

KONINKLIJKE PHILIPS NV  
Form 20-F  
February 23, 2016  
Table of Contents

As filed with the Securities and Exchange Commission on February 23, 2016

**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, 2015**

**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 N.V.**

(Exact name of Registrant as specified in charter)

**ROYAL PHILIPS**

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(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**

(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:**

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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, 2015
Koninklijke Philips N.V.	931,130,387 shares, including
Common Shares par value EUR 0.20 per share	14,026,801 treasury shares

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.  Item 17  Item 18

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



## **Table of Contents**

### **IFRS basis of presentation**

The financial information included in this document is based on IFRS, as explained in note 1, 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).

### **Significant developments**

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. We have established a stand-alone structure for Philips Lighting within the Philips Group effective February 1, 2016. We expect to be able to announce the separation of the Lighting business in the first half of 2016, subject to market conditions and other relevant circumstances. As previously stated, we are reviewing all strategic options for Philips Lighting, including an initial public offering and a private sale.

It should however be noted that the completion of the separation could take more time than originally planned or anticipated and that there is no certainty as to the method or timing of the separation of the Lighting business, which may expose Philips to risks of additional cost and other adverse consequences. For further information on specific risks involved in the separation please refer to chapter 7, Risk management, of this report.

The separation impacts all businesses and markets as well as all supporting functions and all assets and liabilities of the Group. With effect from Q1 2016 onwards Philips plans to report and discuss its financial performance on the basis of different reportable segments than the sectors currently presented and discussed in this Annual Report. For more details on the new segment reporting in 2016 and onwards, please refer to the introduction of chapter 6, Sector performance, of this report.

As announced on January 22, 2016, the agreement pursuant to which the consortium led by GO Scale Capital would acquire an 80.1% interest in the combined businesses of Lumileds and Automotive, has been terminated. Philips is now actively engaging with other parties that have expressed an interest in the businesses and will continue to report the Lumileds and Automotive businesses as discontinued operations (see note 3, Discontinued operations and other assets classified as held for sale).

Further updates will be provided in the course of 2016.

Philips ArenaVision LED is the world's first LED pitch lighting to meet the stringent requirements of international television broadcasters and sports federations, ensuring a fantastic match experience, both for the fans in the stadium and those watching at home.

Increasingly, Philips is 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.

Contents

	<u>Introduction</u>	5
	<u>Forward-looking statements</u>	6
	<u>Use of non-GAAP information</u>	7
	<u>Form 20-F cross reference table</u>	8
1	<u>Performance highlights</u>	14
2	<u>Message from the CEO</u>	16
3	<u>Philips in 2015 at a glance</u>	19
4	<u>Our strategic focus</u>	20
4.1	<u>Addressing global challenges</u>	20
4.2	<u>How we create value</u>	22
4.3	<u>Accelerate! journey continues</u>	24
4.4	<u>Lives improved</u>	25
4.5	<u>Global presence</u>	25
4.6	<u>Our strategy in action</u>	26
5	<u>Group performance</u>	33
5.1	<u>Financial performance</u>	33
5.2	<u>Social performance</u>	51
5.3	<u>Environmental performance</u>	57
5.4	<u>Proposed distribution to shareholders</u>	62
5.5	<u>Outlook</u>	63
5.6	<u>Critical accounting policies</u>	64
6	<u>Sector performance</u>	66
6.1	<u>Healthcare</u>	67
6.2	<u>Consumer Lifestyle</u>	73
6.3	<u>Lighting</u>	77
6.4	<u>Innovation, Group &amp; Services</u>	83
7	<u>Risk management</u>	88
7.1	<u>Our approach to risk management and business control</u>	88
7.2	<u>Risk categories and factors</u>	91
7.3	<u>Strategic risks</u>	92
7.4	<u>Operational risks</u>	93
7.5	<u>Compliance risks</u>	95
7.6	<u>Financial risks</u>	96
7.7	<u>Separation risk</u>	97
8	<u>Management</u>	99
9	<u>Supervisory Board</u>	101
10	<u>Supervisory Board report</u>	103
10.1	<u>Report of the Corporate Governance and Nomination &amp; Selection Committee</u>	106
10.2	<u>Report of the Remuneration Committee</u>	107
10.3	<u>Report of the Audit Committee</u>	112



**Table of Contents**

11	<u>Corporate governance</u>	114
11.1	<u>Board of Management</u>	114
11.2	<u>Supervisory Board</u>	118
11.3	<u>General Meeting of Shareholders</u>	122
11.4	<u>Meeting logistics and other information</u>	123
11.5	<u>Investor Relations</u>	126
11.6	<u>Additional information</u>	127
12	<u>Group financial statements</u>	131
12.1	<u>Management's report on internal control</u>	132
12.2	<u>Report of the independent auditor</u>	132
12.3	<u>Independent auditors' reports on the consolidated financial statements and on internal control over financial reporting</u>	133
12.4	<u>Consolidated statements of income</u>	135
12.5	<u>Consolidated statements of comprehensive income</u>	136
12.6	<u>Consolidated balance sheets</u>	137
12.7	<u>Consolidated statements of cash flows</u>	139
12.8	<u>Consolidated statements of changes in equity</u>	140
12.9	<u>Notes</u>	141
	<u>General, sector and main countries information</u>	
	<u>Significant accounting policies</u>	141
	<u>Information by sector and main country</u>	152
	<u>Discontinued operations and other assets classified as held for sale</u>	154
	<u>Acquisitions and divestments</u>	155
	<u>Interests in entities</u>	156
	<u>Notes related to the income statement</u>	
	<u>Income from operations</u>	157
	<u>Financial income and expenses</u>	159
	<u>Income taxes</u>	160
	<u>Earnings per share</u>	163
	<u>Notes related to the balance sheet</u>	
	<u>Property, plant and equipment</u>	164
	<u>Goodwill</u>	165
	<u>Intangible assets excluding goodwill</u>	167
	<u>Other financial assets</u>	168
	<u>Other assets</u>	169
	<u>Inventories</u>	169
	<u>Receivables</u>	169
	<u>Equity</u>	169
	<u>Debt</u>	172
	<u>Provisions</u>	173
	<u>Post-employment benefits</u>	176
	<u>Accrued liabilities</u>	181
	<u>Other liabilities</u>	181
	<u>Notes related to the cash flow statement</u>	
	<u>Cash used for derivatives and current financial assets</u>	182
	<u>Purchase and proceeds from non-current financial assets</u>	182
	<u>Other notes</u>	
	<u>Contractual obligations</u>	182
	<u>Contingent assets and liabilities</u>	183
	<u>Related-party transactions</u>	186
	<u>Share-based compensation</u>	186



