business. Novo Nordisk will have a readout from an OSA trial for their GLP-1. And clearly, obesity is a major contributor

to sleep apnea. Although on the other hand, it's a very under-diagnosed condition. So just thinking about how the world seemingly has changed in the last few months around GLP-1s and the potential for even better drugs, the potential for eventually generics to help lower the price point. Does that change your long-term view on the sleep apnea business, particularly in light of the fact that you're actually just even going to be out of the market for a year or two as well, at least in the US? Obviously, you're able to sell OUS, but the US has historically been your biggest market.

Roy Jakobs: Yeah, thank you, Lisa. I think we don't see changing structurally the market opportunity. We believe that there is a significant patient base out there, as you say, that's undiagnosed. Yes, I think there will be a medication that will help address some of the causes of sleep apnea. We also note that, on average, a sleep apnea patient has five comorbidities. Obesity is one of those. So this will help but will not take the root causes away.

We also know that CPAP and BiPAP is by far the most effective therapy that is preferred and also in use and in demand. So we are committed to that segment. We also see the opportunity strong. We're fully focused on working through now the clarified roadmap for the US And outside of US, of course, we are already coming back into play. So we believe that there is a strong road ahead that we will work through based on the improved clarity that we now have.

Lisa Clive: Thanks for that.

Operator: Thank you. As a final reminder, if you would like to ask a question, please press star followed by two times one. One moment please. We will now go to the next question. And the next question comes from the line of Sezgi Özener from HSBC. Please go ahead. Hello, Sezgi, is your line on mute? Due to no response, I will go to the next question. And your next question comes from the line of Graham Doyle from UBS. Please go ahead.

Graham Doyle (UBS): Good morning. Thanks for taking my questions. Just two kind of areas. So firstly, just in terms of the adjustments and sort of the restructuring charge, and secondly around the consent decree.

In terms of the adjustments, kind of quick housekeeping one. Could you maybe elaborate on what the €81 million of D&T remediations related to in Q4 '23? And then just for 2024, it looks like if you do the sums, roughly 100 basis points of the expected adjustments to EBIT is going to be related to the recall again, which it just seems - it seems a large number of route, given you also say in the statement that more than 99% of the sleep recall was done. So could you give us a sense on when these adjustments will end, I suppose?

And then separate to that, just on the consent decree. Is there anything in your 2025 guide for Sleep & Respiratory sales in the US? And I know you don't want to comment on the specific products that were withdrawn on Friday. But given the quantum and the previous breakdown of revenue from these products, it seems like a fairly sizable headwind, particularly in the first couple of quarters next year when maybe you don't have the tailwinds coming through in revenue. So how should we be thinking about that H2 weighting that Abhijit just referred to for 2024? Thank you.

Roy Jakobs: Yeah, let me take the first one on the €81 million in charge that we took. So as I said, when we start the plan, patient safety and quality is an important focus area for us, and we will put in new efforts to actually improve quality across the portfolio. That actually is where these charges reside from because we are also taking action across all our businesses. And in this case, it was in the D&T area that we took the quality action, and that is part of the improvement of quality.

We also signalled that as part of the plan. We would invest behind that. These are some of these charges that you currently see coming through.

Abhijit Bhattacharya: Regarding the adjustment of 100 bps, so let me clarify, there are two parts. One is related to the consent decree where we have running costs of the remediation. The second that we mentioned is regarding overall remediation in Respiratory Care, but also for the rest of the company.

Now part of that is the legal costs will continue. There is some testing costs that will continue. So yes, we are at 99% on the remediation of sleep. There is a very small portion that is left. We still have to do the ventilators for which we have a provision now. But let's say, the last part of the legal costs and testing and other related costs will continue into next year.

Your last question was on, yeah, the sizable headwinds. I also saw it in your note, you talked about €400 million of headwinds. I think Roy has clarified the €1 billion is the bottom that we see that was the revenue for 2023, and that is the bottom. So we don't see any further headwinds to that revenue number going forward. And in our outlook, all of this is taken into consideration.

Graham Doyle: Okay. Super helpful. Maybe just on the - that point, the last point on the €1 billion of Sleep & Respiratory. You have given us plenty of disclosure in the past, so we can kind of reasonably estimate what masks this. It gets us to a number of €700 million or something in that region for all of the other non-mask, non-sleep revenue in this division. And if I just go to the US website, pretty much every product has been removed by the BiPAPs, which you're now not selling. So like it just seems like a large number. Even if it's half that number or half of that number, it's still a big number. So that's why I'm asking, is there something that we're missing in terms of sales that's coming from a different part of Sleep & Respiratory that we either overlook or analysts have overlooked? That will be quite helpful to know, and that obviously helps to bridge that 25 gap.

Roy Jakobs: Yeah. Maybe Graham, so first, let me start from what Abhijit said, right? So the €1 billion, that's the number that we built back from when we talk about this is the roadmap to restore the business, that's where we start from. What you see, of course, is there are mix shift underneath. We already stopped selling a lot in US right? So actually, we are building there from already a base that actually was out there, right? We continue with patient interface, which was the biggest part, which already was in the forecast, including consumables and accessories.

