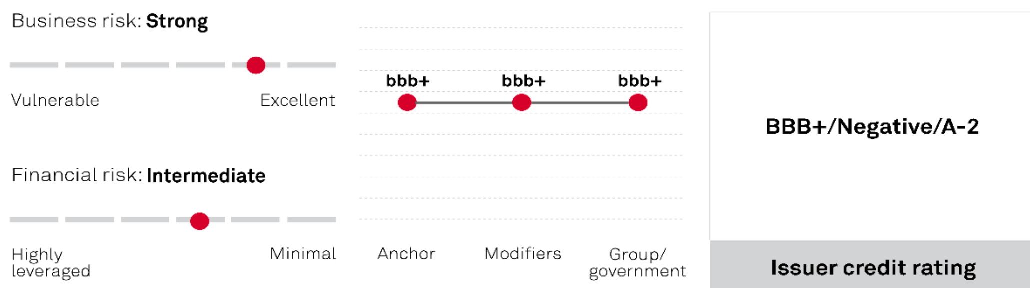
# Koninklijke Philips N.V.

**December 11, 2023**

## Ratings Score Snapshot

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## Credit Highlights

**Overview**

| Key strengths | Key risks |
|---|---|
| Well-diversified offering with leadership positions in key categories, such as image-guided therapy, patient monitoring, and digitalized health care solutions and services. | Highly competitive market, where scale and leading positions are key to driving productivity and margin growth. |
| Highly innovative portfolio--with strong capabilities in digital, artificial intelligence (AI), and informatics--supporting strong brand recognition market position. | Pending litigation-related expenses are likely to negatively affect financial performance beyond 2023. |
| Solid operational performance throughout 2023 as the company strengthened its supply-chain reliability as part of its execution plan, increased its operating efficiency; it also implemented a cost-efficiency plan. | Macroeconomic uncertainty amid inflationary and currency volatility could challenge growth and margins in the next 12 months. |

**Philips' 2023 was marked by a solid operational recovery and an ease in supply-chain challenges versus last year.** Philips' third-quarter reporting showed the group getting its operational performance back on track after a complicated 2022 marked by difficulties sourcing critical components and extraordinary costs linked to repairing and replacing respiratory devices. The third-quarter results show signs of a rapid pickup in sales and margins. Sales for the third quarter were €4.5 billion, or 11% comparable growth, while income from operations stood at €224 million, versus a loss of €1.5 billion in the previous year. Group-adjusted EBITA totaled €457 million, or 10.2% of sales, which was more than double last year's.

Although supply chains have not completely recovered, we believe the business and sales growth across segments, particularly in diagnostics, is closely linked to better supply-chain conditions and management. Philips continues to try to improve supply-chain reliability and shorten order lead times. Although order intake is lower versus last year (9% lower), partially due to a high comparison base in 2022 but also due to a lag in orders in China and competitive pressures in certain categories, where Philips has longer lead times than peers, we continue to view its order book as strong. We also note its ongoing efficiency efforts, including restructuring and productivity improvements, which saved €258 million just in the third quarter. We forecast the S&P Global Ratings-adjusted EBITDA margins will improve to 11%-12% in 2023, from 7% in 2022 and 10.5% in 2021. We also expect the group will report positive free operating cash flows (FOCF) of up to €800 million in 2023. Moreover, we forecast that debt to EBITDA will decrease to 3.0x-3.5x, versus 5.3x in 2022.

**Macroeconomic uncertainties, subdued consumer demand, and future litigation costs could challenge our forecasts.** Although the order book in the third quarter signals support to sales in the next few quarters, other challenges persist. One of these is significantly fewer orders in China. We understand the situation in China is mainly due to the Chinese authorities' investigation into hospital administrators, which has slowed order momentum. We think this could add to lower sales growth prospects for next year. Another challenge relates to legal claims. In September, Philips reached an agreement to resolve all economic-loss claims brought by private plaintiffs in the U.S. related to Philips Respironics' voluntary recall of certain sleep and respiratory care devices. For these costs the group had provisioned €575 million in first-quarter 2023. However, we think legal claims related to potential personal injury could depress Philips' financial metrics in the future. The timing and potential impact of these claims is uncertain, and Philips has booked no provision. Although we have not included potential personal injury claim settlements in our base case, our negative outlook on our long-term ratings on Philips reflects potential ratings downside related to any such costs.