<u>Information on remuneration</u>	189
<u>Fair value of financial assets and liabilities</u>	192
<u>Details of treasury / other financial risks</u>	195
<u>Subsequent events</u>	199
<b>13 <u>Company financial statements</u></b>	<b>200</b>
13.1 <u>Balance sheets before appropriation of results</u>	201
13.2 <u>Statements of income</u>	202
13.3 <u>Statement of changes in equity</u>	202
13.4 <u>Notes</u>	203
<u>Net income</u>	203
<u>Audit fees</u>	203
<u>Intangible assets</u>	203
<u>Financial fixed assets</u>	203
<u>Other financial assets</u>	204
<u>Receivables</u>	204
<u>Shareholders' equity</u>	204
<u>Debt</u>	206
<u>Other current liabilities</u>	206
<u>Employees</u>	206
<u>Contractual obligations and contingent liabilities not appearing in the balance sheet</u>	206
<u>Subsequent events</u>	206
13.5 <u>Independent auditor's report</u>	207
<b>14 <u>Sustainability statements</u></b>	<b>213</b>
14.1 <u>Economic indicators</u>	219
14.2 <u>Social statements</u>	219
14.3 <u>Environmental statements</u>	231
14.4 <u>Independent Auditor's Assurance Report</u>	237
14.5 <u>Global Reporting Initiative (GRI) table 4.0</u>	238
<b>15 <u>Reconciliation of non-GAAP information</u></b>	<b>249</b>
<b>16 <u>Five-year overview</u></b>	<b>253</b>
16.1 <u>Five-year overview (condensed)</u>	255
<b>17 <u>Investor Relations</u></b>	<b>257</b>
17.1 <u>Key financials and dividend</u>	257
17.2 <u>Share information</u>	259
17.3 <u>Philips' rating</u>	261
17.4 <u>Performance in relation to market indices</u>	261
17.5 <u>Financial calendar</u>	264
17.6 <u>Investor contact</u>	264
17.7 <u>Taxation</u>	266
17.8 <u>New York Registry Shares</u>	269
<b>18 <u>Definitions and abbreviations</u></b>	<b>270</b>

---

**Table of Contents**

19	<u>Exhibits</u>	272
19.1	<u>Index of exhibits</u>	272
19.2	<u>Signatures</u>	273
19.3	Exhibits	274
19.4	Exhibit 1 English translation of the Articles of Association of the Company	275
19.5	Exhibit 4 (a) Services contract between the Company and Mr F.A. van Houten	289
19.6	Exhibit 4 (b) Services contract between the Company and Mr A. Bhattacharya	294
19.7	Exhibit 4 (c) Services contract between the Company and Mr P.A.J. Nota	299
19.8	Exhibit 7	304
19.9	Exhibit 8 List of subsidiaries	305
19.10	Exhibit 12 (a) Certification	314
19.11	Exhibit 12 (b) Certification	315
19.12	Exhibit 13 (a)	316
19.13	Exhibit 13 (b)	317
19.14	Exhibit 15 (a)	318
19.15	Exhibit 15 (b) Letter of KPMG relating to disclosure under Item 16F	319
19.16	Exhibit 15 (c)	320

4 Annual Report 2015

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**Table of Contents**

**[Introduction](#)**

**[Introduction](#)**

This document contains information required for the Annual Report on Form 20-F for the year ended December 31, 2015 of Koninklijke Philips N.V. (the 2015 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, the cautionary statement forward-looking statements and explanation on use of non-GAAP information on the next three 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 2015 Form 20-F and is furnished to the Securities and Exchange Commission for information only.

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

**IFRS based information**

The audited consolidated financial statements as of December 31, 2015 and 2014, and for each of the years in the three-year period ended December 31, 2015, included in the 2015 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 2015 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.

**Non-GAAP information**

In presenting and discussing the Philips Group's financial position, operating results and cash flows, management uses certain non-GAAP financial measures such as: comparable growth; adjusted income from operations; net operating capital; net debt; cash flow before financing activities; net capital expenditures and free cash flow. These non-GAAP 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 measure(s). Reference is made to the section titled Use of non-GAAP information for further 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 2015 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.

**Fair value information**

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 do not exist, fair values are estimated using valuation models, which we believe are appropriate for their purpose. They 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 2015 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

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public reference rooms and their copy charges. Philips SEC filings are also publicly available through the SEC's website at [www.sec.gov](http://www.sec.gov).

For definitions and abbreviations reference is made to chapter 18, Definitions and abbreviations, of this report.

Annual Report 2015 5

## **Table of Contents**

### **Introduction**

### **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 disclosures 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 their nature, forward-looking statements involve risk and uncertainty, because they relate to events that depend on circumstances that will occur in the future. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking 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, changes in exchange and interest rates, changes in tax rates, 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 the Lighting business and the Lumileds and Automotive business.

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.

