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KONINKLIJKE PHILIPS NV

Form 20-F

February 20, 2018

0000313216 FY 2017 --12-31 false 0000313216 2017-01-01 2017-12-31 0000313216 2017-12-31 0000313216
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As filed with the Securities and Exchange Commission on February 20, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 20-F

(Mark one)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934
OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
OR

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number 001-05146-01

KONINKLIJKE PHILIPS NV

(Exact name of Registrant as specified in charter)

ROYAL PHILIPS

(Translation of Registrant's name into English)

The Netherlands

(Jurisdiction of incorporation or organization)

Philips Center, Amstelplein 2, 1096 BC Amsterdam, The Netherlands

(Address of principal executive office)

Marnix van Ginneken, Chief Legal Officer & Secretary to the Board of Management

+31 20 59 77232, marnix.van.ginneken@philips.com, Philips Center, Amstelplein 2, 1096 BC Amsterdam, The Netherlands

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(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Shares – par value	New York Stock Exchange
Euro (EUR) 0.20 per share	

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

(Title of class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

Class	Outstanding at December 31, 2017
Koninklijke Philips N.V.	926,191,723 shares

Common Shares par value EUR 0.20 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

Note-Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated filer Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP International Financial Reporting Standards as issued by Other

by the International Accounting Standards Board

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.
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If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

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IFRS basis of presentation

The financial information included in this document is based on IFRS, as explained in [Significant accounting policies](#), of this report, unless otherwise indicated.

Dutch Financial Markets Supervision Act

This document comprises regulated information within the meaning of the Dutch Financial Markets Supervision Act (*Wet op het financieel toezicht*).

Statutory financial statements and management report

The chapters Group financial statements and Company financial statements contain the statutory financial statements of the Company. The introduction to the chapter Group financial statements sets out which parts of this Annual Report form the Management report within the meaning of Section 2:391 of the Dutch Civil Code (and related Decrees).

In 2017, Philips reinforced its leadership in image-guided therapy solutions with the global launch of Philips Azurion, the next-generation image-guided therapy platform that enables clinicians to perform a wide range of routine and complex procedures, helping them to optimize interventional lab performance and provide superior care.

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Introduction

This document contains information required for the Annual Report on Form 20-F for the year ended December 31, 2017 of Koninklijke Philips N.V. (the 2017 Form 20-F). Reference is made to the Form 20-F cross reference table herein. Only (i) the information in this document that is referenced in the Form 20-F cross reference table, (ii) this introduction and the cautionary statement “forward-looking statements” on the next two pages and (iii) the Exhibits shall be deemed to be filed with the Securities and Exchange Commission for any purpose. Any additional information in this document which is not referenced in the Form 20-F cross reference table, or the Exhibits themselves, shall not be deemed to be so incorporated by reference, shall not be part of the 2017 Form 20-F and is furnished to the Securities and Exchange Commission for information only.

The terms “Philips”, “Company”, “Philips Group”, “Group”, “we”, “our” and “us” refer to Koninklijke (Royal) Philips N.V. and applicable to its subsidiaries and/or its interest in joint ventures and associates.

IFRS based information

The audited consolidated financial statements as of December 31, 2017 and 2016, and for each of the years in the three-year period ended December 31, 2017, included in the 2017 Form 20-F have been prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed by the European Union (EU). All standards and interpretations issued by the International Accounting Standards Board (IASB) and the IFRS Interpretations Committee effective year-end 2017 have been endorsed by the EU, except that the EU did not adopt certain

paragraphs of IAS 39 applicable to certain hedge transactions. Philips has no hedge transactions to which these paragraphs are applicable. Consequently, the accounting policies applied by Philips also comply with IFRS as issued by the IASB.

Use of non-IFRS information

In presenting and discussing the Philips Group financial position, operating results and cash flows, management uses certain non-IFRS financial measures. These non-IFRS financial measures should not be viewed in isolation as alternatives to the equivalent IFRS measure and should be used in conjunction with the most directly comparable IFRS measures. Non-IFRS financial measures do not have standardized meaning under IFRS and therefore may not be comparable to similar measures presented by other issuers. A reconciliation of these non-IFRS measures to the most directly comparable IFRS measures is contained in this document. Reference is made in [Reconciliation of non-IFRS information](#).

Third-party market share data

Statements regarding market share, contained in this document, including those regarding Philips' competitive position, are based on outside sources such as specialized research institutes, industry and dealer panels in combination with management estimates. Where full year information regarding 2017 is not yet available to Philips, market share statements may also be based on estimates and projections prepared by outside sources or management. Rankings are based on sales unless otherwise stated.

Use of fair-value measurements

In presenting the Philips Group's financial position, fair values are used for the measurement of various items in accordance with the applicable accounting standards. These fair values are based on market prices, where available, and are obtained from sources that are deemed to be reliable. Readers are cautioned that these values are subject to changes over time and are only valid at the balance sheet date. When quoted prices or observable market values are not readily available, fair values are estimated using valuation models, and unobservable inputs. Such fair value estimates require management to make significant assumptions with respect to future developments which are inherently uncertain and may therefore deviate from actual developments. Critical assumptions used are disclosed in the financial statements. In certain cases independent valuations are obtained to support management's determination of fair values.

Documents on display

It is possible to read and copy documents referred to in the 2017 Form 20-F that have been filed with the SEC at the SEC's public reference room located at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms and their copy charges. Philips SEC filings are also publicly available through the SEC's website at www.sec.gov.

For definitions and abbreviations reference is made to [Definitions and abbreviations](#).

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Forward-looking statements

Pursuant to provisions of the United States Private Securities Litigation Reform Act of 1995, Philips is providing the following cautionary statement.

This document, including the information referred to in the Form 20-F cross reference table, contains certain forward-looking statements with respect to the financial condition, results of operations and business of Philips and certain of the plans and objectives of Philips with respect to these items, in particular, among other statements, certain statements in Item 4 “Information on the Company” with regard to management objectives, market trends, market standing, product volumes, business risks, the implementation of our Accelerate! program, the statements in Item 5 “Operating and financial review and prospects” with regards to trends in results of operations, margins overall market trends, risk management, exchange rates, the statements in Item 8 “Financial Information” relating to legal proceedings and goodwill and statements in Item 11 “Quantitative and qualitative disclosure about market risks” relating to risk caused by derivative positions, interest rate fluctuations and other financial exposure are forward-looking in nature. Forward-looking statements can be identified generally as those containing words such as “anticipates”, “assumes”, “believes”, “estimates”, “expects”, “should”, “will”, “will likely result”, “forecast”, “outlook”, “projects”, “may” or similar expressions. In their nature, these statements involve risk and uncertainty because they relate to future events and circumstances and there are many factors that could cause actual results and developments to differ materially from those expressed or implied by these statements.

These factors include, but are not limited to, domestic and global economic and business conditions, developments within the euro zone, the successful implementation of our strategy and our ability to realize the benefits of this strategy, our ability to develop and market new products, changes in legislation, legal claims, intellectual property, disputes, data protection challenges including cybersecurity, changes in exchange and interest rates, changes in tax rates and regulations, pension costs and actuarial assumptions, raw materials and employee costs, our ability to identify and complete successful acquisitions and to integrate those acquisitions into our business, our ability to successfully exit certain businesses or restructure our operations, the rate of technological changes, political, economic and other developments in countries where Philips operates, industry consolidation and competition and the state of international capital markets as they may affect the timing and nature of the disposition by Philips of its interests in Philips Lighting.

As a result, Philips’ actual future results may differ materially from the plans, goals and expectations set forth in such forward-looking statements. For a discussion of factors that could cause future results to differ from such forward-looking statements, reference is made to the information in Item 3D “Risk Factors”.

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Form 20-F cross reference table

Only (i) the information in this document that is referenced in the Form 20-F cross reference table, (ii) the Introduction and the cautionary statements concerning forward-looking statements of this report on pages 5-6, and (iii) the Exhibits shall be deemed to be filed with the Securities and Exchange Commission for any purpose. The content of Philips’ websites and other websites referenced herein should not be considered to be a part of or incorporated into the 2017 Form 20-F. Any additional information which is not referenced in the Form 20-F cross reference table or the Exhibits themselves shall not be deemed to be so incorporated by reference, shall not be part of the 2017 Form 20-F and is furnished to the Securities and Exchange Commission for information only.

The table below sets out the location in this document of the information required by SEC Form 20-F. The exact location is included in the column ‘Location in this document’. The column “Page” refers to the starting page of the section for reference only (and is not intended to refer to the starting page of the specific subsection, if applicable).

Item	Form 20-F caption	Location in this document
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1Message from the CEO

I am pleased with our transformation progress to become a focused leader in health technology and see tremendous further potential to grow Philips' market positions and expand margins.

Frans van Houten
CEO Royal Philips

Dear Stakeholder,

2017 was a good year of solid progress for Philips, as we continued our transformation to become a focused leader in health technology and delivered on our improvement targets for the year. In line with our commitments we delivered 4% comparable sales growth ¹⁾, resulting in a 10-basis-point gain in market share. We also improved operating profitability, with an Adjusted EBITA ¹⁾ margin increase of 110 basis points, and generated a strong EUR 1.2 billion free cash flow ¹⁾. This underscores our ability to stay the course, in this case against a background of challenging economic circumstances in Europe and considerable uncertainty in the US around healthcare policy.

Our organic growth initiatives are delivering tangible results. Overall we recorded 6% order growth for the year. In Diagnostic Imaging, for instance, we ended the year with high-single-digit order growth and realized market share gains in China and India, driven by the renewal of 60% of our portfolio. We also noted a strong increase in order intake in our Digital Pathology Solutions business, double-digit growth of our Sleep & Respiratory Care devices, and the continued success of our OneBlade hybrid facial hair styler. And we introduced several important innovations, gained traction with our solutions approach – securing multiple long-term strategic partnerships – and continued to invest in quality and talent.

We further strengthened our portfolio through targeted acquisitions, the largest being Spectranetics, a global leader in vascular intervention and lead management solutions. The integration of these acquisitions is on track. Toward the end of the year we deconsolidated Philips Lighting as we reduced our shareholding to below 30%, in line with our stated aim to fully sell down our stake.

2017 saw the completion of the industry reclassification of our stock to Healthcare at all major indices. Our customers and the financial markets appreciate the way we have pivoted and executed on our strategic roadmap. And we increased our brand value to USD 11.5 billion in the 2017 Interbrand ranking.

Continuing to drive our five-year 'Healthy people, sustainable planet' program, with its focus on Circular Economy, Access to Care and Climate Action, we improved the lives of 2.2 billion people around the world in 2017, and we again received top rankings from leading indices such as the Dow Jones Sustainability Index and the Carbon Disclosure Project. At the United Nations in September we made an extended commitment to improve the lives of 300 million people in underserved healthcare communities by 2025.

Overall, I am pleased with the progress we made in 2017. Our purpose is very clear. We are here to improve health and healthcare through innovations! We have a vibrant, highly committed workforce, with employee engagement consistently above the high-performing norm and rising from 74% to 76% this year. We have good momentum on our way to position ourselves for a future with higher growth and earnings potential. Clearly, we can still improve operational excellence: making further progress on product performance and our commitment to quality is our highest

priority for 2018. However, I am very confident in our ability to capture the opportunities and deal with the challenges ahead, as we work toward our goal of improving the lives of 3 billion people a year by 2025.

Innovating with purpose

In the face of growing and aging populations, the rise of chronic diseases, and global resource constraints, health systems the world over are under enormous strain. Digital technology is transforming the healthcare industry, increasingly shifting value towards software and services. It also has the potential to enable more and more people to actively take ownership of their health and well-being.

For Philips – with leadership positions in both personal health and professional healthcare – we see that innovation can transform the delivery of care across the health continuum, enabling new relationships between care providers and patients/consumers, and driving better patient outcomes, higher productivity and a better user experience for all concerned.

We are driving this transformation in different ways:

- By offering consumers connected solutions – like our Sonicare DiamondClean Smart oral care and DreamWear sleep therapy solutions – that support superior preventive care and those living with chronic disease respectively.
- By giving clinicians the solutions they need to perform care with better outcomes and higher productivity, such as our Healthcare Informatics solutions. These support first-time-right diagnosis and increase productivity by integrating radiology, pathology and genomics information at the point of care, with AI-driven clinical decision support.
- By empowering clinicians to deliver precision treatments supported by ground-breaking innovations for image-guided therapies, including our advanced live image-guidance solutions, hybrid operating rooms and smart devices such as our diagnostic and therapeutic catheters.
- By enabling the seamless flow of data needed to care for patients in real time wherever they are, by ‘joining up the dots’ from the ICU to the home with our HealthSuite digital platforms and patient monitoring solutions, again supported by powerful algorithms that can predict adverse patient incidents hours in advance.

All of this with the objective of supporting the shift to value-based healthcare, a model that aims to improve patient outcomes while at the same time increasing productivity – that is *innovation with purpose*. And there’s more to come from our pipeline, thanks to our consistently high levels of investment in R&D, where some 60% of our people are focused on software and data science.

The road forward

Looking ahead, we see significant opportunities to further increase the value we deliver – by boosting growth in our existing core business, growing in adjacencies, and driving customer and operational excellence. We know that our strategy has traction, so now it is execution that matters most.

Boosting growth in core business

One of the ways we will capture new growth in our core business is by continuing to leverage products and solutions that have worked well in mature markets and bringing them to growth geographies where we have a strong footprint and brand recognition – as we have done with our Sonicare power toothbrushes in China.

In addition, we are increasingly partnering with hospital customers in new business models, engaging in long-term strategic partnerships to innovate value-added, integrated solutions that deliver better outcomes and higher

productivity.

We now have over 110 of these long-term partnerships, up from 60-plus in 2016, and the number continues to rise. The combination of compelling solutions and consultative partnership contracts drives above-average growth rates and a higher proportion of recurring revenues.

Growing in adjacencies

We have completed two substantial M&A transactions over the last few years, Volcano and Spectranetics. These were targeted to meet our strategic objectives, to complement our leadership in cardiovascular interventions with smart devices, so that we can support complete vascular procedures. Volcano has worked out very well, having risen to double-digit growth and much improved profitability since we integrated the business; and we have similar expectations of Spectranetics, as we leverage our post-merger integration capabilities to unlock maximum value.