We expect S&P Global Ratings-adjusted margins to be 15%-16% on average in 2024 and 2025, with FOCF of €900 million-€1 billion on average over the same period. We also expect leverage to go below 3.0x in 2024-2025.

**Innovation will support Philips' market leadership in the medium term.** Of its peers in medical technology, we view Philips as better able to adapt to changing technological needs in its markets. In health care, data analytics, artificial intelligence, and big data have the potential to more easily identify patterns in patients' health statistics. Ultimately, this could improve patient care and make hospitals and care homes more efficient. Remote patient monitoring is another area of Philips' focus. Philips' hospital patient monitoring division has developed an adaptable and scalable monitoring ecosystem to support clients' inorganic growth. This system can also be connected to non-Philips' devices, allowing clinical insights across medical acuities and adapting to care providers' existing medical equipment. Such integration allows clinicians to assess and monitor cerebral oxygenation, anesthetic sedation, and patient respiratory performance from the same monitor.

Philips is leading the market in ambulatory and hospital patient monitoring. Positively, the group is continuing to invest about 9% of sales in R&D in 2023, which remains higher than some of its peers (7.5% industry average). For instance, in 2022, Medtronics spent about 8.5% and Baxter about 4.2% (the Boston Scientific Group invested nearly 10%, similar to Philips). We view Philips as having a good capacity to acquire innovative technologies from smaller players in the market, and we think it has the expertise to navigate regulatory approval processes and market the products. This translates into a product portfolio that remains competitive and should see Philips maintain its leadership position in the medium term. We view this as a competitive advantage in a fast-changing technological environment.

# Outlook

The negative outlook reflects uncertainties related to our base-case assumptions--in particular any potential cash outflows for personal injury claims connected with sleep and respiratory care devices in the U.S.

If significant costs materialize, Philips might not be able to reduce leverage to back below 3x.

## Downside scenario

Ratings downside could materialize if Philips' profitability and cash flow do not improve as we currently expect, leaving leverage above 3x.

In such a scenario, Philips could engage in more-extensive restructuring than anticipated, to address the under absorption of its cost base. This could cause profitability to remain low and credit metrics to be subpar.

Any adverse developments relating to the recall of Philips' respiratory devices, heightening litigation risk, could lead us to consider a downgrade because cash outflows could place deleveraging at risk.

## Upside scenario

We could revise our outlook on Philips to stable if delivery volumes continued to meaningfully increase, leading to lower inventory levels and enabling the group to generate cash, significantly improve profitability, and strengthen its credit ratios. An outlook revision would also depend on Philips gradually improving its S&P Global Ratings-adjusted EBITDA margin toward 15%, with leverage below 3x, and continuously improving its performance, as well as reaching a conclusion on pending respiratory-devices-related regulatory and legal matters in the U.S.

# Our Base-Case Scenario

## Key metrics

### Koninklijke Philips N.V.--Key Metrics*

| Mil. € | 2021a | 2022a | 2023e | 2024f | 2025f |
|---|---|---|---|---|---|
| Revenue | 17.2 | 17.8 | 18.6 | 19.5 | 20.3 |
| Revenue growth (%) | (12.2) | 3.9 | 4.4 | 4.8 | 4.3 |
| EBITDA | 1.8 | 1.3 | 2.1 | 2.9 | 3.2 |
| EBITDA margin (%) | 10.5 | 7.1 | 11.1 | 15.0 | 15.6 |
| Funds from operations (FFO) | 1.4 | 0.7 | 1.6 | 2.3 | 2.5 |
| Free operating cash flow (FOCF) | 0.9 | (1.0) | 0.8 | 0.9 | 1.1 |
| Adjusted debt | 4.5 | 6.7 | 7.0 | 7.3 | 7.0 |

**Koninklijke Philips N.V.--Key Metrics***

| Mil. € | 2021a | 2022a | 2023e | 2024f | 2025f |
|---|---|---|---|---|---|
| Debt to EBITDA (x) | 2.5 | 5.3 | 3.4 | 2.5 | 2.2 |
| FFO to debt (%) | 31.6 | 11.0 | 22.4 | 31.6 | 35.0 |
| FOCF to debt (%) | 19.4 | (14.6) | 11.2 | 13.0 | 15.3 |

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

# Company Description

Founded in 1891 and headquartered in the Netherlands, Philips is a leading health technology group, globally. The group generated S&P Global Ratings-adjusted revenue of €17.8 billion in 2022, with an EBITDA margin of 7.1%.