**Table of Contents****Introduction****Use of non-GAAP information**

Koninklijke Philips N.V. believes that an understanding of sales performance is enhanced when the effects of currency movements and acquisitions and divestments (changes in consolidation) are excluded. Accordingly, in addition to presenting nominal sales growth, comparable sales growth is provided.

Comparable sales exclude the effects of currency movements and changes in consolidation. As indicated in the note 1, Significant accounting policies, sales and income are translated from foreign currencies into the Company's reporting currency, the euro, at the exchange rate on transaction dates during the respective years. As a result of significant currency movements during the years presented, the effects of translating foreign currency sales amounts into euros could have a material impact. Therefore, these impacts have been excluded in arriving at the comparable sales in euros. Currency effects have been calculated by translating previous years' foreign currency sales amounts into euros at the following year's exchange rates in comparison with the sales in euros as historically reported. The years under review were characterized by a number of acquisitions and divestments, as a result of which activities were consolidated or deconsolidated. The effect of consolidation changes has also been excluded in arriving at the comparable sales. For the purpose of calculating comparable sales, when a previously consolidated entity is sold or contributed to a venture that is not consolidated by the Company, relevant sales are excluded from impacted prior-year periods. Similarly, when an entity is acquired, relevant sales are excluded from impacted periods.

Philips discusses adjusted income from operations in the 2015 Form 20-F. Adjusted income from operations represents income from operations before amortization and impairment of intangible assets generated in acquisitions (excluding software and capitalized development expenses).

The Company uses the term adjusted income from operations to evaluate the performance of the Philips Group and its sectors. Referencing adjusted income from operations is considered appropriate in light of the following:

Philips has announced that one of its strategic drivers is to increase profitability through re-allocation of its resources towards opportunities offering more consistent and higher returns. Moreover, Philips intends to redeploy capital through value-creating acquisitions. Since 2006, management has used the adjusted income from operations measurement internally to monitor performance of the businesses on a comparable basis. As of 2007, Philips has also set external performance targets based on this measurement as it will not be distorted by the unpredictable effects of future, unidentified acquisitions.

Philips believes that an understanding of the Group's financial condition is enhanced by the disclosure of net operating capital (NOC), as this figure is used by Philips' management to evaluate the capital efficiency of the Philips Group and its operating sectors. NOC is defined as: total assets excluding assets classified as held for sale less: (a) cash and cash equivalents, (b) deferred tax assets, (c) other non-current financial assets and current financial assets, (d) investments in associates, and after deduction of: (e) provisions, (f) accounts and notes payable, (g) accrued liabilities, (h) other non-current liabilities and other current liabilities.

Net debt is defined as the sum of long- and short-term debt minus cash and cash equivalents. The net debt position as a percentage of the sum of group equity (shareholders' equity and non-controlling interests) and net debt is presented to express the financial strength of the Company. This measure is widely used by management and investment analysts and is therefore included in the disclosure.

Cash flows before financing activities, being the sum total of net cash from operating activities and net cash from investing activities, and free cash flow, being net cash from operating activities minus net capital expenditures, are presented separately to facilitate the reader's understanding of the Company's funding requirements.

Net capital expenditures comprise of purchase of intangible assets, proceeds from sale of intangible assets, expenditures on development assets, capital expenditures on property, plant and equipment and proceeds from disposals of property, plant and equipment. This measure is widely used by management to calculate free cash flow.

**Table of Contents**

**Form 20-F cross reference table**

**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, the cautionary statements concerning Forward-looking statements and explanation on use of non-GAAP information, of this report on pages 5-7, 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 2015 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 2015 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 includes the starting page of the section/ paragraph for reference only.

8 Annual Report 2015

**Table of Contents**

Form 20-F cross reference table

Item	Form 20-F caption	Location in this document	Page
<b>Part 1</b>			
1	<b>Identity of directors, senior management and advisors</b>	<i>Not applicable</i>	
2	<b>Offer statistics and expected timetable</b>	<i>Not applicable</i>	
3	<b>Key information</b>		
	A Selected financial data	16.1. Five-year overview (condensed)	255
		17.1. Key financials and dividend - Proposed distribution	257
		17.1. Key financials and dividend - Information for investors in New York Registry shares program	257
	B Capitalization and indebtedness	<i>Not applicable</i>	
	C Reason for the offer and use of proceeds	<i>Not applicable</i>	
	D Risk factors	7.2. Risk categories and factors - <i>Second paragraph</i>	91
		7.3. Strategic risks	92
		7.4. Operational risks	93
		7.5. Compliance risks	95
		7.6. Financial risks	96
		7.7. Separation risk	97
4	<b>Information on the Company</b>		
	A History and development of the company	Contents - Significant developments	2
		5.1.6. Restructuring and impairment charges	40
		5.1.11. Discontinued operations	43
		5.1.13. Acquisitions and divestments	43
		5.1.15. Cash flows provided by continuing operations	45
		6. Sector performance - Our structure in 2015 & 2016 and beyond	66
		11. Corporate governance - Corporate governance of the Philips Group - Introduction	114
		11.5. Investor Relations - Corporate seat and head office	126
		Note 3 Discontinued operations and other assets classified as held for sale	154
		Note 4 Acquisitions and divestments	155
		Note 32 Subsequent events	199
		17.6. Investor contact - How to reach us	264
	B Business Overview	Introduction - Third-party market share data	5
		5.1. Financial performance- from 5.1.1 to 5.1.2 and from 5.1.4 to 5.1.14	33
		5.1.24. Procurement	51
		5.2.10. Addressing issues deeper in the supply chain	57
		6. Sector performance - Our structure in 2015	66
		6.1.2. About Healthcare in 2015	68
		6.1.4. 2015 financial performance	70
		6.2.2. About Consumer Lifestyle in 2015	74
		6.2.4. 2015 financial performance	75
		6.3.2. About Lighting in 2015	78
		6.3.4. 2015 financial performance	79



