PHILIPS

Q4 & Full Year Update Call

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Introduction

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Good morning, everyone. Thanks for joining our Fourth Quarter and Full Year 2021 Update Call at short notice. I'm here with our CEO, Frans van Houten, and our CFO, Abhijit Bhattacharya. Frans will make brief opening remarks. And after that, there will be an opportunity for Q&A.

The fourth quarter and full year 2021 financial results will be reported on 24th January 2022. So during today's call, we ask you to focus your questions on the information contained in this morning's press release.

Over to you, Frans.

Opening Remarks

Frans van Houten

CEO, Koninklijke Philips

Yeah. Hello, everyone, and thank you for joining us today. I would like to provide some further background on the update on financial performance in the fourth quarter that was published at 7.00am this morning.

In the quarter, we faced intensified global supply chain volatility and challenges across our businesses, primarily related to the shortage of electronic components and shipping times. In addition to that, we saw customers pushed out equipment installations in hospitals as they struggled with site readiness and the impact of COVID on their people and operations in December.

While we flagged these risks to you in October at our third quarter results publication, the rapid re-emergence of COVID created a larger impact than we had anticipated at that time. This constrained our ability to fully convert our strong order book to revenue, which in turn led to an additional impact of around €350 million on our sales compared to our earlier expectations for the quarter.

Comparable sales are expected to decline approximately 10% in the quarter, mainly due to these effects and including the impact of the earlier announced Respironics recall.

Sales for the full year 2021 are expected to be approximately €17.2 billion, which is a 1% comparable decline. Supply chain headwind, combined with the impact related to the recall, amounted to approximately 5 percentage points for the full year.

I am very encouraged to see that our end markets remain very healthy, and the competitive momentum of our solutions is strong. Comparable order intake growth has remained robust with 4% growth in the quarter, driven by double-digit growth in the Diagnosis & Treatment businesses, resulting in a 4% growth for the full year 2021. This order intake growth further builds on the high-single-digit growth in Q4 and full year 2020, resulting in an all-time high

order book for Philips. We signed 35 long-term strategic partnerships across the world in the fourth quarter.

Adjusted EBITA for the quarter is expected to be approximately €650 million or 13% of sales, impacted primarily by the lower sales. Adjusted EBITA was also impacted by higher supply costs, including extraordinarily high pricing on spot buys and an expected push out of an IP deal.

Adjusted EBITA for the full year is expected to be around €2.1 billion or 12% of sales. Group restructuring, acquisition-related and other charges are expected to amount to €420 million in the fourth quarter. This is €350 million above the previously guided charges, primarily due to a €225 million increase of the provision related to the recall, which I will explain in a minute, as well as a provision for other quality actions in connected care, an increase of the provision for the onerous ventilator contract from 2020 and a legal provision which are not related to the recall.

The repair and replacement programme related to the sleep recall is underway globally, and we have substantially ramped up our production service and repair capacity. Following a comprehensive patient and customer outreach programme, Philips Respironics expanded the eligibility of certain older devices in the interest of patients and in alignment with the relevant competent authorities.

Consequently, Philips Respironics now expects to remediate a total of around 5.2 million registered devices globally and is increasing the field call provision by around €225 million, mainly due to this higher volume of units now requiring remediation and increased supply cost to do that.

Patient well-being is at the heart of everything we do at Philips, and we aim to get a solution to the patients as fast as possible. To-date, we have produced a total of approximately 1.5 million repair kits and replacement devices, of which approximately 700,000 have reached customers. We expect to complete the remediation programme and to be able to serve new Sleep & Respiratory Care customers in the fourth quarter of 2022.

I'm also encouraged by the VOC test results to-date for the first generation DreamStation devices, which we published in December 2021. The results indicate that VOCs do not exceed safe exposure thresholds specified in the applicable safety standards. Using conservative health protective exposure thresholds, the additional testing suggests no increased risk for adverse health effects in the general patient population, nor the higher risk patient population as a result of VOC exposure.

As we announced in December, it's important to note that the tested DreamStation devices were not exposed to ozone cleaning in accordance with the instructions for use.

Further, health risk assessments are ongoing. Comprehensive particulate testing and analysis are expected to be completed in the second quarter of 2022 as testing protocols in compliance with the full extent of the relevant ISO standards for all affected product platforms require long lead times. We will continue to provide timely updates on findings from these assessments.