Another route to growth in adjacencies is through organic growth and investments in R&D. To extend our strong portfolio in patient monitoring, for example, we have invested in medical-grade wearables so that patients don't need to be wired up but can be continuously measured, wherever they are. We continue to invest in Digital Pathology, as we believe the digitization of tissue slides is going to completely transform the clinical practice of pathology. We are pleased we are now able to market our IntelliSite Pathology Solution for primary diagnostic use in the USA, and we have since seen a sharp increase in order growth.

At the same time, we do not need to do everything ourselves. In 2017, for example, we entered into a partnership with B. Braun to innovate and accelerate growth in ultrasound-guided regional anesthesia and vascular access. And we have a host of other value-adding alliances where we have decided we can better expand our capabilities through partnering, rather than going it alone.

Continuing the digital transformation of Philips is absolutely fundamental to our future. We continue to invest in our secure HealthSuite digital eco-system platform – to enable digital health propositions that connect consumers and doctors to Philips through the cloud, enabling new business models and unlocking new revenue streams. We currently have over 30 cloud-connected propositions in the market.

Today, we sell a large proportion of our Personal Health products through online channels, aided by digital marketing. And now we are transferring that marketing capability to our health systems channels, so that we become more effective at reaching healthcare professionals. We are also connecting our back-office systems to our customers to enable new recurring revenue streams and enhanced customer loyalty in Software as a Service and Product as a Service business models.

Driving customer and operational excellence

To ensure that our solutions are truly customer-centric, we use 'design thinking' and our proven 'Co-create' methodology, whereby we come together with healthcare professionals to explore how our combined knowledge, resources and shared vision could improve the delivery of care.

In our drive for operational excellence we continue with disciplined implementation of the Philips Business System and Lean principles. The adoption of Hoshin methodology to plan and drive execution has yielded significant gains across the group. Our productivity measures will add up to over EUR 1.2 billion over the three-year period 2017-2019, having delivered around EUR 480 million in 2017.

We continue to drive quality and regulatory performance improvement throughout the company. Nevertheless, we did not fully deliver to our 2017 plan as we continue to address two significant regulatory challenges that arose from years ago. We must continue our improvement journey forcefully.

Building on the strong 6% order growth for the full year 2017, consistent execution on these value drivers will enable us to deliver, in 2018, on our medium-term targets of 4-6% comparable sales growth ¹⁾ and an average annual improvement in Adjusted EBITA ¹⁾ margin of 100 basis points.

In conclusion

We have made strong progress in our transformation to become a focused leader in health technology. Going forward, we are committed to single-mindedly improve performance and attain higher levels of growth. To this end we are continuing to strengthen our culture – putting our customers first, acting with quality and integrity, teaming up to win, taking ownership to deliver fast, and learning, improving and inspiring each other, every step of the way.

I am confident that, by doing so, we will be able to expand our strong positions across the health continuum, extend our solutions capability to address our customers' unmet needs, and deliver the full benefits of data-enabled connected care.

It only remains for me to thank our customers, shareholders and other stakeholders for the support they continue to give us. And to thank our Philips people around the world for their tremendous engagement and efforts over the past year.

Frans van Houten

Chief Executive Officer

¹⁾Non-IFRS financial measure. For the definition and reconciliation to the most directly comparable IFRS measure, refer to [Reconciliation of non-IFRS information](#)

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2Our strategic focus

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2.1 Addressing health challenges through innovation

All around the world, resource constraints are driving a shift to value-based healthcare – a system that aims to increase access to care and improve patient outcomes while also raising cost productivity. At the same time, aging populations and the rise of chronic diseases like heart disease and respiratory conditions are driving up demand for healthcare.

In parallel, a growing focus on healthy living and prevention means more and more people are looking for new ways to proactively monitor and manage their health, also in home and community settings. And the digitalization of healthcare has reached the point where value is shifting from stand-alone products to solutions combining systems, smart devices, software and services, which deliver greater benefits to customers.

Philips sees significant value in more integrated forms of healthcare, unlocking the power of data and artificial intelligence at the point of care, while at the same time optimizing care delivery across the health continuum. This includes putting increased emphasis on both primary and secondary prevention and population health management programs.

At Philips, we are striving to make the world healthier and more sustainable through innovation, with the goal of improving the lives of 3 billion people a year by 2025.

In today's increasingly connected world, the convergence of Philips' consumer technologies that facilitate healthy living, medical technologies that help clinicians to deliver better diagnosis and treatment, and cloud-based

technologies that support data sharing and analysis, will be a key enabler of more effective, lower-cost integrated health solutions.

We like to visualize healthcare as a continuum since it suggests the notion of continuous care. And it becomes very compelling when one thinks of this continuum as being *connected*.

Healthy living

Prevention

Diagnosis

Treatment

Home care

Connected care and health informatics

By addressing healthcare as a ‘connected whole’ in this way, we can unlock gains and efficiencies and drive innovations that help deliver on the ‘quadruple aim’: enhancing the patient experience, improving health outcomes, lowering the cost of care, and improving the work life of care providers.

With our global reach, deep insights and leading innovations, we are uniquely positioned in ‘the last yard’ to consumers and care providers, delivering:

- connected products and services supporting the health and well-being of people
- integrated modalities and clinical informatics to deliver definitive diagnosis
- real-time guidance and smart devices for minimally invasive interventions
- connected therapeutic products and services for chronic care patients.

Underpinning these solutions, and spanning the health continuum, our connected care and health informatics solutions enable us to:

- connect patients and providers for more effective, coordinated, personalized care
- manage population health, leveraging real-time patient data and clinical analytics.

We are focusing on end-to-end pathways – at present primarily cardiology, oncology, respiratory care, and pregnancy and parenting – where we believe our integral approach can add even greater value for our customers.

More and more, we are teaming up with hospital and health systems to understand their needs, provide integrated solutions, and engage in multi-year cooperation to drive improvements in terms of patient outcomes, quality of care delivery and cost productivity.

In this context, we are pioneering new business models that fit our customers’ needs better. These include Technology Managed Services, as well as Software as a Service and Product as a Service models. We have also started to take co-accountability for our customers’ patient outcomes and productivity.

As we embark on the next phase of our health technology journey, the drivers below are designed to help deliver higher levels of customer value and quality, boost growth, deliver winning solutions, and improve our results:

Focus on

Driven by

Resulting in

Growth in core businesses

- Capture geographic growth opportunities
- Pivot to consultative customer partnerships and business models
- Drive innovative value-added, integrated solutions

Growth in adjacencies

- Portfolio extensions through M&A, organic investments and partnerships

Customer and operational excellence

- Continue to lead the digital transformation
- Improve customer experience, quality systems, operational excellence and productivity

Revenue growth

Margin expansion

Increased cash generation

Improved return on invested capital

Increased shareholder value

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2.2 How we create value

Meeting people's unmet needs

At Philips, value creation always starts with listening to people in local markets – consumers, doctors, nurses, hospital executives and administrators – so we understand the specific challenges they face in their day-to-day work.

This gives us a deep insight into their needs and aspirations. We then apply our innovative competencies, strong brand, global footprint and talented, engaged people – often in long-term partnerships – to deliver solutions that meet these needs, making the world healthier and more sustainable.

To measure the impact we are having around the world, we have developed our independently verified Lives Improved model. We take a two-dimensional approach – social and ecological – to improving people's lives. Products and solutions that directly support the curative (care) or preventive (well-being) side of people's health, determine the contribution to the social dimension. The contribution to the ecological dimension is determined by means of our Green Products and Solutions portfolio.

Our business system

With its four interlocking elements, the Philips Business System (PBS) is designed to help us deliver on our mission and vision – and to ensure that success is repeatable. As we execute our strategy and invest in the best opportunities, leverage our unique strengths and become operationally excellent, we will be able to consistently deliver value to our customers, consumers and other stakeholders.

- **Strategy – Where we invest:** We manage our businesses with clearly defined strategies to deliver solutions across the health continuum and allocate resources to maximize value creation.
- **Capabilities, Assets and Positions – Our unique strengths:** We strengthen and leverage our core Capabilities, Assets and Positions – our deep customer insights, technological innovation, global footprint, our

people, and the trusted Philips brand – as they create differential value.

- **Excellence – How we operate:** We are a learning organization that applies common operating principles and practices to deliver to our customers with excellence.
- **Path to Value – What we deliver:** We define and execute business plans that deliver sustainable results along a credible Path to Value.

The ‘Creating value for our stakeholders’ diagram, based on the International Integrated Reporting Council framework, shows how – with the Philips Business System at the heart of our endeavors – we use six different forms of capital to drive value in the short, medium and long term. All numbers are for the year ended December 31, 2017.

Capital input

The capitals (resources and relationships) that Philips draws upon for its business activities

Value outcomes

The result of the application of the capitals to Philips’ business activities and processes as shaped by the Philips Business System

Capabilities, Assets and Positions

Our unique strengths

Strategy

Where we invest

Excellence

How we operate

Path to Value

What we deliver

Philips

Business

System

Human

- Employees 73,951, 120 nationalities, 36% female
- Philips University 1,200 new courses, 830,000 hours, 570,000 training completions
- 27,997 employees in growth geographies
- New Inclusion & Diversity programs

Intellectual

- Invested in R&D EUR 1.76 billion (Green Innovation EUR 233 million)
- Employees in R&D 9,787 across the globe including growth markets

Financial

- Net debt EUR 2.8 billion
- Equity EUR 12.0 billion
- Market capitalization EUR 29.2 billion

Manufacturing

- Manufacturing sites 38, cost of materials used EUR 4.9 billion
- Total assets EUR 25.3 billion
- Capital expenditure EUR 420 million

Natural

- Energy used in manufacturing 3,072 terajoules
- Water used 888,000 m³
- Recycled plastics in our products 1,850 tonnes

Social

- Philips Foundation
- Stakeholder engagement
- New volunteering policy

Human

- Employee Engagement Index 76% positive
- Sales per employee EUR 240,429
- Employee benefit expenses EUR 5,824 million

Intellectual

- New patent filings 1,200
- IP Royalties Adjusted EBITA EUR 225 million
- 165 design awards

Financial

- Comparable sales growth 4%
- Adjusted EBITA¹⁾ as a % of sales 12.1%
- Net cash provided by operating activities EUR 1,870 million
- Net capital expenditures EUR 685 million
- Dividend EUR 742 million
- Corporate taxes paid EUR 349 million
- 60% Green Revenues

Manufacturing

- EUR 17.8 billion products and solutions sold, with 2.2 billion Lives improved

Natural

- 11% revenues from circular propositions
- Net CO₂ emissions 627 kilotonnes
- 245,000 tonnes (estimated) products put on the market
- 24.6 kilotonnes waste, of which 80% recycled
- Environmental impact Philips' operations EUR 200 million

Social

- Brand value USD 11.5 billion
- Partnerships with UNICEF, Red Cross and Ashoka

Human

We employ diverse and talented people and give them the skills and training they need to ensure their effectiveness and their personal development and employability.

Intellectual

We apply our innovation and design expertise to create new products and solutions that meet local customer needs.

Financial

We raise the funds we need from shareholders and other capital providers. We allocate this capital to the businesses and markets we think offer the best prospects for growth and returns.

Manufacturing

We apply Lean techniques to our manufacturing processes to produce high-quality products. We manage our supply chain in a responsible way.

Natural

We are a responsible company and aim to minimize the environmental impact of our supply chain, our operations, and also our products and solutions.

Social

We contribute to our customers and society through our products and solutions, our tax payments, the products and services we buy, and our investments in local communities.

- 1) Non-IFRS financial measure. For the definition and reconciliation to the most directly comparable IFRS measure, refer to Reconciliation of non-IFRS information.

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3Group performance

2017 was a year of solid progress, as we generated sales of EUR 17.8 billion underpinned by a 4% comparable sales growth, improved our operating profitability margin by 110 basis points, delivered a strong operating cash flow of EUR 1.9 billion, reduced our interest expenses by over EUR 100 million and increased net income from continuing operations to EUR 1,028 million.

Abhijit Bhattacharya

CFO Royal Philips

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3.1Financial performance

Management summary

- Sales rose to EUR 17.8 billion, a nominal increase of 2%, which reflected 3% nominal growth in the Personal Health businesses and Diagnosis & Treatment businesses and flat year-on-year sales in the Connected Care & Health Informatics businesses. On a comparable basis ¹⁾ the 4% growth was driven by 6% growth in the Personal Health businesses and 3% growth in the Connected Care & Health Informatics and Diagnosis & Treatment businesses.
- As of December 31, 2017, Philips' shareholding in Philips Lighting was decreased to 29.01% of Philips Lighting's issued share capital. As a result, Philips no longer has control over Philips Lighting and has ceased to consolidate Philips Lighting. With the completion of this transaction, Philips reached an important milestone in pivoting Philips into a focused health technology company. For further information, refer to Philips Lighting sell-down.
- Net income amounted to EUR 1.9 billion and increased by EUR 379 million compared to 2016, driven by improvements in operational performance, lower net financial expenses and higher discontinued operations results, partly offset by higher restructuring and acquisition-related charges and higher income taxes, which

included a tax charge of EUR 171 million due to the US Tax Cuts and Jobs Act. Net income is not allocated to segments as certain income and expense line items are monitored on a centralized basis.