## Edgar Filing: KONINKLIJKE PHILIPS NV - Form 20-F

	6.4.1. About Innovation, Group & Services in 2015	83
	6.4.2. 2015 financial performance	86
	7.1. Our approach to risk management and business control	88
	7.3. Strategic risks- <i>Last paragraph</i>	92
	7.4. Operational risks - <i>Third &amp; fourth paragraph</i>	93
	7.5. Compliance risks	95
	11. Corporate governance- Corporate governance of the Philips Group - Introduction	114
	Note 2 Information by sector and main country	152
	14.2.8. Supplier indicators - Responsible Sourcing of Minerals: Addressing issues deeper in the supply chain	225
	18. Definitions and abbreviations	270
C Organizational structure	6. Sector performance - Our structure in 2015	66
	Note 2 Information by sector and main country	152

Annual Report 2015 9

**Table of Contents****Form 20-F cross reference table**

<b>Item</b>	<b>Form 20-F caption</b>	<b>Location in this document</b>	<b>Page</b>
		Note 5 Interests in entities	156
		19.9. Exhibit 8 List of subsidiaries	305
	D Property, plant and equipment	Note 2 Information by sector and main country	152
		Note 10 Property, plant and equipment	164
		Note 19 Provisions - Environmental provisions	173
		Note 25 Contractual obligations	182
		Note 26 Contingent assets and liabilities - Contingent liabilities - Environmental remediation	183
<b>4A</b>	<b>Unresolved staff comments</b>	<i>Not applicable</i>	
<b>5</b>	<b>Operating and financial review and prospects</b>		
	A Operating results	Use of non-GAAP information	7
		5.1. Financial performance- Management summary	33
		5.1. Financial performance - from 5.1.1 to 5.1.2 and from 5.1.4 to 5.1.14	33
		6.1.2. About Healthcare in 2015 - Regulatory requirements	68
		6.1.4. 2015 financial performance	70
		6.2.2. About Consumer Lifestyle in 2015 - Regulatory requirements	74
		6.2.4. 2015 financial performance	75
		6.3.2. About Lighting in 2015 - Regulatory requirements	78
		6.3.4. 2015 financial performance	79
		6.4.2. 2015 financial performance	86
		5.6. Critical accounting policies	64
		Note 3 Discontinued operations and other assets classified as held for sale	154
		Note 4 Acquisitions and divestments	155
		Note 6 Income from operations	157
		Note 7 Financial income and expenses	159
		Note 11 Goodwill	165
		Note 12 Intangible assets excluding goodwill	167
		Note 31 Details of treasury / other financial risks	195
		7.3. Strategic risks	92
		7.4. Operational risks	93
		7.5. Compliance risks	95
		7.6. Financial risks	96
		7.7. Separation risk	97
		15. Reconciliation of non-GAAP information	249
	B Liquidity and capital resources	5.1. Financial performance - from 5.1.15 to 5.1.23	33
		Note 17 Equity	169
		Note 18 Debt	172
		Note 25 Contractual obligations	182
		Note 31 Details of treasury / other financial risks	195
	C Research and development, patents and licenses, etc.	5.1.4. Research and development	39
		6.4.1. About Innovation, Group & Services in 2015	83
	D Trend information	5.5. Outlook	63
	E Off-balance sheet arrangements	5.1.23. Cash obligations	50

## Edgar Filing: KONINKLIJKE PHILIPS NV - Form 20-F

	Note 25 Contractual obligations	182
	Note 26 Contingent assets and liabilities	183
	Note 31 Details of treasury / other financial risks	195
F Tabular disclosure of contractual obligations	5.1.23. Cash obligations	50
	Note 25 Contractual obligations	182
G Safe Harbor	Forward-looking statements	6
10	Annual Report 2015	

**Table of Contents**

Form 20-F cross reference table

Item	Form 20-F caption	Location in this document	Page
<b>6</b>	<b>Directors, senior management and employees</b>		
	A Directors and senior management	8. Management	99
		9. Supervisory Board	101
		11.1. Board of Management - Introduction	114
		11.1. Board of Management - (Term of) Appointment and conflicts of interest	114
		11.2. Supervisory Board - (Term of) Appointment, individual data and conflicts of interests	118
	B Compensation	Note 20 Post-employment benefits	176
		Note 28 Share-based compensation	186
		Note 29 Information on remuneration	189
		10.2. Report of the Remuneration Committee	107
	C Board practices	8. Management	99
		9. Supervisory Board	101
		10. Supervisory Board report	103
		11.1. Board of Management	114
		11.2. Supervisory Board	118
		11.4. Meeting logistics and other information - Internal controls and disclosure policies	123
		11.4. Meeting logistics and other information - Auditor information	123
	D Employees	5.2.4. Employment	54
		Note 6 Income from operations - Employees	157
	E Share ownership	11.1. Board of Management- Amount and composition of the remuneration of the Board of Management	114
		Note 17 Equity	169
		Note 28 Share-based compensation	186
		Note 29 Information on remuneration	189
<b>7</b>	<b>Major shareholders and related party transactions</b>		
	A Major shareholders	11.5. Investor Relations - Major shareholders and other information for shareholders	126
		11.6. Additional information - Articles of association	127
		17.2. Share information	259
	B Related party transactions	11.1. Board of Management	114
		Note 5 Interests in entities	156
		Note 27 Related-party transactions	186
	C Interests of experts and counsel	<i>Not applicable</i>	
<b>8</b>	<b>Financial information</b>		
	A Consolidated statements and other financial information	12. Group financial statements - from 12.4 to 12.9	131