Philips operates in three major segments:

- Diagnosis and treatment (approximately 50% of group sales): Diagnostic imaging, ultrasound, and image guided therapy;
- Connected care (30%): Hospital patient and home monitoring, sleep and respiratory care, and enterprise informatics (both connected care and enterprise diagnosis informatics); and
- Personal health (20%): Oral health care, mother and childcare, and personal care.

The group has a presence in over 100 countries and its largest markets are North America (about 40% of revenue), Asia (30%), and Western Europe (20%).

# Liquidity

The short-term rating on Philips is 'A-2'. We continue to assess Philips' liquidity as strong because sources will cover uses by more than 1.5x for the next 12 months. Moreover, we believe Philips would be able to withstand adverse market conditions over the next 24 months with sufficient liquidity to meet its obligations. The average tenor of the group's long-term debt is more than eight years and it has no long-term debt maturities before 2025.

## Principal liquidity sources

- Estimated available free cash and cash equivalents of about €1.155 billion.
- An undrawn revolving credit facility of €1 billion maturing in March 2028.
- Cash funds from operations totaling about €3 billion over the next two years.
- A working capital release of up to €900 million over 2023 and 2024.

## Principal liquidity uses

- Short-term debt maturities of about €500 million.
- Execution of committed share buyback futures totaling about €300 million in 2024.
- Capex of about €700 million-€800 million per year, of which part is noncritical and therefore discretionary.
- Cash dividends of up to about €400 million annually, and we expect a meaningful portion to be paid out as script dividends.

# Environmental, Social, And Governance

Social factors are a positive consideration in our credit rating analysis of Philips. In our view, the group is well-positioned to provide individuals and communities access to medical care thanks to its global footprint and leading portfolio of medical technology products and ancillary services. Its business model is based on providing integrated and customized solutions to hospitals and should continue to support customer retention and satisfaction, as it did during the pandemic. The connected nature of Philips' products and services has also supported its penetration in markets that have limited health care infrastructure and a growing middle-class, such as India and Indonesia. Nevertheless, as for other medical device manufacturers, product safety remains an important social risk factor. This was demonstrated by the recent events regarding its sleep apnea and ventilator devices, which had to be recalled. In our analysis, we consider that Philips' recent completion of its transition into a focused global medical technology group indicates its ability to successfully execute the strategic choices made by the board and management.

# Issue Ratings--Subordination Risk Analysis

## Capital structure

The vast majority of debt is senior unsecured and issued directly by Koninklijke Philips N.V., the group's top holding company.

## Analytical conclusions

All the long-term senior unsecured notes are rated 'BBB+', in line with our issuer credit rating on Philips.

### Rating Component Scores

| | |
|---|---|
| **Foreign currency issuer credit rating** | BBB+/Negative/A-2 |
| **Local currency issuer credit rating** | BBB+/Negative/A-2 |
| **Business risk** | Strong |
| Country risk | Low |
| Industry risk | Low |
| Competitive position | Strong |
| **Financial risk** | Intermediate |
| Cash flow/leverage | Intermediate |
| **Anchor** | bbb+ |
| Diversification/portfolio effect | Neutral (no impact) |
| Capital structure | Neutral (no impact) |
| Financial policy | Neutral (no impact) |
| Liquidity | Strong (no impact) |
| Management and governance | Satisfactory (no impact) |
| Comparable rating analysis | Neutral (no impact) |
| **Stand-alone credit profile** | bbb+ |

# Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Ratings Detail (as of December 11, 2023)*

| | | |
|---|---|---|
| **Koninklijke Philips N.V.** | | |
| Issuer Credit Rating | | BBB+/Negative/A-2 |
| Senior Unsecured | | BBB+ |
| **Issuer Credit Ratings History** | | |
| 08-Nov-2022 | *Foreign Currency* | BBB+/Negative/A-2 |
| 28-Jul-2015 | | BBB+/Stable/A-2 |
| 02-Oct-2014 | | A-/Negative/A-2 |
| 08-Nov-2022 | *Local Currency* | BBB+/Negative/A-2 |
| 28-Jul-2015 | | BBB+/Stable/A-2 |
| 02-Oct-2014 | | A-/Negative/A-2 |

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.