- Adjusted EBITA 1 totaled EUR 2.2 billion, or 12.1% of sales, an increase of EUR 232 million, or 110 basis points as a % of sales, compared to 2016. The productivity programs delivered annual savings of approximately EUR 483 million, ahead of the targeted savings of EUR 400 million, and included approximately EUR 260 million procurement savings, led by the Design for Excellence (DfX) program, and EUR 223 million savings from other productivity programs.
- Net cash provided by operating activities amounted to EUR 1.9 billion and increased by EUR 700 million compared to 2016. Free cash flow 1 amounted to EUR 1.2 billion and increased by EUR 756 million compared to 2016. The increase was mainly driven by higher earnings and the dividend related to the retained interest in the combined businesses of Lumileds and Automotive, lower outflows related to pension de-risking settlements, as well as the cash outflows in Q4 2016 of EUR 280 million related to the Masimo agreements. For further information on the Masimo agreements, refer to Provisions.
- On June 28, 2017, Royal Philips announced a EUR 1.5 billion share buyback program. Philips started the program in the third quarter of 2017 and continues to make progress. As the program was initiated for capital reduction purposes, Philips intends to cancel all of the shares acquired under the program.
- In line with our mission to improve people's lives, we have embedded sustainability at the heart of our business processes, and Philips was named industry leader in the Dow Jones Sustainability Index for the 3rd year in a row. In the Carbon Disclosure Project, we achieved the highest score for the 5th year in a row. Green Revenues, including products and solutions sales, increased to 60% of total revenues in 2017.

Philips Group

Key data

in millions of EUR unless otherwise stated

2015-2017

	2015	2016	2017
Sales	16,806	17,422	17,780
Nominal sales growth	16%	4%	2%
Comparable sales growth ¹⁾	4%	5%	4%
Income from operations	658	1,464	1,517
<i>as a % of sales</i>	<i>3.9%</i>	<i>8.4%</i>	<i>8.5%</i>
Financial expenses, net	(359)	(442)	(137)
Investments in associates	30	11	(4)
Income taxes	(169)	(203)	(349)
Income from continuing operations	160	831	1,028
Discontinued operations	479	660	843
Net income	638	1,491	1,870
Adjusted EBITA ¹⁾	1,688	1,921	2,153
<i>as a % of sales</i>	<i>10.0%</i>	<i>11.0%</i>	<i>12.1%</i>
Other indicators			
Net income attributable to shareholders per common share in EUR:			
basic	0.68	1.58	1.78
diluted	0.68	1.56	1.75
<i>Net cash provided by operating activities</i>	<i>598</i>	<i>1,170</i>	<i>1,870</i>
<i>Net capital expenditures</i>	<i>(752)</i>	<i>(741)</i>	<i>(685)</i>
Free cash flow ¹⁾	(154)	429	1,185

¹⁾Non-IFRS financial measure. For the definition and reconciliation to the most directly comparable IFRS measure, refer to [Reconciliation of non-IFRS information](#).

The year 2016

- Sales rose to EUR 17.4 billion, a nominal increase of 4%, which was driven by 5% nominal growth in the Personal Health businesses and Connected Care & Health Informatics businesses and 3% nominal growth in the Diagnosis & Treatment businesses. On a comparable basis ¹⁾ the 5% growth was driven by 7% growth in the Personal Health businesses and 4% growth in the Connected Care & Health Informatics and Diagnosis & Treatment businesses.
- Green Revenues, including products and solutions sales, increased to 58% of total revenues in 2016. In recognition of our sustainability achievements, Philips was named industry group leader in the Capital Goods category in the 2016 Dow Jones Sustainability Index
- Net income amounted to EUR 1.5 billion and increased by EUR 853 million compared to 2015, driven by improvements in operational performance, lower charges related to pension de-risking, higher discontinued operations results due to the Funai arbitration award, and lower restructuring and acquisition charges. For more details on the Funai arbitration award please refer to [Discontinued operations and assets classified as held for sale](#).
- Adjusted EBITA ¹⁾ totaled EUR 1.9 billion, or 11% of sales, an increase of EUR 233 million, or 100 basis points as a % of sales, compared to 2015. The increase was attributable to higher volumes.
- Net cash provided by operating activities amounted to EUR 1,170 million, an increase of EUR 572 million compared to 2015. Free cash flow ¹⁾ amounted to EUR 429 million and increased by EUR 583 million compared to 2015. The increase was mainly due to higher earnings and lower outflows related to pension de-risking settlements and CRT litigation settlements, partly offset by a EUR 280 million outflow related to legal agreements and a EUR 91 million premium payment related to the October 2016 bond redemption.
- As of October 20, 2016, Philips had completed the 3-year EUR 1.5 billion share buy-back program. During the year Philips returned EUR 868 million in dividends and share repurchases.

¹⁾Non-IFRS financial measure. For the definition and reconciliation to the most directly comparable IFRS measure, refer to [Reconciliation of non-IFRS information](#).

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3.1.1 Philips Lighting sell-down

In September 2014, Philips announced its plan to sharpen its strategic focus by establishing two stand-alone companies focused on the HealthTech and Lighting opportunities respectively. To this end, a stand-alone structure was established for Philips Lighting within the Philips Group, effective February 1, 2016. Then, on May 27, 2016, Philips Lighting was listed and started trading on Euronext in Amsterdam under the symbol 'LIGHT'. Following the listing of Philips Lighting, Philips retained a 71.23% stake. The Initial Public Offering resulted in a net cash inflow of EUR 863 million and an increase of shareholders' equity of EUR 109 million.

In the course of 2017, Philips successfully completed three accelerated bookbuild offerings to institutional investors of a total of 65.35 million shares in Philips Lighting, gradually reducing Philips' stake in Philips Lighting's issued share capital to 29.01% by the end of 2017.

The first two transactions in February and April 2017, involving 48.25 million shares, resulted in a net cash inflow of EUR 1,065 million and had a positive impact on shareholders' equity of the Company of EUR 327 million. In April 2017, we concluded that a loss of control was highly probable due to further sell-downs of the remaining shares within

one year. From that date Lighting was presented as a discontinued operation.

In November 2017, by selling another 17.1 million shares, Philips lost control, resulting in the deconsolidation of Philips Lighting. The sale of shares resulted in a net cash inflow of EUR 544 million and a gain of EUR 599 million recognized in Discontinued operations.

As of December 31, 2017, the retained interest in Philips Lighting represents a value of EUR 1,264 million. Philips will sell down its retained interest in Philips Lighting within one year and it is therefore presented under Assets classified as held for sale. The current position of 29.01% is a temporary position which fits in our overall single coordinated plan to sell Philips Lighting in its entirety. Consequently, any future results related to the retained interest – like value adjustments, results upon disposal and dividends – will be reflected in Discontinued operations.

Subsequent to deconsolidation, Philips recognized a valuation loss of EUR 104 million in discontinued operations related to the retained interest, reflecting the stock price developments of Philips Lighting until December 31, 2017.

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3.1.2 Results of operations

Sales

The composition of sales growth in percentage terms in 2017, compared to 2016, is presented in the table below.

Philips Group
Sales growth composition
in %
2017 versus 2016

	nominal growth	currency effects	consolidation changes	comparable growth ¹⁾
Personal Health	3.0	1.9	0.7	5.6
Diagnosis & Treatment	3.1	2.0	(1.6)	3.5
Connected Care & Health Informatics	0.2	1.9	1.1	3.2
<i>HealthTech Other</i>	(13.2)	0.2	0.1	(12.9)
Philips Group	2.1	1.9	(0.1)	3.9

¹⁾Non-IFRS financial measure. For the definition and reconciliation to the most directly comparable IFRS measure, refer to [Reconciliation of non-IFRS information](#).

Group sales amounted to EUR 17,780 million in 2017 and increased 2% on a nominal basis. Adjusted for a 1.8% negative currency effect and consolidation impact, comparable sales ¹⁾ were 4% above 2016.

Our Personal Health businesses' sales amounted to EUR 7,310 million, which was EUR 211 million higher than in 2016, or 3% higher on a nominal basis and 6% higher on a comparable basis ¹⁾. For further information, refer to [Financial performance](#).

Our Diagnosis & Treatment businesses' sales amounted to EUR 6,891 million, which was EUR 205 million higher than in 2016, or 3% higher on both a nominal and a comparable basis ¹⁾. For further information, refer to [Financial performance](#).

Our Connected Care & Health Informatics businesses' sales amounted to EUR 3,163 million, which was EUR 5 million higher than in 2016, flat year-on-year on a nominal basis and 3% higher on a comparable basis ¹⁾. For further information, refer to [Financial performance](#).

HealthTech Other reported sales of EUR 415 million, which was EUR 63 million lower than in 2016. For further information, refer to [Financial performance](#).

The composition of sales growth in percentage terms in 2016, compared to 2015, is presented in the table below.

Philips Group
Sales growth composition
in %
2016 versus 2015

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	nominal growth	currency effects	consolidation changes	comparable growth ¹⁾
Personal Health	5.2	2.0	0.0	7.2
Diagnosis & Treatment	3.1	0.9	(0.4)	3.6
Connected Care & Health Informatics	4.5	0.1	(0.1)	4.5
<i>HealthTech Other</i>	(5.0)	0.0	0.0	(5.0)
Philips Group	3.7	1.1	0.1	4.9

¹)Non-IFRS financial measure. For the definition and reconciliation to the most directly comparable IFRS measure, refer to [Reconciliation of non-IFRS information](#).

Group sales amounted to EUR 17,422 million in 2016, which represents 4% nominal growth compared to 2015. Adjusted for a 1% negative currency effect and consolidation impact, comparable sales ¹) were 5% above 2015.

Our Personal Health businesses' sales amounted to EUR 7,099 million, which was EUR 348 million higher than in 2015, or 5% higher on a nominal basis and 7% higher on a comparable basis ¹). For further information, refer to [Financial performance](#).

Our Diagnosis & Treatment businesses' sales amounted to EUR 6,686 million, which was EUR 202 million higher than in 2015, or 3% higher on a nominal basis and 4% higher on a comparable basis ¹). For further information, refer to [Financial performance](#).

Our Connected Care & Health Informatics businesses' sales amounted to EUR 3,158 million, which was EUR 136 million higher than in 2015, or 5% higher on a nominal basis and 4% higher on a comparable basis ¹). For further information, refer to [Financial performance](#).

HealthTech Other reported sales of EUR 478 million, which was EUR 25 million lower than in 2015. For further information, refer to [Financial performance](#).

Performance per geographic cluster

Philips Group
Sales by geographic cluster
in millions of EUR
2015 - 2017

Nominal sales growth by geographic cluster
in %
2015 - 2017

	2015	2016	2017
Mature geographies ¹⁾	16.0	3.9	0.8
Growth geographies	15.3	3.2	4.8
Philips Group	15.8	3.7	2.1

¹⁾Mature geographies include Western Europe, North America and Other mature geographies.

Comparable sales growth by geographic cluster ¹⁾

in %

2015 - 2017

	2015	2016	2017
Mature geographies ²⁾	2.7	3.3	1.9
Growth geographies	8.1	8.4	8.0
Philips Group	4.4	4.9	3.9

¹Non-IFRS financial measure. For the definition and reconciliation to the most directly comparable IFRS measure, refer to [Reconciliation of non-IFRS information](#).

²Mature geographies include Western Europe, North America and Other mature geographies.

Sales in mature geographies were EUR 91 million higher than in 2016, or 1% higher on a nominal basis and 2% higher on a comparable basis ¹. Sales in Western Europe were 1% higher than in 2016 on a nominal basis and 3% higher on a comparable basis ¹. Comparable sales in Western Europe reflected mid-single-digit growth in the Connected Care & Health Informatics businesses and Personal Health businesses, and flat year-on-year sales in the Diagnosis & Treatment businesses. Sales in North America increased by EUR 130 million, or 2% on a nominal basis and 3% on a comparable basis ¹. Comparable sales in North America reflected mid-single-digit growth in the Connected Care & Health Informatics businesses and low-single-digit growth in the Personal Health businesses and Diagnosis & Treatment businesses. Sales in other mature geographies decreased by 5% on a nominal basis and by 2% on a comparable basis ¹. Comparable sales in other mature geographies showed low-single-digit growth in the Diagnosis & Treatment businesses, while the Connected Care & Health Informatics businesses and Personal Health businesses recorded a low-single-digit decline.

In growth geographies, sales were EUR 266 million higher than in 2016 and increased 5% on a nominal basis. The 8% increase on a comparable basis ¹ reflected double-digit growth in the Personal Health businesses, high-single-digit growth in the Diagnosis & Treatment businesses and low-single-digit growth in the Connected Care & Health Informatics businesses. The increase was driven by double-digit growth in Middle East & Turkey and high-single-digit growth in China, Latin America and Central & Eastern Europe.

Sales in mature geographies were EUR 443 million higher in 2016 than in 2015, or 4% higher on a nominal basis and 3% higher on a comparable basis ¹. Sales in Western Europe were 2% higher than in 2015 on a nominal basis and 4% higher on a comparable basis ¹. Comparable sales in Western Europe reflected growth in the Personal Health businesses and Diagnostics & Treatment businesses, partly offset by a decline in the Connected Care & Health Informatics businesses. Sales in North America increased by EUR 215 million, or 4% on a nominal basis and 3% on a comparable basis ¹. Nominal sales in other mature geographies increased by 9%. Comparable sales ¹ in other mature geographies showed a 2% increase, with growth in the Connected Care & Health Informatics businesses and Personal Health businesses, while Diagnostics & Treatment businesses declined 1%.

In growth geographies, sales were EUR 175 million higher in 2016 than in 2015, which represents a 3% increase on a nominal basis. The 8% increase on a comparable basis ¹ reflected double-digit growth in the Diagnostics & Treatment businesses, high-single-digit growth in the Personal Health businesses and low-single-digit growth in the Connected Care & Health Informatics businesses. The increase was driven by double-digit growth in Central & Eastern Europe and high-single-digit growth in China, Latin America and Middle East & Turkey.

Gross margin

In 2017, Philips' gross margin increased to EUR 8,181 million, or 46.0% of sales, from EUR 7,939 million, or 45.6% of sales, in 2016. Gross margin in 2017 included EUR 98 million of restructuring and acquisition-related charges, whereas 2016 included EUR 22 million of restructuring and acquisition-related charges. 2017 also included EUR 40 million of charges related to quality and regulatory actions, EUR 14 million of charges related to the consent decree focused on the defibrillator manufacturing in the US, and a EUR 36 million net release of provisions. Gross margin in 2016 also included a EUR 12 million net release of provisions and EUR 4 million of charges related to the separation of the Lighting business. The year-on-year increase was mainly driven by improved operational performance in the Personal Health, Diagnosis & Treatment and Connected Care & Health Informatics businesses, partly offset by higher restructuring and acquisition-related charges.