Edgar Filing: KONINKLIJKE PHILIPS NV - Form 20-F

	17.1. Key financials and dividend - Dividend policy	257
B Significant changes	Note 32 Subsequent events	199
<b>9 The offer and listing</b>		
A Offer and listing details	17.4. Performance in relation to market indices	261
B Plan of distribution	<i>Not applicable</i>	
C Markets	17.4. Performance in relation to market indices	261
D Selling shareholders	<i>Not applicable</i>	

Annual Report 2015 11

**Table of Contents****Form 20-F cross reference table**

<b>Item</b>	<b>Form 20-F caption</b>	<b>Location in this document</b>	<b>Page</b>
	E Dilution	<i>Not applicable</i>	
<b>10</b>	<b>F Expense of the issue Additional information</b>	<i>Not applicable</i>	
	A Share capital	<i>Not applicable</i>	
	B Memorandum and articles of association	11.1. Board of Management - (Term of) Appointment and conflicts of interest	114
		11.2. Supervisory Board - (Term of) Appointment, individual data and conflicts of interest	118
		11.3. General Meeting of Shareholders - Main powers of the General Meeting of Shareholders	122
		11.4. Meeting logistics and other information	123
		11.6. Additional information - Articles of association	127
		19.1. Index of exhibits - Exhibit 1	272
	C Material contracts	10.2.2. Contracts for the provision of services	107
		19.1. Index of exhibits - Exhibit 4 (a), (b) and (c)	272
	D Exchange controls	11.6. Additional information- Exchange controls	127
	E Taxation	17.7. Taxation	266
	F Dividends and paying agents	<i>Not applicable</i>	
	G Statements by experts	<i>Not applicable</i>	
	H Documents on display	Introduction - Documents on display	5
	I Subsidiary information	<i>Not applicable</i>	
<b>11</b>	<b>Quantitative and qualitative disclosure about market risk</b>		
	A Quantitative information about market risk	Note 31 Details of treasury / other financial risks	195
	B Qualitative information about market risk	Note 31 Details of treasury / other financial risks	195
	C Interim periods	<i>Not applicable</i>	
	D Safe harbor	Note 31 Details of treasury / other financial risks Forward-looking statements	195 6
	E Small business issuers	<i>Not applicable</i>	

**Description of securities other than equity securities**

A Debt securities	<i>Not applicable</i>	
B Warranty and rights	<i>Not applicable</i>	
C Other securities	<i>Not applicable</i>	
D American depository shares	17.8. New York Registry Shares	269

**Part 2**

<b>13</b>	<b>Defaults, dividend arrearages and delinquencies</b>	<i>Not applicable</i>
-----------	--	-----------------------

12 Annual Report 2015

**Table of Contents****Form 20-F cross reference table**

<b>Item</b>	<b>Form 20-F caption</b>	<b>Location in this document</b>	<b>Page</b>
<b>14</b>	<b>Material modifications to the rights of security holders and use of proceeds</b>	<i>Not applicable</i>	
<b>15</b>	<b>Controls and procedures</b>		
	A Disclosure controls and procedures	12.1.1. Disclosure controls and procedures	132
	B Management Annual Report on internal control over financial reporting	12.1. Management's report on internal control	132
	C Attestation report of the registered public accounting firm	12.3.2. Independent auditors' report on internal control over financial reporting	134
	D Changes in internal control over financial reporting	12.1.2. Changes in internal control over financial reporting	132
<b>16A</b>	<b>Audit Committee Financial Expert</b>	11.2. Supervisory Board - The Audit Committee	118
<b>16B</b>	<b>Code of Ethics</b>	7.1. Our approach to risk management and business control - Financial Code of Ethics	88
<b>16C</b>	<b>Principal Accountant Fees and Services</b>	10.3. Report of the Audit Committee	112
		11.4. Meeting logistics and other information - Auditor policy	123
		Note 6 Income from operations - Audit fees	157
<b>16D</b>	<b>Exemptions from the Listing Standards for Audit Committees</b>	<i>Not applicable</i>	
<b>16E</b>	<b>Purchases of Equity Securities by the Issuer and Affiliated Purchasers</b>	11.3. General Meeting of Shareholders - Repurchase and issue of (rights to) own shares	122
		17.2. Share information - Share repurchase programs for capital reduction purposes	259
<b>16F</b>	<b>Change in Registrant's Certifying Accountant</b>	11.6. Additional information - Change in Registrant's Certifying Accountant	127
<b>16G</b>	<b>Corporate Governance</b>	11. Corporate governance - Corporate governance of the Philips Group - Introduction	114
		11.6. Additional information - General	128
		11.6. Additional information - Board structure	128
		11.6. Additional information - Independence of members of our Supervisory Board	128
		11.6. Additional information - Committees of our Supervisory Board	128
		11.6. Additional information - Equity compensation plans	129
		11.6. Additional information - Code of business conduct	129
<b>16H</b>	<b>Mine Safety Disclosure</b>	<i>Not applicable</i>	
<b>Part 3</b>			
<b>17</b>	<b>Financial statements</b>	<i>Not applicable</i>	
<b>18</b>	<b>Financial statements</b>	12. Group financial statements - from 12.4 to 12.9	131
<b>19</b>	<b>Exhibits</b>	19.1. Index of exhibits	272



**Table of Contents**

## Performance highlights 1

## 1 Performance highlights

Philips Group

**Key data** in millions of EUR unless otherwise stated

2014 - 2015

	<b>2014</b>	<b>2015</b>
Sales	21,391	24,244
Comparable sales growth	(1)%	2%
Adjusted IFO	821	1,372
<i>as a % of sales</i>	<i>3.8%</i>	<i>5.7%</i>
IFO	486	992
<i>as a % of sales</i>	<i>2.3%</i>	<i>4.1%</i>
Net income	411	659
Net income attributable to shareholders per common share in EUR:		
basic	0.45	0.70
diluted	0.45	0.70
Net operating capital	8,838	11,096
Free cash flow	497	325
Shareholders' equity	10,867	11,662
Employees at December 31	113,678	112,959
continuing operations	105,365	104,204
discontinued operations	8,313	8,755

