MOODY'S
RATINGS

Rating Action: Moody's Ratings changes Philips' outlook to stable, affirms Baa1 rating

02 May 2024

Frankfurt am Main, May 02, 2024 -- Moody's Ratings (Moody's) has today affirmed Royal Philips N.V.'s (Philips or the company) Baa1 long-term issuer rating, its Baa1 senior unsecured rating and its P-2 commercial paper rating. The outlook changed to stable from negative.

RATINGS RATIONALE

"Today's change of outlook to stable from negative reflects the company's progress in improving its operating performance with ongoing sales growth and improving profitability since 2022 and the close to final resolution of the Respironics recall program and associated legal claims" says Dirk Goedde, a Moody's Vice President – Senior Analyst and lead analyst of Philips. "The company improved its free cash flow generation during 2023 on the back of increasing margins and better working capital management and should therefore be able to pay the $1.1 billion capped settlement in the US from its cash position in 2025."

Since the initiation of the productivity initiative in 2022, Philips credit metrics continue to improve, albeit we expect full effects after costs only being visible by the end of 2025. The company has weathered the supply chain crisis well and maintains a solid order book of around 40% of revenues, providing some visibility. Regional negative impacts, especially in China will nevertheless dampen growth expectations in 2024 but we forecast revenue growth of around 3% and expect an acceleration in 2025. When adjusted for litigation and recall associated costs, the company's profitability has improved to 11% Moody's adjusted EBITDA and we expect further improvements towards 13% on the back of stringent cost focus although the high inflation environment continues to persist and creates some headwind. In terms of cash generation, we expect ongoing improvement in working capital and disciplined capital expenditure, leading to around €1.0 billion Moody's adjusted free cash flow in 2024. This is also supported by the full stock dividend while we expect the company returning to cash pay dividend as of 2025 which will reduce cash generation. We forecast the company to repay gross debt in 2024 and 2025 while maintaining its cash position at least at €1.0 billion. As a result, we forecast Moody's adjusted debt/EBITDA to improve below 3.0x during 2025, a level that is commensurate with a Baa1 rating. Although not included in our projections, we consider the risks of further product recall and associated negative impacts being inherent to the company's business model in the highly regulated healthcare industry.

Philips' Baa1 long-term issuer rating remains supported by its large scale and market-leading positions in most of the health spaces in which it operates; its well-balanced geographic footprint, its diversified product portfolio and positive fundamental drivers supporting volume growth and stability of the demand.

The rating also takes into account the company's mixed quality track record including past manufacturing issues in some of its facilities in the US and the recent quality issues in some of its sleep and respiratory devices which prompted the recall program; its lower profit margin than its industry peers; the competitive market environment, which led to industry-wide price pressure historically and need for innovation; the company's appetite for acquisitions historically which represents an event risk even if M&A activity has not translated in recent years into material releveraging; and the capital allocation to dividends and share buybacks, which constrain credit metrics.

OUTLOOK RATIONALE

The stable outlook reflects the expectation that credit metrics will continue to improve into the requirements for the recent rating category. This includes Moody's adjusted EBITDA being maintained in the double-digit in percentage terms, a strong focus on free cash flow generation as well as an unchanged prudence in terms of financial policy.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Upward rating pressure could develop in the medium term in case the Moody's adjusted debt/EBITDA decreases below 2.5x on a sustained basis; the Moody's adjusted free cash flow/debt approaches 20%; the company sustainably improves its operating margin.

Downward rating pressure could develop in case the Moody's adjusted debt/EBITDA remains above 3.0x for a prolonged period or the Moody's adjusted free cash flow/debt stays below 10% on a sustained basis.

LIQUIDITY

Philips' liquidity is good, supported by €1.4 billion of cash and cash equivalents as of end-March 2024 representing 7% of LTM sales and a fully undrawn €1.0 billion revolving credit facility maturing in 2029. Moody's forecasts Philips' free cash flow (according to Moody's definition that is after dividends and leases repayment) of around €1.0 billion in 2024 reducing to €0.7 billion in 2025 driven by the return to cash pay dividends. These amounts are sufficient to cover the expected litigation payment of €1.1 billion in 2025. Moody's projected cash outflow also include debt repayments of in total €1.0 billion until end of 2025 while we expect some local debt facilities being rolled over.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Medical Products and Devices published in October 2023 and available at https://ratings.moodys.com/rmc-documents/410354. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

COMPANY PROFILE

Headquartered in Amsterdam, the Netherlands, Royal Philips N.V. is one of the world's leading health technology companies. In 2022, it generated revenue of around €17.8 billion, operating in more than 100 countries worldwide with workforce of around 69,100 at the end of March 2024. Philips is a publicly listed company, with a well-diversified shareholder base and market capitalisation of around €23 billion as of 2 May 2024.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions .

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