In 2016, Philips' gross margin was EUR 7,939 million, or 45.6% of sales, compared to EUR 7,212 million, or 42.9% of sales, in 2015. 2015 included EUR 114 million of restructuring and acquisition-related charges, EUR 21 million of charges related to the devaluation of the Argentine peso, a EUR 28 million currency revaluation of other provisions,

and EUR 3 million related to the separation of the Lighting business. The year-on-year increase was driven by improved operational performance, as well as lower restructuring and acquisition-related charges.

Selling expenses

Selling expenses amounted to EUR 4,398 million in 2017, or 24.7% of sales, compared to EUR 4,142 million, or 23.8% of sales, in 2016. Selling expenses in 2017 included EUR 127 million of restructuring and acquisition-related charges, compared to EUR 47 million in 2016. Selling expenses in 2017 also included EUR 9 million related to the separation of the Lighting business and EUR 4 million of charges related to the consent decree. Selling expenses in 2016 also included EUR 38 million related to the separation of the Lighting business.

Selling expenses increased from EUR 4,048 million in 2015 to EUR 4,142 million in 2016. Selling expenses as a % of total sales decreased from 24.1% in 2015 to 23.8% in 2016. 2015 included EUR 28 million of restructuring and acquisition-related charges, EUR 31 million of charges related to a legal provision, and EUR 61 million related to the separation of the Lighting business.

General and administrative expenses

General and administrative expenses decreased to EUR 577 million, or 3.2% of sales, in 2017, compared to EUR 658 million, or 3.8% of sales, in 2016. 2017 included EUR 19 million of restructuring and acquisition related-charges, compared to EUR 5 million in 2016. General and administrative expenses in 2017 also included charges of EUR 21 million related to the separation of the Lighting business. 2016 also included charges of EUR 109 million related to the separation of the Lighting business, a EUR 26 million impairment of real estate assets, as well as a EUR 46 million gain from the settlement of a pension-related claim.

General and administrative expenses amounted to EUR 658 million, or 3.8% of sales, in 2016, compared to EUR 1,003 million, or 6.0% of sales, in 2015. 2015 included EUR 31 million of restructuring and acquisition related-charges, as well as charges of EUR 345 million mainly related to settlements for pension de-risking and EUR 110 million related to the separation of the Lighting business.

Research and development expenses

Research and development costs increased from EUR 1,669 million, or 9.6% of sales, in 2016 to EUR 1,764 million, or 9.9% of sales, in 2017. Research and development costs in 2017 included EUR 72 million of restructuring and acquisition-related charges, compared to EUR 21 million in 2016. 2017 also included charges of EUR 22 million related to portfolio rationalization measures, EUR 7 million of charges related to quality and regulatory actions, and EUR 2 million of charges related to the consent decree. The year-on-year increase was mainly due to higher restructuring and acquisition-related charges. Excluding these charges, research and development costs amount to 9.3% of sales.

Philips Group
Research and development expenses
in millions of EUR unless otherwise stated
2015 - 2017

	2015	2016	2017
Personal Health	383	412	415
Diagnosis & Treatment	596	629	715
Connected Care & Health Informatics	386	388	399
<i>HealthTech Other</i>	189	217	221
<i>Legacy Items</i>	8	23	14
Philips Group	1,562	1,669	1,764
<i>as % of sales</i>	<i>9.3%</i>	<i>9.6%</i>	<i>9.9%</i>

Research and development costs increased from EUR 1,562 million, or 9.3% of sales, in 2015 to EUR 1,669 million, or 9.6% of sales, in 2016. 2015 included EUR 16 million of restructuring and acquisition-related charges. The year-on-year increase was mainly due to higher spend in the Personal Health businesses and Diagnosis & Treatment businesses.

Net income, Income from operations (EBIT) and Adjusted EBITA ¹⁾

Net income is not allocated to segments as certain income and expense line items are monitored on a centralized basis, resulting in them being shown on a Philips Group level only.

The overview below shows sales, Income from operations and Adjusted EBITA ¹⁾ according to the 2017 segment classifications.

Philips Group

Sales, Income from operations and Adjusted EBITA ¹⁾

in millions of EUR unless otherwise stated

2016 - 2017

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	Sales	Income from operations	%	Adjusted EBITA ¹⁾	%
2017					
Personal Health	7,310	1,075	14.7%	1,221	16.7%
Diagnosis & Treatment	6,891	488	7.1%	716	10.4%
Connected Care & Health Informatics	3,163	206	6.5%	372	11.8%
<i>HealthTech Other</i>	415	(149)		(109)	
<i>Legacy Items</i>	1	(103)		(48)	
Philips Group	17,780	1,517	8.5%	2,153	12.1%
2016					
Personal Health	7,099	953	13.4%	1,108	15.6%
Diagnosis & Treatment	6,686	546	8.2%	631	9.4%
Connected Care & Health Informatics	3,158	275	8.7%	324	10.3%
<i>HealthTech Other</i>	478	(129)		(66)	
<i>Legacy Items</i>	1	(181)		(76)	
Philips Group	17,422	1,464	8.4%	1,921	11.0%

¹⁾Non-IFRS financial measure. For the definition and reconciliation to the most directly comparable IFRS measure, refer to Reconciliation of non-IFRS information.

Net income increased by EUR 379 million compared to 2016, driven by improvements in operational performance, lower net financial expenses and higher discontinued operations results, partly offset by higher restructuring and acquisition-related charges and higher income taxes, which included a total non-cash tax charge of EUR 171 million due to the US Tax Cuts and Jobs Act.

In 2017, Income from operations increased by EUR 53 million year-on-year to EUR 1,517 million, or 8.5% of sales. Restructuring and acquisition-related charges amounted to EUR 316 million, including the charges related to Spectranetics, compared to EUR 94 million in 2016. Income from operations in 2017 also included EUR 47 million of charges related to quality and regulatory actions, EUR 31 million of charges related to the separation of the Lighting business, EUR 26 million of provisions related to the CRT (Cathode Ray Tube) litigation in the US, EUR 22 million of charges related to portfolio rationalization measures, EUR 20 million of charges related to the consent decree focused on the defibrillator manufacturing in the US, a EUR 59 million net gain from the sale of real estate assets, and a EUR 36 million net release of provisions. 2016 also included EUR 152 million of charges related to the separation of the Lighting business, a EUR 26 million impairment of real estate assets, a EUR 12 million net release of provisions, and a EUR 46 million gain from the settlement of a pension-related claim.

Adjusted EBITA ¹⁾ amounted to EUR 2,153 million, or 12.1% of sales, and improved by EUR 232 million or 110 basis points as a % of sales compared to 2016. The improvement was mainly attributable to higher volumes, procurement savings and other cost productivity.

Philips Group

Sales, Income from operations and Adjusted EBITA ¹⁾

in millions of EUR unless otherwise stated

2015

	Sales	Income from operations	%	Adjusted EBITA ¹⁾	%
Personal Health	6,751	736	10.9%	966	14.3%
Diagnosis & Treatment	6,484	322	5.0%	515	7.9%
Connected Care & Health Informatics	3,022	173	5.7%	294	9.7%
<i>HealthTech Other</i>	503	49		8	
<i>Legacy Items</i>	46	(622)		(95)	
Philips Group	16,806	658	3.9%	1,688	10.0%

¹⁾Non-IFRS financial measure. For the definition and reconciliation to the most directly comparable IFRS measure, refer to [Reconciliation of non-IFRS information](#).

Net income increased by EUR 853 million compared to 2015, driven by improvements in operational performance, lower charges related to pension de-risking, higher discontinued operations results due to the Funai arbitration award, and lower restructuring and acquisition charges.

In 2016, Income from operations increased by EUR 806 million year-on-year to EUR 1,464 million, or 8.4% of sales. 2015 included restructuring and acquisition-related charges of EUR 186 million, charges of EUR 183 million related to the separation of the Lighting business, EUR 345 million mainly related to settlements for pension de-risking, EUR 21 million related to the devaluation of the Argentine peso, EUR 31 million relating to legal provisions, EUR 28 million related to the currency revaluation of other provisions, and a EUR 37 million gain related to the sale of real estate assets.

Adjusted EBITA ¹⁾ improved by EUR 233 million or 100 basis points as a % of sales compared to 2015. The improvement was mainly attributable to higher volumes and cost productivity, partly offset by higher expenditure for growth initiatives and innovation.

Personal Health businesses

In 2017, Income from operations amounted to EUR 1,075 million, or 14.7% of sales, an increase of EUR 122 million and a margin increase of 130 basis points compared to 2016. Adjusted EBITA ¹⁾ amounted to EUR 1,221 million, or 16.7% of sales, an increase of EUR 113 million or 110 basis points as a % of sales compared to 2016. For further information, refer to [Financial performance](#).

In 2016, Income from operations amounted to EUR 953 million, or 13.4% of sales, an increase of EUR 217 million and a margin increase of 250 basis points compared to 2015. Adjusted EBITA ¹⁾ amounted to EUR 1,108 million, or 15.6% of sales, an increase of EUR 142 million or 130 basis points as a % of sales compared to 2015. For further information, refer to [Financial performance](#).

Diagnosis & Treatment businesses

In 2017, Income from operations amounted to EUR 488 million, or 7.1% of sales, a decrease of EUR 58 million and a margin decrease of 110 basis points compared to 2016. Adjusted EBITA ¹⁾ amounted to EUR 716 million, or 10.4% of sales, an increase of EUR 85 million or 100 basis points as a % of sales year-on-year. For further information, refer to [Financial performance](#).

In 2016, Income from operations totaled EUR 546 million, or 8.2% of sales, an increase of EUR 224 million and a margin increase of 320 basis points compared to 2015. Adjusted EBITA ¹⁾ totaled EUR 631 million, or 9.4% of sales, an increase of EUR 116 million or 150 basis points as a % of sales year-on-year. For further information, refer to [Financial performance](#).

Connected Care & Health Informatics businesses

In 2017, Income from operations totaled EUR 206 million, or 6.5% of sales, a decrease of EUR 69 million and a margin decrease of 220 basis points as a % of sales compared to 2016. Adjusted EBITA ¹⁾ totaled EUR 372 million, or 11.8% of sales, an increase of EUR 48 million or 150 basis points as a % of sales year-on-year. For further information, refer to [Financial performance](#).

In 2016, Income from operations totaled EUR 275 million, or 8.7% of sales, an increase of EUR 102 million and a margin increase of 300 basis points as a % of sales compared to 2015. Adjusted EBITA ¹⁾ totaled EUR 324 million, or 10.3% of sales, an increase of EUR 30 million or a margin increase of 50 basis points as a % of sales year-on-year.

For further information, refer to [Financial performance](#)

HealthTech Other

In HealthTech Other we report on the items Innovation, Emerging Businesses, IP Royalties, Central costs and Other.

In 2017, Income from operations amounted to a net cost of EUR 149 million, compared to a net cost of EUR 129 million in 2016. Adjusted EBITA ¹⁾ amounted to a net cost of EUR 109 million, compared to EUR 66 million in 2016. For further information, refer to [Financial performance](#).

In 2016, Income from operations amounted to a net cost of EUR 129 million, compared to net gain of EUR 49 million in 2015. Adjusted EBITA ¹⁾ amounted to a net cost of EUR 66 million, compared to a net gain of EUR 8 million in 2015. For further information, refer to [Financial performance](#).

Legacy Items

Income from operations in 2017 amounted to a loss of EUR 103 million, and improved by EUR 78 million compared to 2016. For further information, refer to [Financial performance](#).

Income from operations in 2016 amounted to a loss of EUR 181 million, and improved by EUR 441 million compared to 2015. For further information, refer to [Financial performance](#).

Financial income and expenses

A breakdown of Financial income and expenses is presented in the following table.

Philips Group
Financial income and expenses
in millions of EUR
2015 - 2017

	2015	2016	2017
Interest expense (net)	(300)	(299)	(182)
Sale of securities	20	3	1
Impairments	(46)	(24)	(2)
Other	(33)	(122)	46
Financial income and expenses	(359)	(442)	(137)

Net interest expense in 2017 was EUR 117 million lower than in 2016, mainly driven by lower interest expenses on net debt ¹⁾, as a result of the bond redemptions. Other financial income amounted to EUR 46 million in 2017, mainly due to dividend income related to the retained interest in the combined businesses of Lumileds and Automotive. For further information, refer to [Financial income and expenses](#).

Net interest expense in 2016 was in line with 2015. Impairments in 2016 included an amount of EUR 24 million related to Corindus Vascular Robotics. Other financial expense amounted to EUR 122 million in 2016, primarily consisting of financial charges related to the early redemption of USD bonds in October 2016 and January 2017, partly offset by a release of an interest provision related to the Masimo litigation. For further information, refer to [Financial income and expenses](#)

Net financial income and expense showed a EUR 359 million expense in 2015. Total financial income of EUR 94 million included EUR 44 million of interest income.

Income taxes

Income taxes amounted to EUR 349 million, compared to EUR 203 million in 2016. The effective income tax rate in 2017 was 25.3%, compared to 19.9% in 2016. This increase was largely due to a tax charge of EUR 72 million for a valuation adjustment of Philips' US deferred tax assets following the enactment of the US Tax Cuts and Jobs Act in December 2017.

For 2018, we expect our effective tax rate to be within the range of 26%-28%, depending on the geographical mix of taxable income.

Income taxes amounted to EUR 203 million in 2016, compared to EUR 169 million in 2015. The effective income tax rate in 2016 was 19.9%, compared to 54.0% in 2015. The decrease was largely due to a change in the weighted average statutory tax rate and the absence of one-off tax charges in 2016 mainly relating to recognition of deferred tax assets.

Investment in associates

Results related to investments in associates decreased from a gain of EUR 11 million in 2016 to a loss of EUR 4 million in 2017, mainly due to an impairment of EUR 4 million and lower share of income of associates in 2017 compared to 2016.