Furthermore, as you know, we are building back outside of the US, right? So that's something that comes actually on top of what we're doing because that was not in the earlier guidance. So I think, yes, we are - have published a list of pruning products, but that's not part of kind of lowering guidance, no. Actually, we have taken that into the guidance, and we

will be building back from here. So I think that's where we just really want to be clear that there should be no misunderstanding that: A, we have taken all in the guidance. So actually, we delivered 3% to 5%, including the pruning that we did in SRC, but also the pruning that we did in other businesses; B, that we have reached the bottom, and we will build back. So we will make sure we comply as well as that we further restore the business and what we also said as we will kind of have not included this as part of our guidance and the plan 2023-2025.

We will not go into the specific breakdowns per product line of a business because that's what we don't do in any business. And it should also not be of your concern as actually reiterated that we have a strong outlook, right, and that we are committed to deliver that 3% to 5% growth, that profit further step up to 11% to 11.5%, and the cash, which is a really important focus area. You saw that we are very much focused on that. We had a very strong close on cash, and we will continue that cash discipline moving forward.

And that totality of Philips, that actually we see strengthening, and we will, after a strong first year where we over-delivered on our plan significantly versus what we came out with in January, we want to continue that performance trajectory in 2024.

Abhijit Bhattacharya: And maybe –

Graham Doyle: Sorry, Abhijit, go ahead.

Abhijit Bhattacharya: The cost of repetition, Roy mentioned earlier, pruning parts of our portfolio is something that we have been doing for a while also to focus on our high growth drivers and to get our innovations out there and put scale behind our winning products. So maybe there is a heightened sense of sensitivity around the pruning in Sleep & Respiratory, but just look at it as part of stuff that we do across the portfolio, across the company.

Graham Doyle: Okay. No, that's really helpful. A follow-up, Leandro, just to make sure I haven't misunderstood. Thanks a lot, guys.

Roy Jakobs: Sure. Thank you.

Operator: Thank you. The next question comes from the line of Sezgi Özener from HSBC. Please go ahead.

Sezgi Özener (HSBC): I'm so sorry about a few seconds ago. I hope you can hear me now. I will have two questions, please, and thanks for taking them. One of them on the Respiratory Care portfolio. You said you will - I mean, disclose about this continuation of the sales of these products. You had said in the past that in order to deal with the recall, you had quadrupled capacity of CPAP, BiPAP production. I know you've been undergoing a lot of changes restructuring. How much of that capacity has been built away? Or will you - how much of that will you be able to utilize in OUS sales or in other products? And if we think about long-term profitability of Connected Care, my impression was that Sleep & Respiratory Care had higher profitability than patient monitoring. How does that impact your long-term margins for these segments?

And my second question will be, you're showing much lower inventory levels in all of your segments at the end of year-end. Do you expect further downside or are these inventory levels sustainable? Will they - or do you - should we pencil in some rise going forward?

Abhijit Bhattacharya: Yeah, I think on the capacity, what we have done, the additional capacity that we put in was flex capacity with comakers. So they were kind of not in our own plants, but we did it with comakers. Those have been wound down as we have progressed with the remediation. So that's not something that will remain as an overhang.

In terms of SRC profitability, say, it was never higher than Monitoring. Monitoring, of course, is a very highly profitable business. SRC in the past was mid to high-teens profitability business. It will probably not get back there, but we will improve profitability over the period so that we get into the guided range for Connected Care as we have given for 2025.

Regarding the inventory, yes, we have done a big reduction last year. There are still a couple of areas that we would want to reduce this year. So yes, we will have a couple of hundred million reduction this year as well on inventory so that we get our supply chain then working at an optimal level.

Sezgi Özener: Thanks very much.

Operator: Thank you. The next question is a follow-up question and comes from the line of Veronika Dubajova from Citi. Please go ahead.

Veronika Dubajova (Citi): Hi guys. Thank you so much for squeezing me in for a follow-up. I'm going to go back to the topic that I think a bunch of people have asked. Just maybe for clarification, we can close the circle. But I think when you gave the guidance back last year, the mid-term guidance, you had assumed a 10% CAGR for S&RC sales. I just want to confirm whether that still stands? Or should our working assumption be different?

And maybe just to confirm that S&RC sales went from €1.3 billion to €1 billion '22 to '23. Just so we have the right starting point, that would be great. Thank you.

Abhijit Bhattacharya: Yeah, I think the €1 billion sales for 2023 is what we have said now multiple times in this call. So it's confirmed and reconfirmed again, Veronika.

Regarding the growth rate for Sleep & Respiratory, we are not giving a separate guidance at this point of time. We have the overall guidance for Connected Care. And within that, we will manage the Sleep & Respiratory Monitoring, Enterprise Informatics and all of the businesses to get to the target that we have set for ourselves.

And you see there's quite a big step up in profitability from where we are now, and we have high confidence of getting there in the next two years.

Veronika Dubajova: That's very clear. Thank you, Abhijit. And the €1 billion, are you able to give us a flavour for US versus OUS in terms of the breakdown of that?