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**Performance** in millions of EUR unless otherwise stated

2014 - 2015

	2014	Group 2015		2014	Healthcare 2015		2014	Consumer Lifestyle 2015		2014	Lighting 2015	
Sales	21,391	24,244	13%	9,186	10,912	19%	4,731	5,347	13%	6,869	7,411	8%
Green Product sales	11,065	13,014	18%	3,508	4,580	31%	2,605	3,091	19%	4,952	5,343	8%
Sales in mature geographies <sup>1)</sup>	14,004	15,836	13%	6,890	8,207	19%	2,508	2,784	11%	4,182	4,425	6%
Sales in growth geographies <sup>1)</sup>	7,387	8,408	14%	2,296	2,705	18%	2,223	2,563	15%	2,687	2,986	11%
Adjusted IFO	821	1,372	67%	616	1,024	66%	573	673	17%	293	594	103%
Net operating capital	8,838	11,096	26%	7,565	9,212	22%	1,353	1,453	7%	3,638	3,813	5%

<sup>1)</sup> For a definition of mature and growth geographies see chapter 18, Definitions and abbreviations, of this report

**Table of Contents**

[Performance highlights](#) 1

[Annual Report 2015](#) 15

## **Table of Contents**

[Message from the CEO 2](#)

[2 Message from the CEO](#)

After separating, Philips will focus on driving higher growth and higher value from its core activities in the field of health technology, and Lighting will have a great future as a stand-alone company. Frans van Houten, CEO Royal Philips

### **Dear stakeholder,**

2015 was a crucial year for Philips as we restored growth and improved productivity. We also took the decisive next step in our Accelerate! transformation – separating out our Lighting business and moving away from a diversified holding structure to create two stand-alone companies, each with their own clearly defined strategic direction and focus. We believe this is the best way to create lasting value for our customers and shareholders and a bright future for our employees.

Given the major challenges the world faces, for instance in terms of population health management, energy resource constraints and climate change, we see significant opportunities for the two companies – both leveraging the trusted Philips brand – to apply their innovative competencies and capture higher growth in attractive end-markets, which are very much in a state of transition.

### **Two companies with a bright future**

Philips will focus on the exciting opportunities in the area of health technology, delivering meaningful innovation to improve people's lives across the health continuum – through new, more integrated forms of care delivery.

With an expanding and aging population, the rise of chronic diseases, and global resource constraints, health systems all over the world are under tremendous pressure. At the same time, more and more people are keen to take an active role in managing their own health. And digital technology, whilst bringing vast new opportunities, is shifting value from devices to software and services. All of this is driving the convergence of professional healthcare and consumer end-markets.

By leveraging our advanced technology, deep clinical and consumer insights, long-standing customer relationships, our new HealthSuite digital cloud platform, and integrated solutions portfolio, we can improve people's health and enable better outcomes at lower cost across the health continuum.

16 Annual Report 2015

---

**Table of Contents**

[Message from the CEO 2](#)

In the field of lighting, the industry is undergoing a radical transformation. Population growth and urbanization are increasing demand for light, specifically energy-efficient light. At the same time, the rapid rise of LED and the mass adoption of digital technology are driving a shift towards connected lighting. With connected lighting, the lighting fixtures not only provide high-quality illumination, but are also fitted with sensors and connected to the building's IT network infrastructure, forming an information pathway. This is opening up new applications where we can deliver extraordinary value beyond illumination, also via new service-based business models.

As a more agile, stand-alone company with direct access to capital markets, we believe that our Lighting business will be better able to strengthen its position as the world leader in lighting solutions, boost scale and capture growth.

**2015 a year of solid progress**

Amidst all this transformation, it was vital that we improved our performance in 2015, giving our customers the product and service innovation they expect.

Overall, 2015 was a solid year for Philips, in which we recorded consistent performance improvements in the face of challenging economic conditions. Sales were up 2% on a comparable basis, driven by 4.5% growth in our HealthTech portfolio. Profitability also increased thanks to the improved operational performance, overhead cost savings, a reduction in cost of goods sold and process optimization, partly offset by the significant impact of currency headwinds, higher investments in R&D, settlement costs for pension de-risking, and ongoing investments to improve our quality management systems.

We reinvigorated our Healthcare business in North America and gained momentum in winning large-scale multi-year healthcare enterprise deals, e.g. with Westchester Medical Center (USA) and Mackenzie Health (Canada). And at our Imaging Systems facility in Cleveland we saw a gradual ramp-up of production in the course of the year. In February 2015 we completed the acquisition of Volcano, improving our position in the growing image-guided therapy market and strengthening our ability to deliver the benefits of minimally invasive therapies, such as faster recovery and shorter hospital stays. Post-merger integration is making good progress.

We also continued to deliver impressive growth and strong earnings across the majority of our Consumer Lifestyle portfolio. Our Health & Wellness and Personal Care businesses performed very well, delivering another year of high growth and margin expansion. Expanding our offering to help consumers make healthier choices, we launched the first in a series of personal health apps at the IFA trade fair in Berlin. Built on our Philips HealthSuite digital platform, these personal health programs represent a new era in connected care, as healthcare continues to move outside the hospital and into our homes and everyday lives.

Lighting had another year of excellent operational improvements, recording double-digit growth and margin expansion in LED, the key segment in the industry, while continuing to actively manage the decline of the conventional lighting market. Further improvement in profitability was mainly driven by cost productivity and procurement savings.