Results related to investments in associates decreased from a gain of EUR 30 million in 2015 to a gain of EUR 11 million in 2016, mainly reflecting the proceeds from the sale of Assembléon Technologies B.V. in 2015.

Discontinued operations

Discontinued operations consist primarily of the segment Lighting, the combined Lumileds and Automotive businesses, and certain divestments formerly reported as discontinued operations. The results related to these businesses are reported under Discontinued operations in the Consolidated statements of income and Consolidated

statements of cash flows.

In 2017, Philips completed several transactions in Philips Lighting shares, which reduced the interest in this company from 71.23% as of December 31, 2016 to 29.01% as of December 31, 2017. In April 2017, triggered by a sale of Philips Lighting shares, we concluded that a loss of control was highly probable due to further sell-downs of the remaining shares within one year. From that date Lighting was presented as a discontinued operation. In November 2017 Philips lost control, resulting in the deconsolidation of Philips Lighting.

On June 30, 2017, Philips completed the sale of an 80.1% interest in the combined Lumileds and Automotive businesses to certain funds managed by affiliates of Apollo Global Management, LLC. The combined businesses of Lumileds and Automotive were reported as discontinued operations as from the end of November 2014.

Philips Group

Discontinued operations, net of income taxes

in millions of EUR

2015 - 2017

	2015	2016	2017
Lighting	247	244	896
The combined Lumileds and Automotive businesses	233	282	(29)
Other	(1)	134	(24)
Discontinued operations, net of income taxes	479	660	843
Net income of Discontinued operations			

Discontinued operations results increased by EUR 183 million, mainly due to a EUR 599 million net gain from the deconsolidation of Philips Lighting, partly offset by a EUR 104 million charge related to the change in value of the retained interest in Philips Lighting, a tax charge of EUR 99 million due to the US Tax Cuts and Jobs Act, and the exclusion of the operational results of the combined businesses of Lumileds and Automotive from Discontinued operations following the divestment in Q2 2017. The year 2016 included the Funai arbitration award.

In 2016, income from discontinued operations increased by EUR 181 million to EUR 660 million. The year-on-year increase was mainly due to the Funai arbitration award of EUR 144 million, which includes disbursements and interest as compensation for damages.

For further information, refer to Discontinued operations and assets classified as held for sale.

Net income

Net income amounted to EUR 1,870 million, an increase of EUR 379 million compared to 2016, driven by improvements in operational performance, lower net financial expenses and higher discontinued operations results, partly offset by higher restructuring and acquisition-related charges and higher income taxes, which included a tax charge of EUR 171 million due to the US Tax Cuts and Jobs Act.

Basic earnings per common share from net income attributable to shareholders increased from EUR 1.58 per common share in 2016 to EUR 1.78 per common share in 2017.

Net income is not allocated to segments as certain income and expense line items are monitored on a centralized basis.

Net income amounted to EUR 1,491 million, an increase of EUR 853 million compared to 2015, driven by improvements in operational performance, lower charges related to the pension de-risking, higher discontinued operations results due to the Funai arbitration award, and lower restructuring and acquisition charges.

Basic earnings per common share from net income attributable to shareholders increased from EUR 0.68 per common share in 2015 to EUR 1.58 per common share in 2016.

Non-controlling interests

Net income attributable to non-controlling interests increased from EUR 43 million in 2016 to EUR 214 million in 2017, mainly as a result of three sales transactions in Philips Lighting shares, which reduced the interest in this company from 71.23% as of December 31, 2016 to 29.01% as of December 31, 2017. Philips Lighting was deconsolidated as from the end of November 2017.

Net income attributable to non-controlling interests increased from EUR 14 million in 2015 to EUR 43 million in 2016, mainly as a result of the sale of the 28.775% minority interest in Philips Lighting.

¹)Non-IFRS financial measure. For the definition and reconciliation to the most directly comparable IFRS measure, refer to Reconciliation of non-IFRS information.

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3.1.3 Advertising and promotion

Philips' total advertising and promotion expenses were EUR 939 million in 2017, an increase of EUR 24 million compared to 2016. The total advertising and promotion investment as a percentage of sales was 5.3% in 2017 and was in line with 2016.

Philips' brand value increased by 2% to over USD 11.5 billion as measured by Interbrand. In the 2017 listing, Philips is ranked the 41st most valuable brand in the world.

Philips' total advertising and promotion expenses were EUR 915 million in 2016, an increase of 3% compared to 2015. The increase was mainly due to investments in key mature geographies such as the United States, Japan and Germany. The total advertising and promotion investment as a percentage of sales was 5.1% in 2015.

Philips' brand value increased by 4% to over USD 11.3 billion as measured by Interbrand. In the 2016 listing, Philips was ranked the 41st most valuable brand in the world.

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3.1.4 Pensions

In 2017, the total costs of post-employment benefits amounted to EUR 69 million for defined-benefit plans and EUR 315 million for defined-contribution plans. These costs are reported in Income from operations except for the net interest cost component which is reported in Financial expense. The net interest cost for defined-benefit plans was EUR 37 million in 2017.

The overall funded status and balance sheet improved in 2017, mainly due to the transfer of Lighting to Discontinued operations and an additional contribution of EUR 219 million in the US.

2017 included a settlement of the Brazil pension plans leading to a decrease of the defined-benefit obligation of EUR 345 million and the recognition of a settlement loss of EUR 1 million.

In 2016, the total costs of post-employment benefits amounted to EUR 29 million for defined-benefit plans and EUR 299 million for defined-contribution plans. The net interest cost for defined-benefit plans was EUR 48 million in 2016.

2016 included a legal claim settlement gain of EUR 46 million related to the UK pension plan.

The overall funded status and balance sheet improved in 2016, mainly due to contributions of EUR 250 million in the US, partly offset by an increase of the defined-benefit obligation due to lower discount rates.

In 2015, the total costs of post-employment benefits amounted to EUR 537 million for defined-benefit plans and EUR 240 million for defined-contribution plans. The net interest cost for defined-benefit plans was EUR 70 million in 2015.

2015 included settlement costs of EUR 329 million, and past service costs of EUR 14 million were recognized related to de-risking actions taken in the UK. Mainly due to the change to defined-contribution accounting for the Dutch pension plan, the Company's defined-benefit obligation decreased from EUR 27 billion to EUR 4.5 billion at the end of 2015.

The overall funded status in 2015 decreased as the surpluses of the Dutch and UK plans were no longer included due to their settlements in 2015. The pension deficits recognized in the balance sheet decreased, mainly due to the de-risking actions in the US.

For further information, refer to Post-employment benefits.

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3.1.5 Restructuring and acquisition-related charges and goodwill impairment charges

Philips Group
Restructuring and related charges
in millions of EUR
2015 - 2017

	2015	2016	2017
Restructuring and related charges per segment:			
Personal Health	38	16	8
Diagnosis & Treatment	25	6	63
Connected Care & Health Informatics	37	9	81
<i>HealthTech Other</i>	(20)	27	59
<i>Legacy Items</i>	1		
Philips Group	81	58	211
Cost breakdown of restructuring and related charges:			
Personnel lay-off costs	105	63	150
Release of provision	(55)	(34)	(37)
Restructuring-related asset impairment	26	14	77
Transfer to Assets held for sales			(5)
Other restructuring-related costs	5	14	27
Philips Group	81	58	211

In 2017, Income from operations included net restructuring charges totaling EUR 211 million. The most significant restructuring projects impacted the Connected Care & Health Informatics businesses, Diagnosis & Treatment businesses and HealthTech Other businesses and mainly took place in the Netherlands and the US. The restructuring comprised mainly product portfolio rationalization and the reorganization of global support functions.

In 2016, Income from operations included net charges totaling EUR 58 million for restructuring. The most significant restructuring projects were mainly related to overhead cost reduction programs in HealthTech Other and took place in the Netherlands.

In 2015, Income from operations included net charges totaling EUR 81 million for restructuring. In 2015, the most significant restructuring projects were related to the Personal Health, Diagnosis & Treatment and Connected Care & Health Informatics businesses.

For further information on restructuring, refer to [Provisions](#).

Philips Group
Acquisition-related charges
in millions of EUR
2015 - 2017

	2015	2016	2017
Acquisition-related charges per segment:			
Personal Health	(1)		3
Diagnosis & Treatment	107	31	88
Connected Care & Health Informatics	1	4	10
<i>HealthTech Other</i>		1	5
Philips Group	107	37	106

In 2017, acquisition-related charges amounted to EUR 106 million. The Diagnosis & Treatment businesses recorded EUR 88 million of acquisition-related charges, mainly related to the acquisition of Spectranetics, a US-based global leader in vascular intervention and lead management solutions. Acquisition-related charges relating to Volcano were also included as part of the Diagnosis & Treatment businesses' acquisition-related charges.

The 2016 acquisition-related charges amounted to EUR 37 million. The Diagnosis & Treatment businesses recorded EUR 31 million of acquisition-related charges, mainly related to Volcano.

The 2015 acquisition-related charges amounted to EUR 107 million. The Diagnosis & Treatment businesses recorded EUR 107 million acquisition-related charges, mainly related to Volcano.

In 2017, in addition to the annual goodwill-impairment tests for Philips, trigger-based impairment tests were performed during the year, resulting in a goodwill impairment of EUR 9 million.

In 2016, in addition to the annual goodwill-impairment tests for Philips, trigger-based impairment tests were performed during the year, resulting in a goodwill impairment of EUR 1 million.

In 2015, the goodwill impairment was nil.

For further information on goodwill sensitivity analysis, please refer to [Goodwill](#).

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3.1.6 Acquisitions and divestments

Acquisitions

In 2017, Philips completed several acquisitions, with The Spectranetics Corporation (Spectranetics) being the largest. Spectranetics is a US-based global leader in vascular intervention and lead management solutions and is present in 11 countries. Acquisitions in 2017 and prior years led to acquisition and post-merger integration charges of EUR 88 million in the Diagnosis & Treatment businesses and EUR 10 million in the Connected Care & Health Informatics businesses.

In 2016, Philips completed two acquisitions, the largest being Wellcentive, a leading US-based provider of population health management software solutions. Acquisitions in 2016 and prior years led to acquisition and post-merger integration charges of EUR 31 million in the Diagnosis & Treatment businesses and EUR 4 million in the Connected Care & Health Informatics businesses.

In 2015, Philips completed four acquisitions, the largest being Volcano Corporation, an image-guided therapy company based in the United States, and Blue Jay Consulting, a leading provider of hospital emergency room consulting services. Acquisitions in 2015 and prior years led to acquisition and post-merger integration charges of EUR 107 million, mainly in the Diagnosis & Treatment businesses.

Divestments

Apart from the sale of interest in Lumileds and Philips Lighting, Philips completed two divestments during 2017 for an aggregate cash consideration of EUR 54 million.

For details regarding the sale of interests in Lumileds and Philips Lighting, reference is made to Discontinued operations and assets classified as held for sale and Philips Lighting sell-down.

In 2015, Philips completed seven divestments, which included the sale of Assembléon Holding B.V., OEM Remote Controls, Axsun Technologies LLC, and several small businesses within the HealthTech portfolio.

For details, please refer to Acquisitions and divestments.

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3.1.7 Changes in cash and cash equivalents, including cash flows

The movement in cash and cash equivalents for the years ended December 31, 2015, 2016 and 2017 are presented and explained below:

Condensed consolidated cash flow statements ¹⁾
in millions of EUR
2015 - 2017

	2015	2016	2017
Beginning cash balance	1,873	1,766	2,334
<i>Net cash provided by operating activities</i>	598	1,170	1,870
<i>Net capital expenditures</i>	(752)	(741)	(685)
Free cash flows ²⁾	(154)	429	1,185
Acquisitions and divestments of businesses	(1,046)	(197)	(2,280)
Other cash flow from investing activities	(53)	(156)	(234)
Treasury share transactions	(425)	(526)	(414)
Change in debt	1,252	(1,611)	(205)
Dividend paid to shareholders of the Company	(298)	(330)	(384)
Sale of shares of Philips Lighting		825	1,060
Other cash flow items	80	(18)	(186)
Net cash flows from discontinued operations	537	2,151	1,063
Ending cash balance	1,766	2,334	1,939

¹Please refer to Consolidated statements of cash flows.

²Non-IFRS financial measure. For the definition and reconciliation to the most directly comparable IFRS measure, refer to Reconciliation of non-IFRS information.

Net cash provided by operating activities

Net cash provided by operating activities amounted to EUR 1,870 million in 2017, which was EUR 700 million higher than in 2016, mainly due to EUR 379 million higher earnings in 2017 and the higher outflows recorded in 2016 related to the Masimo agreements.

Net cash provided by operating activities amounted to EUR 1,170 million in 2016, which was EUR 572 million higher than in 2015, mainly due to EUR 853 million higher earnings and EUR 198 million net improvements in working capital-related inflows. Net cash provided by operating activities in 2015 included EUR 382 million cash outflows related to CRT litigation claims and higher pension de-risking settlements. 2016 also included EUR 280 million outflow related to the Masimo agreements (refer to Provisions) and a EUR 91 million premium payment related to the October 2016 bond redemption.

Net cash used for investing activities

In 2017, acquisitions of businesses (including acquisition of investments in associates) amounted to a cash outflow of EUR 2,344 million, which included the acquisition of Spectranetics for EUR 1.9 billion. Net cash proceeds from divestment of businesses amounted to EUR 64 million and were received mainly from divested businesses held for sale. Other investing activities mainly included EUR 295 million net cash used for foreign exchange derivative contracts related to activities for funding and liquidity management, partly offset by EUR 90 million received related to TPV Technology Limited loans.

In 2016, acquisitions of businesses (including acquisition of investments in associates) amounted to a cash outflow of EUR 197 million, which included the acquisition of Wellcentive. Other investing activities mainly included EUR 128 million net cash used for foreign exchange derivative contracts related to activities for funding and liquidity management.