Let me conclude now. We remain focused on working through the headwinds from global supply chain issues and on closely working with suppliers and governments to address the

impact of this in health care and ensure that they recognise the importance of prioritising life-saving medical equipment. We are also doing everything we can to deliver a solution to patients and caregivers affected by the sleep recall as fast as possible.

Our strategy and portfolio resonate very well with customers, and I remain confident in the medium-term growth and profit expansion potential of our company. Based on strong customer demand and our growing order book, we expect to resume our growth and margin expansion trajectory in 2022 as we work through the headwinds. We will provide more colour on that later this month when we publish the Q4 and full year 2021 results.

And with that, we will now open the line for your questions. 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 question. 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. Our first question today comes from Veronika Dubajova from Goldman Sachs. Please state your question.

Veronika Dubajova (Goldman Sachs): Hi, Frans. Hi, Abhijit. Thanks for the call this morning. I just would love to get your thoughts on how you're thinking about 2022. Obviously, helpful to hear from you that you expect to drive growth and margin improvement. But I think you've previously talked about 2022 being consistent with the mid-term guidance that you've provided for the business. What's your current thinking around that in light of what you're seeing in the environment out there in the market?

Frans van Houten: Hi, Veronika. Good morning. Yeah. As I just said, we see the discussion around 2022 more suited for 24th January when we have longer time, and we would like to focus today on the results announced.

Now what I can say to you is that order growth was strong, in fact, better. We have a very strong order book. So that bodes very well to the underpinning of next year for 2022. At the same time, I think we need to be realistic that supply chain issues will also still affect 2022, which we also said, right? We said at least till the summer. We said it in October.

And then we need to reckon with the effects of COVID. So there are many moving pieces that we are currently constructing. And of course, then link it back to the lower ending point of 2021. And I hope that you can accept that we then talk about it on 24th January.

Veronika Dubajova: Okay. Understood. Thanks, Frans. I guess maybe just give us a little bit of flavour in terms of the revenues that you've lost this quarter against the original plan, what proportion of that is in businesses where you are unlikely to recover those revenues versus what proportion is in the businesses where you think this is just a delay to revenue recognition?

Frans van Houten: Yeah. The – there was also a miss in personal health. And typically, the personal health demand is more fungible than health systems. Health systems orders shifts

into 2022. We have had no customers, let's say, cancelling. They are struggling to reschedule and sometimes also they pushed it out, right, as we said.

So I look at Abhijit whether we can – take the proportion.

Abhijit Bhattacharya: Yeah. I think about 85% is health system, so the PH miss was relatively less. So should take 85% as Health Systems, then most of it will come back during the course of coming quarters.

Veronika Dubajova: That's helpful. Thank you. And then I think, if I can, just quick follow-up on the respiratory recall. I think you are quoted, Frans, in the press today as saying you might need to take a legal provision as well. I'm just kind of curious – I don't think that's a new statement per se. But just curious when you think you might be able to give us colour on that legal provision? And you're thinking on that legal liability risk now that you [inaudible].

Frans van Houten: That was a Bloomberg journalist this morning and the discussion was the legal provision expansion is for the field to recall action. And then, you said – so that does not include legal. I said, no, that does not include legal, right. Now, it's too early to say anything about it. And frankly speaking, we need all that testing result to provide, let's say, the ammunition to also give confidence in the market that the risk to the patients is much lower than a lot of people think, right.

Now, the VOC testing, it is, of course, a great outcome, all right, where is no VOC risk to the patients, as I've also covered in my introductory remarks. Now, there's a lot more testing to be done also in a way that stand up and is accepted by the regulators. And this is also why it takes more time, all right. Because I know that there's frustration out there that it takes so much time. I share that. But we need to do this test in a very comprehensive manner and according to very strict protocols, in multiple test houses, and that just takes time.

And by the way, there is a capacity constraint in these test houses as well that doesn't make it any easier. But we are on the right path there. And the – once we have all that data, I think we are in a much better position to make statements that are credible.

Veronika Dubajova: Thank you, guys.

Operator: Thank you. The next question comes from Hassan Al-Wakeel from Barclays. Please state your question.