Abhijit Bhattacharya: The €1 billion is €1 billion, and then we build from there.

Veronika Dubajova: But let me ask you differently. It's fair to assume it's more OUS than US at this stage, correct?

Abhijit Bhattacharya: Yeah. Veronika, I appreciate you asking differently, but let me answer in the same way, the €1 billion remains the €1 billion, right? So we don't want to give more because it gets into a level of so much detail that it creates more confusion than clarity. So I think if we take this as a starting base, I think your models will be simpler and easier to get through.

Veronika Dubajova: Understood. Had to try. Anyhow, thanks guys.

Abhijit Bhattacharya: So 10 marks for trying, Veronika. Well done.

Operator: Thank you. We will now go to our last question for today. And the question comes from the line of Julien Dormois from Jefferies. Please go ahead.

Julien Dormois (Jefferies): Hi. Good morning, Roy. Good morning, Abhijit. And thanks for squeezing me in. I'm left with three questions, if that's okay, but they should be fairly short. The first one, and sorry if you've provided it. But I was just wondering whether you could provide us with the split on the order book between D&T and CC?

Second question relates to the Imaging or to the D&T business, sorry, and given the normalisation in the backlog in that division, do you see anything that could prevent you from returning to the same sort of margins that you exhibited in full year '19, which was a margin of, let's say, between 12% and 13%.

And more specifically into this, if you could give us a sense of where you're Imaging business currently sits. Are we now in the double-digit range for that segment?

And the last question is for the consent decree. I was wondering whether you could give us any sense of when you expect the terms of the consent decree to be formally signed off? Are we talking about a few days, weeks, or could these be months? Thank you very much.

Roy Jakobs: Yeah. Thank you. Yeah, on the - maybe on split, in terms of the -

Abhijit Bhattacharya: Yeah. On the split between D&T and Connected Care, it's pretty much similar, right? We start Connected Care also in monitoring with actually a very strong order book that gives us confidence for the growth in 2025.

D&T, look, we were - I think we ended at 11.6%. So we are very close to the 12% to 13%. So with the profit improvement of this year, we will get to the peak ranges of 2019, as you pointed out. And then on the consent decree, when you expect it to be signed, Roy, maybe you can take that. But we don't have really date there because that is a court process.

Roy Jakobs: It's depending on the FDA and the court. So that is a due process, so we cannot give you a date on that. So that's something that is running. Of course, people will try to expedite to make sure that this gets clarified and closed. But I think there's no data that we could give you here.

Julien Dormois: Okay. Thank you very much. Just for the sake of clarity on the order intake that was down 3% in the fourth quarter, that number would be pretty similar between D&T and CC. Did I get it right?

Roy Jakobs: Yeah, perfect.

Julien Dormois: Yeah. Okay. Thank you. Thank you very much guys.

Roy Jakobs: And important to know, right, Julien, and you probably know that in terms of the order book, it supports 40% of the sales that we have, right? And we have 60%, which is in services, consumables, recurring revenue and Personal Health. And actually, we also saw good growth there. You saw it in the Personal Health growth, but also in the services and software growth. So, of course, we all want to improve the number. That's our target. We

have the actions in place, but I think it's also important to kind of put it into perspective of total €18 billion and what this supports.

Furthermore, as said, 15% higher order book. So actually, if you look to the ratio of conversion going into 2024, we are still actually higher and above the supply chain and COVID crisis numbers in terms of our underpinning of the sales by the ratio of the order book. So that also gives us the confidence going into the year for the 3% to 5%.

Julien Dormois: Crystal clear. Thanks.

Roy Jakobs: Thank you.

Operator: Thank you. Gentlemen, that was the last question. Please continue.

Roy Jakobs: Okay. Thank you all for your questions. I think reiterating, I think, the key messages of today. We came out with our full year results, where if you compare to where we started the year and the guidance of the plan, we had a strong beat on sales where we did 7% versus a guidance of low single-digit, where we had a profit improvement of 310 bps, which actually was high single-digit target, and we delivered 10.5, and we had a cash flow target of €700 million to €900 million, where we did €1.6 billion.

That was on the back of strong execution of our plan, where we focus on patient safety and quality, supply chain and the operating model. Now we continue to execute that plan. That also gives us the confidence into 2024, where we said that actually we give you a range of 3% to 5% of sales growth as our target, then 11% to 11.5% profit improvement. So we continue our trajectory as well on profit and then a strong cash generation of €800 million to €1 billion.

We also provide you with clarity on the consent decree, which I think is a very important milestone that we have all been longing for. And also what the important message there is, on one hand, we have now a roadmap to comply, to also to restore the business. But most importantly, that actually, we stay fully committed to the plan that we have and the financial guidance that we put out there that now includes the full consequences of the consent decree.

And actually, therefore, we are kind of now building from that in terms of further delivery of the plan.

So we're looking forward to further dialogue around how we progress. We will remain focused on executing our plan and delivering continuous improvement. Thank you so much for dialling in and looking forward to talk to you soon.

[END OF TRANSCRIPT]