In 2015, acquisitions of businesses (including acquisition of investments in associates) amounted to a cash outflow of EUR 1,118 million, which was mainly related to the acquisition of Volcano. Net cash proceeds from divestment of businesses and equity interest of EUR 71 million mainly include divestment of Assembléon Holding B.V., the OEM remote control business, Axsun Technologies LLC. Other investing activities included EUR 194 million net cash used for foreign exchange derivative contracts related to activities for funding and liquidity management, partly offset by EUR 121 million received related to TPV Technology Limited loans.

Net cash provided by (used for) financing activities

Net cash provided by financing activities in 2017 was EUR 55 million. Philips' shareholders were given EUR 742 million in the form of a dividend, of which the cash portion of the dividend amounted to EUR 384 million. Net cash proceeds of EUR 1,060 million related to the sales of shares in Philips Lighting. Change in net debt ¹ mainly reflected EUR 1.2 billion cash outflow related to the bond redemption and EUR 1 billion cash inflow from bonds issued. Additionally, net cash outflows for share buy-back and share delivery totaled EUR 414 million.

Net cash used for financing activities in 2016 was EUR 1,643 million. Philips' shareholders were given EUR 732 million in the form of a dividend, of which the cash portion of the dividend amounted to EUR 330 million. Net cash proceeds of EUR 825 million related to the sales of shares in Philips Lighting. Change in net debt ¹ mainly reflected the repayment of a loan related to the Volcano acquisition of EUR 1,186 million. Additionally, net cash outflows for share buy-back and share delivery totaled EUR 526 million.

Net cash provided by financing activities in 2015 was EUR 529 million. Philips' shareholders were given EUR 730 million in the form of a dividend, of which the cash portion of the dividend amounted to EUR 298 million. The net impact of changes in debt was an increase of EUR 1,252 million, which mainly related to financing of the Volcano acquisition. Additionally, net cash outflows for share buy-back and share delivery totaled EUR 425 million.

Cash flows from discontinued operations

Discontinued operations cash flows
in millions of EUR
2015 -2017

	2015	2016	2017
Cash flows from operating activities	761	1,037	350
Cash flows from investing activities	(203)	(112)	856
Cash flows from financing activities	(20)	1,226	(144)
Total discontinued operations cash flows	537	2,151	1,063

In 2017, cash flows from operating activities reflect the period prior to the divestment of the combined Lumileds and Automotive business (six months of cash flows) and prior to the deconsolidation of Lighting (eleven months of cash flows). In 2017, cash flows from investing activities includes the net cash outflow related to the deconsolidation of Philips Lighting of EUR 175 million, consisting of EUR 545 million proceeds from the sale of shares on November 28, 2017, offset by the deconsolidation of EUR 720 million of cash and cash equivalents, and proceeds of EUR 1.1 billion received from the sale of the combined Lumileds and Automotive businesses.

In 2016, cash flows from investing activities includes EUR 144 million cash inflow related to the Funai arbitration and cash flows from financing activities includes new funding of EUR 1.2 billion attracted by Philips Lighting.

In 2015, net cash flows from discontinued operations mainly reflected Philips Lighting net cash provided by operating activities of EUR 569 million. The rest was mainly attributable to net cash flows from the combined Automotive and Lumileds businesses and the Audio, Video, Multimedia & Accessories business.

¹⁾Non-IFRS financial measure. For the definition and reconciliation to the most directly comparable IFRS measure, refer to [Reconciliation of non-IFRS information](#).

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3.1.8 Financing

Condensed consolidated balance sheets for the years 2015, 2016 and 2017 are presented below:

Philips Group

Condensed consolidated balance sheet ¹⁾

in millions of EUR

2015 - 2017

	2015	2016	2017
Intangible assets	12,216	12,450	11,054
Property, plant and equipment	2,322	2,155	1,591
Inventories	3,463	3,392	2,353
Receivables	5,287	5,636	4,148
Assets held for sale	1,809	2,180	1,356
Other assets	4,080	4,123	2,874
Payables	(5,604)	(6,028)	(4,492)
Provisions	(4,243)	(3,606)	(2,059)
Liabilities directly associated with assets held for sale	(407)	(525)	(8)
Other liabilities	(3,204)	(3,052)	(2,017)
Net asset employed	15,719	16,725	14,799
Cash and cash equivalents	1,766	2,334	1,939
Debt	(5,760)	(5,606)	(4,715)
Net debt ²⁾	(3,994)	(3,272)	(2,776)
Non-controlling interests	(118)	(907)	(24)
Shareholders' equity	(11,607)	(12,546)	(11,999)
Financing	(15,719)	(16,725)	(14,799)

¹⁾Please refer to Consolidated balance sheets

²⁾Non-IFRS financial measure. For the definition and reconciliation to the most directly comparable IFRS measure, refer to Reconciliation of non-IFRS information.

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3.1.9Debt position

Total debt outstanding at the end of 2017 was EUR 4,715 million, compared with EUR 5,606 million at the end of 2016.

Philips Group

Balance sheet changes in debt

in millions of EUR

2015 - 2017

	2015	2016	2017
New borrowings/repayments short-term debt	(1,241)	1,319	4
New borrowings long-term debt	(94)	(1,304)	(1,115)
Repayments long-term debt	104	362	1,332
Forward contracts			(1,018)
Currency effects, consolidation changes and other	(425)	(223)	347
Transfer to liabilities directly associated with assets held for sale			1,342
Changes in debt	(1,656)	154	891

In 2017, total debt decreased by EUR 891 million compared to 2016. New borrowings of long-term debt of EUR 1,115 million were mainly due to the issuance of EUR 500 million floating-rate bonds due 2019 and EUR 500 million fixed-rate bonds due 2023. Repayments of long-term debt amounted to EUR 1,332 million, mainly due to the early redemption of the 5.750% bonds due 2018 in the aggregate principal amount of USD 1,250 million. Payment obligations from forward contracts are mainly related to the EUR 1.5 billion share buyback program for capital reduction purposes announced on June 28, 2017 and are recorded as a financial liability under Long-term and Short-term debt. Other changes mainly resulting from consolidation and currency effects led to a decrease of EUR 347 million. EUR 1,342 million was transferred to Liabilities directly associated with assets held for sale, mainly Lighting debt.

In 2016, total debt decreased by EUR 154 million compared to 2015. New borrowings of EUR 1,304 million were mainly due to new loan facilities for Philips Lighting of EUR 740 million and USD 500 million to replace intragroup financing from Royal Philips. Repayments amounted to EUR 1,681 million, mainly due to the repayment of a USD 1,300 million bridge loan used for the Volcano acquisition, as well as the early redemption of USD 285 million in the aggregate principal amount of USD bonds. Other changes resulting from consolidation and currency effects led to an increase of EUR 223 million.

At the end of 2017, long-term debt as a proportion of the total debt stood at 86% with an average remaining term of 7.6 years, compared to 72% and 7.8 years at the end of 2016.

Total debt outstanding at the end of 2016 was EUR 5,606 million, compared with EUR 5,760 million at the end of 2015, a decrease of EUR 154 million.

In 2015, total debt increased by EUR 1,656 million. New borrowings of EUR 1,335 million were mainly due to a short-term bridging loan with low interest rate used for the Volcano acquisition, while repayments amounted to EUR 104 million. Other changes resulting from consolidation and currency effects led to an increase of EUR 425 million.

At the end of 2016, long-term debt as a proportion of the total debt stood at 72% with an average remaining term of 7.8 years, compared to 71% and 10.7 years at the end of 2015.

For further information, please refer to [Debt](#).

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3.1.10 Liquidity position

As of December 31, 2017, including the cash position (cash and cash equivalents), as well as its EUR 1 billion committed revolving credit facility, the Philips Group had access to available liquidity of EUR 2,939 million, versus Gross Debt (including short and long-term) of EUR 4,715 million.

As of December 31, 2016, including the cash position (cash and cash equivalents), as well as its then existing EUR 2.3 billion committed revolving credit facilities (including EUR 1.8 billion for Royal Philips and EUR 500 million for

Philips Lighting), the Philips Group had access to available liquidity of EUR 4,634 million, versus Gross Debt (including short and long-term) of EUR 5,606 million.

Philips Group
Liquidity position
in millions of EUR
2015 - 2017

	2015	2016	2017
Cash and cash equivalents	1,766	2,334	1,939
Committed revolving credit facilities/CP program/Bilateral loan	1,800	2,300	1,000
Liquidity	3,566	4,634	2,939
Available-for-sale financial assets at fair value	75	36	49
Short-term debt	(1,665)	(1,585)	(672)
Long-term debt	(4,095)	(4,021)	(4,044)
Net available liquidity resources	(2,119)	(936)	(1,728)

As at December 31, 2017, the reduction in net available liquidity resources compared to 2016 was mainly driven by the refinancing of the revolving credit facility and the transfer of the net liquidity of Philips Lighting (including cash and cash equivalents, short-term debt and long-term debt) into Discontinued operations.

Royal Philips has a EUR 1 billion committed revolving credit facility which was signed in April 2017 and will mature in April 2022. The facility can be used for general group purposes, such as a backstop of its Commercial Paper Programme.

The Commercial Paper Programme amounts to USD 2.5 billion, under which Royal Philips can issue commercial paper up to 364 days in tenor, both in the US and in Europe, in any major freely convertible currency. As of December 31, 2017, Royal Philips did not have any loans outstanding under these facilities.

Additionally, Philips held EUR 49 million of equity investments in available-for-sale financial assets (fair value at December 31, 2017). Refer to Other financial assets. Furthermore, Philips is also a shareholder in Philips Lighting (EUR 1,264 million at year-end 2017) which is publicly listed and classified as asset held for sale.

Royal Philips' existing long-term debt is rated A- (with stable outlook) by Fitch, Baa1 (with stable outlook) by Moody's, and BBB+ (with stable outlook) by Standard & Poor's. Our net debt¹⁾ position is managed in such a way that we seek to retain a strong investment grade credit rating. Furthermore, the Group's aim when managing the net debt¹⁾ position is dividend stability and a pay-out ratio of 40% to 50% of continuing net income after adjustments. Royal Philips' outstanding long-term debt and credit facilities do not contain financial covenants. Adverse changes in the Company's ratings will not trigger automatic withdrawal of committed credit facilities nor any acceleration in the outstanding long-term debt (provided that the USD-denominated bonds contain a 'Change of Control Triggering Event' and the EUR-denominated bonds contain a 'Change of Control Put Event'). A description of Philips' credit facilities can be found in Debt.

As at January 20, 2017, Philips early-redeemed the outstanding 5.750% bonds due 2018 having an aggregate principal amount of USD 1,250 million.

As at September 6, 2017, Philips successfully issued EUR 500 million floating-rate bonds due 2019 and EUR 500 million fixed-rate bonds due 2023. The net proceeds of the offering were used for the refinancing of the EUR 1 billion loan which was entered into for the purpose of financing the acquisition of Spectranetics and for general purposes.

Philips pools cash from subsidiaries to the extent legally and economically feasible. Cash not pooled remains available for local operational or investment needs. The company also faces cross-border foreign exchange controls and/or other legal restrictions in a few countries which could limit its ability to make these balances available on short notice for general use by the group.

Philips believes its current liquidity and direct access to capital markets is sufficient to meet its present financing requirements.

¹⁾Non-IFRS financial measure. For the definition and reconciliation to the most directly comparable IFRS measure, refer to [Reconciliation of non-IFRS information](#).

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3.1.11 Shareholders' equity

Shareholders' equity decreased by EUR 547 million in 2017 to EUR 11,999 million at December 31, 2017. The decrease was mainly due to the negative impact of currency translation differences of EUR 984 million, share repurchases made in the open market over the course of the year, the purchase of forward contracts of EUR 1,079 million, and dividend payments to shareholders of Koninklijke Philips N.V. of EUR 384 million (including tax and service charges). This was mainly offset by net results of EUR 1,870 million and the sale of Philips Lighting shares of EUR 327 million.

The number of outstanding common shares of Royal Philips at December 31, 2017 was 926 million (2016: 922 million). At the end of 2017, the Company held 14.7 million shares in treasury to cover the future delivery of shares (2016: 7.2 million shares). This was in connection with the 20.8 million rights outstanding at the end of 2017 (2016: 33.5 million rights) under the Company's long-term incentive plans. At the end of 2017, the Company held 4.6 million shares for cancellation (2016: 0 shares). In 2016, Philips purchased call options on Philips shares to hedge the majority of the options granted to employees until 2013. As of December 31, 2017 Philips held 6.3 million call options as a hedge of 6.8 million remaining options granted to employees. In order to hedge share buy-back commitments, Philips also entered into several forward contracts in 2017. The total of forward contracts amounted to EUR 1.1 billion in 2017, of which EUR 60 million matured in 2017.

Shareholders' equity increased by EUR 775 million in 2015 to EUR 11,607 million at December 31, 2015. The increase was mainly a result of EUR 624 million net income and EUR 791 million of other comprehensive income, partly offset by EUR 507 million related to the purchase of shares for the share buy-back program. The dividend payment to shareholders in 2015 reduced equity by EUR 298 million including tax and service charges, while the delivery of treasury shares increased equity by EUR 82 million and net share-based compensation plans increased equity by EUR 82 million.

The number of outstanding common shares of Royal Philips at December 31, 2015 was 917 million.

At the end of 2015, the Company held 11.8 million shares in treasury to cover the future delivery of shares. This was in connection with the 39.1 million rights outstanding at the end of 2015 under the Company's long-term incentive plans. At the end of 2015, the Company held 2.2 million shares for cancellation.