The power of our connected lighting propositions, based on IoT (Internet of Things) technology, was underscored by the opening of the world's most sustainable office building, The Edge in Amsterdam, which features Philips' smart connected lighting solution, with Power over Ethernet. In the US, Los Angeles remotely manages more than 100,000 street lights with our CityTouch lighting management system to create a more livable and safe city. And in the home, our Hue connected lighting platform continues to be a resounding success. Towards the end of the year, we teamed up with Cisco and SAP to address the opportunities in the office and street lighting markets respectively.

The termination of the planned sale of Lumileds to a consortium led by GO Scale Capital was of course a disappointing outcome, but we are actively engaging with other parties that have expressed an interest in the Lumileds business.

**Accelerate! driving performance improvement**

In 2015, our multi-year Accelerate! program again helped us to step up growth and increase margins, despite deteriorating macro-economic conditions in a number of markets. Through Accelerate! and the implementation of the Philips Business System (PBS) we continue to drive improvements across the organization. The PBS is helping us to further tighten our focus on quality and excellence and enhance productivity through continuous improvement methodologies, while embedding new capabilities and making us more agile, entrepreneurial and customer-centric, with a culture of higher performance. This is evidenced by the many large-scale multi-year hospital deals we won in 2015 and

our improving growth and margins despite the difficult economic times.

The PBS is also helping to reduce time-to-market for our innovations through Lean transformations of our customer value chains. And it is supporting our drive to become a digital company, both in how we work and in what we offer to the market, e.g. our Philips HealthSuite digital platform and connected LED lighting. Last but not least, it is driving overhead cost and productivity savings, offsetting headwinds and enabling us to improve our operating results over the year, notwithstanding an increase in our Research & Development expenses to 7.9% of sales.

## **Table of Contents**

[Message from the CEO 2](#)

### **Innovating for a healthier, more sustainable world**

In 2015, our innovative solutions and services improved the lives of 2 billion people around the world. Underlining our strength in the creation and protection of intellectual property we filed 1,750 new patents during the year and were named the world's second-largest patent applicant for patents filed at the European Patent Office.

We also entered into a five-year research alliance with Massachusetts Institute of Technology (MIT) to develop breakthrough innovations in health technology and connected lighting. And our North American research organization moved to the Cambridge, Mass. area to facilitate collaboration with MIT, academic hospitals, and business partners.

In 2015, we again delivered on our sustainability commitments, with Green Products accounting for 54% of total sales. Philips was recognized as a world leader for corporate action on climate change, achieving a perfect score (100A) in the Carbon Disclosure Project (CDP) Climate Change survey for the 3rd year in a row, and being named Leader in the Industrial Conglomerates category in the Dow Jones Sustainability Index. Keeping up the momentum, we committed to making Philips' operations carbon-neutral by 2020 at the 2015 Paris climate conference.

Underlining the importance we attach to doing good while doing well, the Philips Foundation entered into global innovation partnerships with the Red Cross and UNICEF, as well as supporting a host of innovation projects designed to make a difference in the communities and lives of those most in need.

### **Strategic priorities for 2016**

In light of the global trends and opportunities outlined above and the innovative competencies we can bring to bear, both our health technology and lighting businesses are well placed to thrive as markets drive greater demand for our solutions and services.

Both companies are deeply committed to delivering on their strategic opportunities. For Philips, serving the health technology markets, this means building strong consultative customer relationships, selling value-added solutions and winning more large-scale, multi-year projects with healthcare providers. It also means delivering growth from innovation investments, establishing the Philips HealthSuite digital platform as a leading cloud-based enabling solution, and boosting scale in its existing businesses.

For Lighting, as a stand-alone company, it means: optimizing returns from conventional products to fund innovation in LED, to outpace the market; leading the shift to LED systems, building the largest IoT connected installed base; capturing adjacent value through new Services business models; and being its customers' best business partner locally, leveraging its global scale.

Both companies will remain strongly committed to improve performance and capture higher growth, focusing ever more closely on customers' needs, driving new ways to innovate and leveraging partnerships, embracing digital technology in their ways of working, and relentlessly driving a mindset of continuous improvement and operational excellence.

It is my deepest conviction that both Philips and Lighting stand to benefit from the separation, as it will enable greater focus on their respective attractive markets and allow them to capture higher growth and deliver higher profitability.

### **In conclusion**

For 2016, we continue to expect modest comparable sales growth and we will build on our 2015 operational performance improvement. Taking into account ongoing macro-economic headwinds and the phasing of costs and sales, we expect improvements in the year to be back-end loaded.

We are proposing to the upcoming Annual General Meeting of Shareholders to maintain this year's distribution at EUR 0.80 per share, in cash or shares.

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I would like to thank our customers, shareholders and other stakeholders for their continued support. I also want to thank all our employees for their dedication and effort this past year.

In 2016, Philips celebrates 125 years in business. That's a tremendous feat for an innovation company, especially in such a fast-changing world. And I'm convinced that there is much more to come, as we continue to improve people's lives through meaningful innovation.

**Frans van Houten**

*Chief Executive Officer*

18 Annual Report 2015



**Table of Contents**

[Philips in 2015 at a glance](#) 3

[3 Philips in 2015 at a glance](#)

[Annual Report 2015](#) 19

## **Table of Contents**

[Our strategic focus 4](#)

[4 Our strategic focus](#)

[4.1 Addressing global challenges](#)

Guided by our passion to improve people's lives, Philips has been a leader in building and shaping markets with meaningful innovations for 125 years. With the world facing the challenge of tackling climate change and energy constraints, as well as providing effective and affordable healthcare to a growing global population, we see compelling opportunities in the health technology and lighting markets.

Determined to win in both, we are separating out our Lighting activities as a stand-alone company. This will create more focus, giving Lighting the opportunity to grow and capture the vast opportunities in energy-efficient, digital lighting products, systems and services, and Philips the enhanced focus to expand its core business to address the opportunities in the health technology market.