Hassan Al-Wakeel (Barclays): Thank you. Good morning. So are the component shortages – component shortage issues more localised in Personal Health? Or is this widespread across the businesses? And do you see any signs at all in relative easing on the semiconductor side towards the end of the quarter or indeed into the start of this year? And what is your base case on the duration of this impact in 2022, please?

Frans van Houten: Yeah. Good morning, Hassan. The supply chain constraints are across the board affecting multiple of our businesses. Abhijit just mentioned PH, but in Connected Care, patient monitoring was affected. And then Precision Diagnosis is significantly affected. The shortages intensified during the quarter. As we said in October, we expect this at least to last till the middle of 2022.

Hassan Al-Wakeel: Perfect. And on the Omicron impact as it relates to staff absenteeism in hospitals, where do you see elective procedures exiting the fourth quarter? And how is this impacting your image-guided therapy business?

Frans van Houten: Yeah. The elective procedures are affected, probably more so in January than in December because in the US the impact started to come full-fledged through, I think, quite late in December. And I think the first two or three weeks or the first months of this year, we will see stronger impact on electives.

I also worry about absenteeism, transport, and shipping issues. I don't think that we, as a society, I mean, a company, but also broader, have fully grasped the potential impact of Omicron as – I mean, people may not get very sick, but they all need to quarantine and leads to absenteeism and partly in Phillips, but more so I think with shipping companies and handling and drivers. And we've also seen that part of the supply issues that we talked about were related to shipping delays, port constraints, right?

And, yeah, if something is two weeks longer in transit, actually, it's hundreds of millions for us, alright. So that also is part of the explanation of what happened in Q4.

Then I think we got quite a lot of questions also on, yeah, visibility. And the semiconductor industry gives us very short visibility even though we have long-term orders out there, the visibility is not great. Sorry, I deviated from your question, Hassan.

Hassan Al-Wakeel: No, that's super helpful. If I can squeeze one more in on the recall, and particularly the extended timeline as you've increased the remit, what does that mean for financial performance in Connected Care? And do you still expect that business to grow in 2022?

Frans van Houten: Well, that's I think more 24th January question. In any case, you need to realise that Q1 of last year still had sleep business recorded, therefore, the year-on-year comparison in Q1 will be quite tough. When we talked to you previously, we also said the recall would take 12 months after the regulators would approve the recall plan. And while the first approval came in, in August, September of last year, there were also many that came in later, all right? So the 12 months horizon to execute the recall is still about intact, all right, which brings us to late Q3, and for the purpose of this call, we have said the resumption or the completion – and the resumption of sales in Q4, right?

So we are not going to be materially different in our statements. So let's promise to come back on this in – on the 24th, Hassan.

Hassan Al-Wakeel: Thank you.

Operator: Thank you. The next question comes from David Adlington from JP Morgan. Please state your question. Mr Adlington, please ensure you're not mute.

David Adlington (JP Morgan): Maybe just on the hospital access point. I just wanted to know any particular reason.

Frans van Houten: Can't hear you.

David Adlington: Hello, can you hear me?

Frans van Houten: Yeah. Now I can.

David Adlington: Hello?

Frans van Houten: Yes, go ahead.

David Adlington: Can you hear me?

Frans van Houten: I can hear you but –

David Adlington: Sorry, guys. Yeah, just in terms of – most of my questions have been asked. But maybe just on a hospital access points. On the hospital access points, are there any particular regions that have been impacted more heavily by access hospitals and what's really impacting that? Thank you.

Frans van Houten: Well, I think we all know, for example, the New York region. But a lot of hospitals are quite loaded with their COVID emergency care and some of the delays are perhaps COVID-related but other parts are site-readiness related, as the contractors on hospitals also struggled with their availability and their parts, constructors' delay, and that made the sites not ready for reception. And as we now see hospitals rescheduling that delayed installation, some of them skipped Q1 because they say, well, you know what, we didn't make it in Q4, but we don't want you in Q1. Therefore there will be delays from Q1 to Q2 or from Q4 to Q2.

So it's a complex puzzle and as we just answered on the question from Hassan on the electives, the impact of COVID will actually be more severe in January than in December, right? So we saw that coming in December, but we will see that continue in Q1 of this year.

David Adlington: Great, thank you.