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3.1.12 Cash obligations

Contractual cash obligations

The table below presents a summary of the Group's fixed contractual cash obligations and commitments at December 31, 2017. These amounts are an estimate of future payments, which could change as a result of various factors such as a change in interest rates, contractual provisions, as well as changes in our business strategy and needs. Therefore, the actual payments made in future periods may vary from those presented in the table below:

Philips Group

Contractual cash obligations ^{1, 2)}

in millions of EUR

2017

	Payments due by period				
	total	less than 1 year	1-3 years	3-5 years	after 5 years
Long-term debt ³⁾	4,314	465	1,170	878	1,801
Finance lease obligations	306	93	131	53	29
Short-term debt	120	120			
Operating leases	741	172	226	147	196
Derivative liabilities	370	167	109		95
Interest on debt	1,785	132	252	226	1,175
Purchase obligations ⁴⁾	480	145	217	86	31
Trade and other payables	2,090	2,090			
Contractual cash obligations	10,205	3,383	2,105	1,389	3,328

¹Obligations in this table are undiscounted

²This table excludes pension contribution commitments and income tax liabilities in respect of tax risks because it is not possible to make a reasonably reliable estimate of the actual period of cash settlement

³Long-term debt includes short-term portion of long-term debt and excludes finance lease obligations

⁴Purchase obligations are agreements to purchase goods or services that are enforceable and legally binding for the Group. They specify all significant terms, including fixed or minimum quantities to be purchased, fixed, minimum or variable price provisions and the approximate timing of the transaction. They do not include open purchase orders or other commitments which do not specify all significant terms.

Philips has no material commitments for capital expenditures.

Certain Philips suppliers factor their trade receivables from Philips with third parties through supplier finance arrangements. At December 31, 2017 approximately EUR 286 million of the Philips accounts payable were known to have been sold onward under such arrangements whereby Philips confirms invoices. Philips continues to recognize these liabilities as trade payables and will settle the liabilities in line with the original payment terms of the related invoices.

Other cash commitments

The Company and its subsidiaries sponsor post-employment benefit plans in many countries in accordance with legal requirements, customs and the local situation in the countries involved. For a discussion of the plans and expected cash outflows, please refer to [Post-employment benefits](#).

The Company had EUR 112 million restructuring-related provisions by the end of 2017, of which EUR 87 million is expected to result in cash outflows in 2018. Refer to [Provisions](#) for details of restructuring provisions.

A proposal will be submitted to the upcoming Annual General Meeting of Shareholders to declare a dividend of EUR 0.80 per common share (up to EUR 750 million if all shareholders would elect cash), in cash or shares at the option of the shareholder, against the net income for 2017. Further details will be given in the agenda for the Annual General Meeting of Shareholders, to be held on May 3, 2018.

Guarantees

Philips' policy is to provide guarantees and other letters of support only in writing. Philips does not provide other forms of support. The total fair value of guarantees recognized on the balance sheet amounts to EUR nil million for both 2016 and 2017. Remaining off-balance-sheet business and credit-related guarantees provided on behalf of third parties and associates decreased by EUR 11 million during 2017 to EUR 17 million (December 31, 2016: EUR 28 million).

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3.1.13 Procurement

In spite of a challenging market environment, Philips came through with the 2017 procurement performance commitment. These results were driven by optimizing costs via various programs, including many DfX events, Total Cost of Ownership (TCO) programs and negotiations to secure the best possible outcome and overcome market headwinds.

Global growth is strengthening but the longer-term challenges remain. Policy stimulus supported the upturn, but the private investment recovery was modest. Continued reliance on credit to fund growth is heightening the risk of an eventual adjustment in China. In addition, a further shift toward protectionist policies in the US and a growing trend in Europe is a distinct threat. The currency risk remains in 2018 as the euro appreciated strongly against the US dollar

and Chinese renminbi in 2017. Geopolitical tensions, terrorism and the European challenge with refugees could also play a key role in the outlook in several economies.

The higher commodity market prices over the last year created a challenging environment for Philips. The situation in 2018 will remain the same or will be more challenging, judging by the continuation of the economic improvement, speculation on further pick-up in commodity demand, and actual material market price increases over 2017. The low price levels of raw materials and energy during the period 2015-2016 have led to reduced investment in future supply. This creates the risk of new headwinds once real consumption picks up significantly again and the supply-demand situation reverses.

The year 2016

In the first quarter of the year, global economic growth was running at its weakest pace in three years. In June, an additional threat to future growth came in the shape of Brexit, high credit growth, debt exposures in emerging markets and volatile financial markets.

Commodity prices continued to weaken at the start of 2016. Oil and metal prices fell to extreme lows on weaker global demand, especially due to the slowdown in manufacturing activity in China, but also because of increases in inventories and supply following the past (mining) investments. Market prices for steel, however, showed increases during 2016, driven by a steeper cost curve, a consolidated market as well as a more aggressive anti-dumping approach.

For commodities, the election of Donald Trump as US President spurred price gains as investors bet that demand for materials would pick up with a focus on infrastructure and further protectionism. However, actual consumption has not yet significantly increased for most materials and the influence of speculation is hard to determine.

Oil, copper, steel and other metals all surged by over 20% in the last few months of the year to the highest price levels since mid-2015, partly driven by additional Chinese fiscal stimulus in the form of public construction sector support and the acceleration of public-private partnership infrastructure projects.

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3.1.14 Real estate

Philips is present in more than 75 countries globally and has its corporate headquarters located in Amsterdam, the Netherlands. In 2017, we further increased the efficiency of our global Real Estate footprint by reducing the space provision by approximately 8%. Our real estate sites are spread across the globe, with key manufacturing and R&D sites in the Americas, Asia and Europe. As our company is very dynamic in streamlining and developing its business portfolio, the real estate activities go hand-in-hand with that. In 2017, we made several adjustments to our footprint in the US (i.e. Foster City Pittsburgh, Nashville Tennessee, and Cambridge Massachusetts), but also in India (i.e. Chennai, Bangalore) and China (i.e. Shanghai), to optimize our global business solutions. We also rightsized and upgraded our Paris and Warsaw offices in EMEA and started to build our global business solutions in India, Poland and the United States. To attract new R&D talent we grew locations in Foster City, Bangalore, Pittsburgh, Moscow and others. With all these adjustments we have established a better balanced real estate footprint globally, which also enables our businesses to be close to their customer base. The vast majority of our locations consist of leased property, and we manage these closely to keep the overall vacancy rates of our property below 3% and to ensure that the right level of space efficiency and flexibility is in place to follow our business developments. The net book value of our land and buildings as at December 31, 2017, represented EUR 584 million, and construction in progress represented EUR 31 million. Our current facilities are in generally good operating condition and are adequate to meet the requirements of our present and foreseeable future operations.

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3.1.13 Procurement

3.2 Social performance

We are a purpose-driven company, aiming to improve the lives of 3 billion people annually by 2025. Our people find this purpose powerful, drawing inspiration from the societal impact we achieve. We have a highly engaged and committed workforce; our employee engagement score is consistently above the high-performing norm of 69%, rising from 71% in 2015, to 76% this year.

Our people strategy supports a constantly evolving workforce, capable of delivering strong business performance and executing our strategy. As such we focus on our Workforce of the Future, and our deep commitment to Inclusion and Diversity across our workforce, supported by a Culture of Performance. The future will require a new type of networked organization, where teams dynamically draw from across the organization and unite around a common purpose.

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3.2.1 Improving people's lives

At Philips, we strive to make the world healthier and more sustainable through innovation. Our goal is to improve the lives of 3 billion people a year by 2025. To guide our efforts and measure our progress, we take a two-dimensional approach – social and ecological – to improving people's lives. Solutions from our portfolio that directly support the curative or preventive side of people's health determine the contribution to the social dimension. This is also our contribution to the UN Sustainable Development Goal 3 ("to ensure healthy lives and promote well-being for all at all ages"). As healthy ecosystems are also needed for people to live a healthy life, the contribution to the ecological dimension is determined by means of our steadily growing Green Solutions portfolio, such as our energy efficient products in our Personal Health businesses. This is our contribution to Sustainable Development Goal 12 ("to ensure sustainable consumption and production patterns").

Through Philips products and solutions that support people's health, we improved the lives of 1.34 billion people in 2017 (2016: 1.22 billion), driven by all segments. Our Green Solutions (including Philips Lighting) that contribute to a healthy ecosystem contributed 1.86 billion lives. After the elimination of double counts – people touched multiple times – we arrived at 2.2 billion lives. This is an increase of around 100 million compared to 2016, driven by all segments, mainly in China, India, and North America.

In 2014, Philips pledged to support the United Nation's Every Woman Every Child initiative, committing to improve the lives of at least 100 million women and children in Africa and South East Asia by 2025. At the United Nations General Assembly week in September 2017, Philips made an extended commitment to improve the lives of 300 million people in underserved healthcare communities by 2025. Philips thereby recognized the often critical needs of women and children in many communities, but also the added burden arising from the increase in non-communicable diseases (NCDs) in communities already struggling without adequate access to healthcare. To monitor our progress on the extended commitment, we use the same Lives Improved methodology and in 2017 we improved the lives of 153 million people in underserved markets (an increase of 16 million compared to 2016).

More information on this metric can be found in Methodology for calculating Lives Improved.

Lives Improved per market

To find out about our Lives Improved metric at global, regional and market level, go to <https://www.results.philips.com/#!/interactive-worldmap>

The following table shows the Lives Improved metric per market.

Philips Group
Lives Improved per market

Philips Group

Lives Improved per market

Market	Lives Improved (million) ¹⁾ ²⁾	Population (million) ³⁾	GDP (USD billion) ⁴⁾
Africa	54	1,210	2,353
ASEAN and the Pacific	246	961	6,213
Benelux	29	29	1,380
Central & East Europe	96	167	1,616
Germany, Austria and Switzerland	94	100	4,749
France	59	66	2,605
Greater China	477	1,422	12,852
Iberia	46	57	1,524
Indian subcontinent	216	1,531	2,799
Italy, Israel and Greece	55	82	2,508
Japan	38	127	4,884
Latin America	177	636	5,693
Middle East & Turkey	110	358	3,120
Nordics	26	27	1,541
North America	358	362	21,003
Russia and Central Asia	67	244	1,880
UK & Ireland	51	71	2,905

¹)Source: Philips, double counts eliminated

²)Includes Philips Lighting

³)Source: The World Bank, CIA Factbook & Wikipedia

⁴)Source: IMF, CIA Factbook & Wikipedia

Philips Group

Lives improved

in billions (includes Philips Lighting)

1.3
by Philips
Health Products
and Solutions

1.9
by Philips
Green Products

1.3
by Philips
Lighting

Total: 2.2 billion (double counts eliminated)

Double counts

Conceptual drawing, areas do not reflect actual proportions

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3.2.2 Workforce of the Future

Changing workforce demographics, the dynamic business environment and limited availability of strategic skill sets mean that we need to focus on building strategic capabilities that we can offer through location and work arrangements. In 2017 we deepened our Strategic workforce planning practices across our businesses, geographies, and functions and continue to expand on our strategic people's practices, alongside business strategy and financials.

In Q3 2017 we addressed holistic workforce management, bringing all contingent workers under the responsibility of the HR function and recognizing the significant contribution of the skills and competencies that contingent workers offer. In 2018 we will further manage workforce demand holistically through workforce modelling and talent intelligence, covering 100% of our workforce.

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3.2.3 Inclusion & Diversity

At Philips, we believe that our workforce should be a reflection of the society in which we operate, a reflection of our customers, and the markets we serve.

We value our full workforce in all aspects of diversity, whether generational, gender, experience, ethnicity, race, sexual orientation, ability, nationality, or other aspects, and believe that an inclusive culture invites a full spectrum of ideas, opinions, and experiences into the decision making.

We believe in fairness, that all individuals have the opportunity to be successful, to be heard and to be valued, without prejudice, and we will strive for this to be felt across Philips. We believe that an inclusive culture and diverse workforce correlates to high performance, and therefore consider improvements in Inclusion & Diversity as a key opportunity for sustainable improvements in business performance.

Fostering Inclusion & Diversity will bring deeper customer insight from a place of understanding, which enables faster and more targeted responses to market changes, ultimately contributing to our collective ability to work together to deliver improved value to our customers.

In 2017 we set a renewed and enhanced intention for Inclusion & Diversity with a number of activations; we set a target for 25% gender diversity of senior leadership by 2020 and provided dashboards for our HR leaders to be able to track diversity for their organizations. We partnered with a leading Inclusion & Diversity training provider to develop unconscious bias training, which will be delivered to our full workforce in 2018. We agreed principles of transparency for appointment and promotion opportunities, whereby we will transparently share open positions, and aim for diverse

candidate slates and diverse interview panels for the recruitment of all senior leadership positions. We enhanced our existing Inclusion & Diversity leadership offerings, increasing instances of our Senior Women's Leadership Program and piloted a Women's Leadership program focused toward emerging professionals. We also revitalized our existing employee resource groups and launched an Executive Inclusion and Diversity Committee.

Philips Group
Gender diversity
in %
2015 - 2017

Data insights

- 120+ nationalities bringing a rich diversity of capabilities, opinions and perspectives
- Gender diversity figures remained stable at 36% overall, with slight increases in the Staff, Professional and Management categories. Diversity of Executives dipped slightly from 19% to 18% female executives

I&D awards

We are delighted to be recognized externally for our inclusive culture externally. This year we achieved three awards in relation to our Life is better when #youareyou campaign, winning ‘Best media representation’ in Workday pride 2017, a Silver award in the category of ‘society’ at the SponsoRing awards, and a silver in the ‘integration award’ for identifying and engaging influencers in the WOMMA awards.

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3.2.4 Culture of Performance

We have made strong progress in increasing performance. However to succeed as the leading health technology company, we need to further improve how we work and step up all aspects of performance. Our strategy requires us to work together to deliver compelling solutions across the health continuum that bring true value to consumers and customers. Our current behaviors include; winning, taking ownership, teamwork and acting with integrity, yet we can sharpen our focus on customers, delivering with quality, acting fast, and being eager to improve. Living our desired Philips culture is foundational to succeeding in delivering on our vision, and to being the best company in health technology for people who share our passion.

We recognize and value inspiring and inclusive leaders, through smart assessment, development planning, leadership programs, and coaching and sponsoring our talent. In 2017, 87% of Executive-level appointments were internal. We expect to continue to see a low percentage of external hiring at Executive level, where we will increasingly aim to develop and promote our talent from within, complemented with targeted external hiring for critical competencies.

Realizing a culture of performance is grounded in proper people management practices, high quality feedback, transparency and acting on performance and talent outcomes. We will increase our focus on individuals being able to drive their own career, supporting our employees with automation and Artificial Intelligence. We will ensure transparency of opportunities, and fair and open HR processes.