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

Lisa Clive (Bernstein): Hi, thanks for the time this morning. Just two questions. One on the – I was at the VOC testing results on the polyester foam email sent 23rd December. Obviously it's nice to see a relatively clean bill of health on that, but did you originally anticipate that the particulate testing would take a lot longer? Because from your prior commentary it seemed like we would get all the information in one go, so if you could just explain why there's now three different timelines, that would be helpful.

And then my second question is on the testing that the FDA requested on the silicone foam. Is that just going to be on VOCs, or will you also have to do particulate testing? And is that timeline going to track the polyester timeline, or will it be a faster process?

Frans van Houten: Yeah, hi Lisa. Great questions. Indeed, originally we were more on a faster track also on the particulates testing. In dialogue with the regulator, the scope of testing on also particulates has been extended. So, let's say, a broader test with more ISO standards, as if a particulate is an implanted device. And of course that sounds a bit strange but if a particle would remain in the body then what's the consequence of that? And that is a longer test protocol, for which we have said in December that we expect that to be completed in the second quarter.

Now, on the silicone, I want to emphasise that the silicone foam is safe, and you can also derive from that fact that the FDA said, you know, that the recall and replacement can continue, and we continue to support these products, that they concur with that. They have

asked for a comprehensive suite of tests around silicone. That is underway. It takes time. The FDA has all sorts of requirements as to the protocols and the procedures. I have all confidence in that. I think it also relates to a desire to have a strong rigour around this, but I want to emphasise that all our own tests and products show that the silicone is safe.

Lisa Clive: Okay, thanks. And just have you – are you aware of what the other manufacturers in the industry are doing at this point in time? ResMed, through our correspondence with their IR, indicated that the FDA had indeed requested information from them, which they have supplied to the FDA. I assume that would be on the foam, the silicone foam that they use. But then there's also polyether. You were investigating polyester and silicone fairly extensively, have you heard anything about the FDA requesting any other manufacturers to do similar analysis of polyether, which my understanding is you don't use any polyether but I'm just trying to understand whether this is a more industry-wide concern, particularly for your comments just now that the FDA is requesting that you look at particulates as if they were implanted. That's clearly not – this could happen with foam breakdown of any type, so just curious what else is going on in the industry.

Frans van Houten: Yes, look, I don't have, of course, information on competitors. You would have to ask them. But it is my impression that there is a broader interest from regulators around VOCs in general and then foam. But not restricted to foam, I think VOCs in general is a broader topic of interest. We use the same silicone foam as some of our competitors, right, and as I said, we feel confident about the silicone foam being safe. I can't answer your question on the other polyether foam.

Lisa Clive: Okay, fair enough. Thank you.

Operator: Thank you. We're now moving to question from James Vane-Tempest of Jefferies. Please state your question.

James Vane-Tempest (Jefferies): Yes, hi, thanks for taking my question. Firstly just on the provision. You state in the release it's more to do with the affected devices, but I also notice there's a provision for quality actions and other matters in Connected Care. Just wonder if you can elaborate a little bit more on the quantum of that and specifically what they relate to, please?

Frans van Houten: Yeah. The quality actions that we are taking in Connected Care, but also in the whole company following the sleep issue, mean that we take proactive action also in some other product areas. We have also in conjunction with the 483 a broad commitment and response to quality and patient safety. There are, let's say, some actions that require provision for which we have taken that, some other products in Connected Care that at this time we cannot identify, let's say, publicly, but we wanted to make sure that we do everything that is right in relation to our commitment to the FDA that we have made.

James Vane-Tempest: Thank you. And as a follow up, just on the VOC testing, I mean you state these studies weren't conducted using ozone cleaning techniques. I'm just curious if this will be done as part of follow ups, as this seems to be one of the key points of concern. And can you comment also whether any other regulators outside the US have expressed concerns with the ongoing repair-replace in the US? Thank you.

Frans van Houten: Well, the favourable or positive results on VOC testing is when the product is used according to the instructions for use and therefore not using ozone cleaning. We are doing some testing to understand what ozone does to the product, but that is at this time not available or not finished and therefore we cannot share that with you.

The other regulators in the world follow closely the news around testing. They have very much interest in understanding that and for example, the VOC testing was very favourably received across the world, because it basically means that the judgment of doctors that patients can continue to use the machine while waiting for the repair is now substantiated as the VOC testing comes out showing no health hazards. So that is very much very important.

There's general concern around, let's say, the speed of the repair and replace actions. Regulators want this to happen as fast as possible and so do we, and we are sparing no effort to do this as fast as possible. The extension for older units is something that very much came up also in the United States but certainly not exclusively so.

James Vane-Tempest: And just a quick clarification –

Frans van Houten: I have to say, you know, the relationship with the regulators across the world is good. There is intensive collaboration and weekly contact. So there is real collaboration going on.

James Vane-Tempest: Thank you. And just a quick clarification on your comments if I can. So you mentioned about the expansion to 5.2 million units. The driver behind that, was that requested by FDA or was that something which you decided with the data that you had, just in terms of the thought process to expand the scope of the repair-recall procedures?

Frans van Houten: It's difficult to deny a patient with an older unit a repair if they are still using it, and sometimes patients have two units that they use alternatingly and we felt it was difficult to say no on an arbitrary five-year limit, even though we know that in the US patients are entitled to new reimbursement. But the fact that there is new reimbursement does not mean that they should stop using the old product, right? And that was also not in the conditions of sale if you like. So we felt that we had to be more lenient on accepting the registrations that were coming through in our database on older units, and when we checked in with the regulators, we were supported in that conclusion.

Operator: Thank you. Unfortunately, we have only time left for two more questions, so our next question comes from Falko Friedrichs from Deutsche Bank. Please state your question.

Falko Friedrichs (Deutsche Bank): Thank you, good morning. I have one question left, actually. It's on China. So to what extent did potentially lower demand in China play a role in these lower results in the fourth quarter, especially in the Personal Health segment?

Frans van Houten: Abhijit, do you want to take that?

Abhijit Bhattacharya: Yeah, no, the demand, I think Frans has mentioned that demand has in general not been the issue. So we have also in PH we have had good demand and whatever we are able to supply, we have been able to sell. So we don't see a demand-related issue in China. Especially in Personal Health.

Falko Friedrichs: Okay, thank you.

Operator: Thank you. And our last question today comes from Sezgi Oezener from HSBC. Please state your question.

Sezgi Oezener (HSBC): Hi, thanks for saving the last question for me. Thanks, Frans, and Abhijit for the presentation. Just one very quick question. If we were to quantify this 5% decline in comparable sales growth, which is attributable to the combination of the supply-chain factors as well as the recall, how would you divide that? And after you take off the recall impact, how would you divide the supply-chain issue impact on the three segments?

Abhijit Bhattacharya: There are two ways in which we can answer it. One is that if you look at the overall decline, about 3% comes from supply chain issues and 2% is related to the sleep recall. So if you look on the full year sales, where we have a decline of 1%, if you would take the supply chain and recall numbers that I just gave you of 5%, let's say excluding these two the sales growth would have been about 4% for the year.

Sezgi Oezener: Yeah. And as –

Abhijit Bhattacharya: Yeah, the supply chain is 3%, like I said, and the recall is 2%. So supply chain is a little bit more than the recall impact.

Sezgi Oezener: Very well, thank you. And in that case, if we were to add that back, that would bring us to 4%, which would be slightly under your 5-6% comparable sales growth guidance for the mid-term. So I would be inclined to say we can expect some of that to come back once the supply chain issues are hopefully resolved some time?

Abhijit Bhattacharya: Actually, when we had talked earlier in the year, we had said that the first year post-COVID – now that we, of course in hindsight it's not a post-COVID year – but last year we had the huge demand on ventilators and other stuff. So therefore we had said that the first year would be between 4-5% and then we would move into the 5-6%. Actually we are in that range that we had planned, apart from these two headwinds. And regarding next year, as Frans said, we will talk of course more later.

Frans van Houten: But it's a good point to end the call on and to say that our ambition has not changed. I want to stress that our ambition has not changed and I really – it's a tough announcement today but, you know, look at our order growth, look at our competitiveness of the products. We will work through these issues on supply and then I think we will be in a much better – and we'll deal with the recall of course – we'll be in a much better space.

So let's, I'd like to end with that optimism. Thank you very much –

Sezgi Oezener: Thanks a lot.

Frans van Houten: – and we'll talk to each other on the 24th.

[END OF TRANSCRIPT]