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3.2.5 Employee engagement

High employee engagement is foundational to achieving our Philips health technology strategy. Our employee survey consistently reports high levels of employee engagement above the high performing norm of 69%, rising from 71% favorable in 2015 to 76% in 2017.

Philips Group
Employee Engagement Index
in %
2015 - 2017

¹2015 includes Philips Lighting

At Philips, we care for our people and believe that we are at our best when our team are at theirs. We understand work is only one part of life. That is why we offer a variety of innovative benefits and health programs to help keep our people mentally and physically strong, and foster flexibility to manage life's unexpected moments. We also continue to improve the employee journey, experience and value proposition, from attraction, through employment, development and progression, through to alumni. In 2017 we focused on improving candidate experience and onboarding experience, receiving a Glassdoor interview experience award.

Our quarterly employee survey supports us in keeping our finger on the pulse of employee sentiment toward the company, listening to employees' ideas for improvement, demonstrating to employees that their feedback is valued, and working to ensure that every member of our global team has a role in creating lasting value for our customers, shareholders, and other stakeholders.

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3.2.6 Employment

The year 2017

In 2017, we built out our health technology portfolio with acquisitions in key areas including image-guided therapy, healthcare consultancy, population health management, digital pathology, and sleep and respiratory care, growing our employee base by a further 1,798.

The total number of Philips Group employees (continuing operations) was 73,951 at the end of 2017, compared to 70,968 at the end of 2016, an increase of 2,983 employees. Following the sale of Lighting, Diagnosis & Treatment is now our largest employee segment with 35%, Personal Health at 31%, Connected Care & Health Informatics at 15% and 19% in HealthTech Other.

Philips Group

Employees per segment

in FTEs at year-end

2015 - 2017

	2015	2016	2017
Personal Health	21,384	22,530	23,170
Diagnosis & Treatment	23,638	23,791	25,757
Connected Care & Health Informatics	10,290	11,033	10,949
<i>HealthTech Other</i>	11,493	13,570	13,965
<i>Legacy Items</i>		43	109
Continuing operations	66,805	70,968	73,951
Discontinued operations	46,154	43,764	
Philips Group	112,959	114,731	73,951
Philips Group Employment in FTEs			

	2015	2016	2017
Balance as of January 1	113,678	112,959	114,731
Consolidation changes:			
Acquisitions	1,865	163	1,812
Divestments	(300)	(571)	(332)
Changes in Discontinued operations	442	753	(43763)
Other changes	(2,726)	1,427	1,502
Balance as of December 31	112,959	114,731	73,951

Further to net growth from acquisitions and divestments, we increased our employee base by 1,480 employees, driven by a 6% increase in comparable sales growth (CSG) ¹⁾ in our Personal Health businesses, an increased focus on Quality & Regulatory, and the transition period to our future Global Business Services operating model.

Geographic footprint

Approximately 62% of the Philips workforce are located in mature geographies and 38% in growth geographies. In 2017, the number of employees in mature geographies increased by 1,774, mainly due to the acquisitions of Spectranetics and others. The number of employees in growth geographies increased by 1,209, driven mainly by the Personal Health sales growth and Global Business Services program.

Philips Group
 Employees per geographic cluster
 in FTEs at year-end
 2015 - 2017

	2015	2016	2017
Western Europe	21,569	20,657	21,055
North America	19,151	19,828	20,937
Other mature geographies	3,592	3,695	3,962
Mature geographies	44,311	44,180	45,954
Growth geographies	22,494	26,788	27,997
Continuing operations	66,805	70,968	73,951
Discontinued operations	46,154	43,764	
Philips Group	112,959	114,731	73,951

Employee turnover

In 2017, employee turnover amounted to 13.6% (of which 8.2% was voluntary) compared to 16.0% (9.6% voluntary) in 2016. The lower turnover in 2017 reflects the increasing employee engagement and strength of our health technology strategy.

Philips Group
Employee turnover
in %
2017

	Staff	Profes-sionals	Manage-ment	Executives	Total
Female	19.2	11.3	10.9	21.4	15.0
Male	19.2	9.5	9.3	15.8	12.8
Philips Group	19.2	10.1	9.7	16.8	13.6

Philips Group
 Voluntary turnover
 in %
 2017

	Staff	Profes-sionals	Manage-ment	Executives	Total
Female	11.0	7.7	6.4	12.9	9.2
Male	11.5	5.9	4.4	5.2	7.7
Philips Group	11.3	6.5	4.9	6.6	8.2

¹)Non-IFRS financial measure. For the definition and reconciliation to the most directly comparable IFRS measure, refer to [Reconciliation of non-IFRS information](#).

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3.2.7 General Business Principles

The Philips General Business Principles (GBP) incorporate and represent the fundamental principles by which all Philips businesses and employees around the globe must abide. They set the minimum standard for business conduct, both for individual employees and for the company and our subsidiaries. Our GBP also serve as a reference for the business conduct we expect from our business partners and suppliers. Translations of the GBP text are available in 32 languages, allowing almost every employee to read the GBP in their native language. Detailed underlying policies, manuals, training, and tools are in place to give employees practical guidance on how to apply and uphold the GBP in their daily work environments. Details can be found at: www.philips.com/gbp.

In 2017, a total of 382 concerns were reported via the Philips Ethics Line and through our network of GBP Compliance Officers. The previous reporting period (2016) saw a total of 339 concerns, resulting in an increase of 13% in the number of reports.

This is a continuation of the upward trend reported since 2014, the year in which Philips updated its General Business Principles and deployed a strengthened global communication campaign. We believe this trend continues to be in line with our multi-year efforts to encourage our employees to speak up.

More information on the Philips GBP can be found in [Risk management](#). The results of the monitoring measures in place are given in [General Business Principles](#).

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3.2.8 Health and Safety

At Philips, we strive for an injury-free and illness-free work environment, with a focus on reducing the number of injuries and improving processes. As of 2016, the Total Recordable Cases (TRC) rate is defined as a Key Performance Indicator (KPI), on which we set yearly targets for the company, Business Groups and industrial sites. For data comparability reasons, we also provide the Lost Workday Injury Cases (LWIC) rate.

We recorded 234 TRCs in 2017, a small decrease compared to 239 in 2016. These are cases where an injured employee is unable to work for one or more days, had medical treatment, or sustained an industrial illness. We will continue to monitor this KPI and actively set reduction targets for all our businesses in 2018.

In 2017, we recorded 113 LWICs. These are occupational injury cases where an injured person is unable to work for one or more days after the injury. This represents a 10% increase compared with 103 in 2016. The LWIC rate increased to 0.17 per 100 FTEs in 2017, compared with 0.16 in 2016. The number of Lost Workdays caused by injuries increased by 965 days (30%) to 4,170 days in 2017, mainly caused by longer recovery periods related to a limited number of incidents.

For more information on Health and Safety, please refer to [Health and Safety performance](#).

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3.2.9 Working with stakeholders

In organizing ourselves around customers and markets, we conduct dialogues with our stakeholders in order to explore common ground for addressing societal challenges, building partnerships and jointly developing supporting ecosystems for our innovations around the world. An overview of stakeholders and topics discussed is provided in [Sustainability statements](#).

For more information on our stakeholder engagement activities in 2017, please refer to [Stakeholder engagement](#).

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3.2.10 Supplier sustainability

Royal Philips has a direct business relationship with approximately 4,600 product and component suppliers and 18,000 service providers. In many cases the sustainability issues deeper in our supply chain require us to intervene beyond tier 1 of the chain.

Supplier sustainability strategy

Managing our large and complex supply chain in a socially and environmentally responsible way requires a structured and innovative approach while being transparent and engaging with a wide variety of stakeholders. Insights gained through our regular stakeholder engagement process are used as an input to manage our supplier sustainability strategy.

Please refer to [Supplier indicators](#) and to the Philips supplier sustainability website for more details on the Philips supplier sustainability program.

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3.3 Environmental performance

Philips has a long sustainability history stretching all the way back to our founding fathers. In 1994, we launched our first program and set sustainability targets for our own operations. Next, we launched our second program in 1998, which focused on the environmental dimension of our operations and products. We also started to focus on sustainability in our supply chain in 2003. We extended our scope further in 2010 by including the social dimension of products and solutions, which is now reflected in our company vision:

We strive to make the world healthier and more sustainable through innovation. Our goal is to improve the lives of 3 billion people a year by 2025.

In 2016, our CEO Frans van Houten launched our new five-year sustainability program, 'Healthy people, sustainable planet', addressing both social and environmental challenges and including associated targets to be achieved by 2020.

The three pillars of the 'Healthy people, sustainable planet' program are:

- Creating value for our customers through **Sustainable Solutions**
- Leading by example in our **Sustainable Operations**
- Multiplying our impact by driving **Sustainability through our supply chain**

More details on the program, as well as the results in 2017, have been addressed in this report.

Every year, Royal Philips publishes a full Integrated Annual Report. Our independent auditor Ernst & Young (EY) has not only audited our financial information but has also provided reasonable (highest level) assurance on Sustainability Information in [Sustainability statements](#) and sections [Social performance](#) and [Environmental performance](#). Please refer to [Assurance report of the independent auditor](#). With this, Philips is a frontrunner in this field.

In this Environmental performance section an overview is given of the most important environmental parameters of the new program. Improving people's lives, Health and Safety, and Supplier Sustainability are addressed in the Social performance section. Details of the 'Healthy people, sustainable planet' parameters can be found in the [Sustainability statements](#).

Environmental impact

Philips has been performing Life-Cycle Assessment (LCAs) since the 1990s. These assessments provide insight into the environmental impacts of our products from cradle to grave, including the supply chain, manufacturing process at Philips, use phase and disposal phase. The insights are used to steer our EcoDesign efforts and to grow our Green solutions portfolio.

As a logical next step we have measured our environmental impact on society at large via a so-called Environmental Profit & Loss (EP&L) account which includes the hidden environmental costs associated with our activities and products, again from cradle to grave. It will support our 'Healthy people, sustainable planet' program by providing insights into the main environmental hotspots from an overall business point of view.

The EP&L account is based on LCA methodology in which the environmental impacts are expressed in monetary terms using conversion factors as developed by CE Delft. We used expert opinions and estimates for some parts of the calculations. The figures reported are Philips' best possible estimate. As we gain new insights and retrieve more and better data, we may enhance the methodology and accuracy of results in the future. For more information we refer to our methodology report.

The current EP&L account only includes the hidden environmental costs along the complete lifecycle of our products and solutions. It does not yet include the benefits to society that Philips generates by improving people's lives through our products and solutions, e.g. our healthcare or healthy food preparation solutions. We have a well-established methodology to calculate the number of lives we positively touch with our products and solution. It is our aim to look into valuing these societal benefits in monetary terms as well and include them in our future EP&L account, where possible.

Results 2017

In 2017, Philips had an environmental impact (loss) of EUR 7.2 billion of which EUR 200 million (3%) is directly caused by Philips' own operations, mainly driven by energy consumption at our factories. The main environmental impact, 86% of total, is related to the usage of our products which is due to electricity consumption. Particulate matter formation and climate change are the main environmental impacts accounting for respectively 43% and 28% of the total impact.

Philips
Environmental impact 2017
EUR 7.2 billion
Materials & components
Supply Chain

EUR 785 M

90%

Electronics

& metals

10%

Plastics

Share of materials/components

in environmental footprint

EUR 35 M

Business travelling

EUR 10 M

Philips

non-industrial sites

EUR 30 M

Philips industrial sites

EUR 130 M

Logistics

Customer

use phase

EUR 6.2 billion

EUR 10 M

Product disposal

Conceptual drawing, areas do not reflect actual proportions

The environmental loss includes the environmental impact of the full life-time of our products that we put on the market in 2017, e.g. an average 7 years of usage in case of a vacuum cleaner or 10 years on average in case of a MRI system.

The environmental loss has been positively influenced over the years by our efforts to increase the energy efficiency of our products. This will be enhanced by society's transition to a renewable energy system. We also expect a shift in our environmental impact from the use phase to our supply chain, i.e. the materials we use in our products. Our supply chain currently has an environmental impact of some EUR 800 million, which is 11% of our total environmental impact. The main contributors are the electronic components, cables and steel used in our products. Through our Circular Economy and Supplier Sustainability programs we will continue to focus on reducing the environmental impact caused by the materials we source and apply in our products.

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3.3.1 Green Innovation

Green Innovation is the Research & Development spend related to the development of new generations of Green Products and Solutions and Green Technologies.

Sustainable Innovation is the Research & Development spend related to the development of new generations of products and solutions that address the United Nations' Sustainable Development Goals 3 ("to ensure healthy lives and promote well-being for all at all ages") or 12 ("to ensure sustainable consumption and production patterns"). With regard to the latter, Philips set a target of EUR 7.5 billion (cumulative) for its health technology businesses for the period 2016 - 2020 as part of the 'Healthy people, sustainable planet' program.

In 2017, Philips invested EUR 233 million in Green Innovation while the health technology businesses invested some EUR 1.4 billion in Sustainable Innovation.

Philips Group
Green Innovation per segment
in millions of EUR
2015 - 2017

Diagnosis & Treatment businesses

Philips develops innovative diagnosis and treatment solutions that enable first-time right diagnosis, precision interventions and therapy, while respecting the boundaries of natural resources. Investments in Green Innovation in 2017 amounted to EUR 99 million, a decrease compared to 2016, as a number of large innovation projects had been completed in 2016. All Philips Green Focal Areas are taken into account as we aim to reduce environmental impact over the total lifecycle. Energy efficiency is an area of focus, especially for our large imaging systems such as MRI. Philips also pays particular attention to enabling the upgrading of pathways, so our customers can benefit from the most advanced enhancements in workflow, dose management, and imaging quality with the equipment that they already own which enables reduced materials use and lower cost. Our Diagnosis & Treatment businesses actively support a voluntary industry initiative to improve the energy efficiency of medical imaging equipment. Moreover, we are actively partnering with multiple leading care providers to look together for innovative ways to reduce the environmental impact of healthcare, for example by maximizing energy-efficient use of medical equipment and optimizing lifecycle value.