### **We see a growing need for better health and better care at lower cost**

Global resource constraints on health systems are driving a shift to value-based healthcare to reduce cost, increase access and improve outcomes. At the same time, aging populations across the globe and the rise of chronic conditions are driving a shift of care to lower-cost settings and the home.

In parallel, more and more people are looking for new ways to proactively monitor and manage their health. And the digitalization of healthcare is shifting value from devices to software and services.

These challenges can only be met through new, more integrated forms of care delivery across the health continuum, with a shift away from today's focus on acute care and late-stage interventions.

In an 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 enable data sharing and analysis, will be a key enabler of more effective, lower-cost integrated health solutions. This fits very well with our core strengths in professional healthcare and in consumer health and well-being.

**Table of Contents**

[Our strategic focus 4.1](#)

In a total addressable market estimated at over EUR 140 billion, we are well positioned to leverage advanced technology and our deep clinical and consumer insights to deliver integrated solutions that improve people's health and enable better outcomes across the health continuum.

We have defined five priority areas: personal health, definitive diagnosis, minimally invasive guided therapy, population health management, and connected care delivery. And our focus on cardiology, oncology, respiratory care, and fertility, pregnancy and parenting already gives us a broad-based opportunity to expand our integrated solutions capabilities.

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.

Going forward, we will further drive the benefits of scale in our current businesses while delivering additional growth from continuing investments in innovation. And establishing the Philips HealthSuite digital platform as a leading cloud solution to connect consumers, patients and providers will allow us to introduce value propositions with recurring revenue streams.

**[We see increasing demand for energy-efficient and connected digital lighting](#)**

The lighting industry is undergoing a radical transformation, driven by the market's transition to LED and digital technology. Three mega-trends present a huge opportunity.

The rapid rise in the world's population and in new lighting applications is driving up global demand for light. At the same time, with lighting accounting for 19% of global electricity consumption, the world needs that light to be energy-efficient. And with the integration of LED technology, lighting controls and software opening up new functionality and services, the world will benefit from the compelling new applications that connected digital lighting can offer, delivering value beyond illumination.

As a stand-alone company, our Lighting business is well positioned to capture the value that is shifting from individual products to connected LED lighting systems and services, more than offsetting the decline of conventional lighting. Its total addressable market is estimated at over EUR 65 billion.

Annual Report 2015 21

## **Table of Contents**

### [Our strategic focus 4.1](#)

Optimizing returns from its conventional products to fund growth, Philips Lighting is committed to innovate in LED to outpace the market. It will continue to lead the shift to Systems, building the industry's largest connected installed base and capturing value through new Services business models with recurring revenue streams, e.g. Light as a Service. And, leveraging its global scale, it will continue to strive to be its customers' best business partner locally.

### [4.2 How we create value](#)

#### **Understanding and meeting people's needs**

Building upon our long history of innovation, we take a systematic approach to value creation. Our starting point is always to understand the specific challenges local people face – whether they be a doctor, a real estate developer, a hospital director, a city planner, a consumer, etc.

Having gained these deep insights, we then apply our innovative competencies, strong brand, global footprint and talented, engaged people often in value-adding partnerships – to deliver solutions that meet these needs. Making the world healthier and more sustainable.

To measure the impact our solutions 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 Product portfolio, such as our energy-efficient lighting.

#### **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.

**Group strategy:** We manage our portfolio with clearly defined strategies and allocate resources to maximize value creation.

**CAPs:** 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:** We are a learning organization that applies common operating principles and practices to deliver to our customers with excellence.

**Path to Value:** 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.



**Table of Contents**

## **Table of Contents**

[Our strategic focus 4.2](#)

[4.3 Accelerate! journey continues](#)

In 2011 we set out on our Accelerate! journey of change and performance improvement. Designed to transform Philips into an agile and entrepreneurial company, Accelerate! is all about delivering meaningful innovation to our customers in local markets and doing so in a fast and efficient way.

The program has three main thrusts:

*transform to address underperformance*

*expand global leadership positions*

*initiate new growth engines*

We are now in the fifth year of this transformation process, and our Path to Value is clearly mapped out:

For 2016, we continue to expect modest comparable sales growth and we will build on our 2015 operational performance improvement. Taking into account ongoing macro-economic headwinds and the phasing of costs and sales, we expect improvements in the year to be back-end loaded.

24 Annual Report 2015

**Table of Contents**

[Our strategic focus 4.4](#)

[4.4 Lives improved](#)

[4.5 Global presence](#)

Regions	Sales in millions of EUR	Number of employees	Employees female	Employees male	R&D centers	Manufacturing sites	Tangible and intangible assets in millions of EUR
Asia & Pacific	6,990	32,533	32%	68%	9	20	2,023
EMEA	7,948	39,903	34%	66%	28	35	2,959
Latin America	1,211	8,154	46%	54%	3	11	136
North America	8,095	23,614	36%	64%	20	29	9,420

Annual Report 2015 25



## **Table of Contents**

Our strategic focus 4.6

4.6 Our strategy in action

### **Training tomorrow's lifesavers**

At Philips, we build relationships to ensure that our products and solutions are addressing people's needs in the right way. And that means supplying help as well as hardware.

In a technologically advanced world, it's no good simply investing in pioneering products such as high-tech radiology devices, MRI scanners and other medical imaging tools: doctors need to know how to use them to improve patient care. Which is where Philips comes in, not only providing the technology, but expert developmental medical training too, by partnering with key stakeholders.

At the American University of Beirut, students and professionals from all over the Middle East join colleagues from Lebanon – along with private companies such as Philips – to develop essential lifesaving skills that they can take back to their home countries, and to learn how they can make a difference through digital innovations. The medical training is a collaboration that not only teaches new skills, but is spreading the finest medical care through some of the world's most vulnerable populations.

26 Annual Report 2015

**Table of Contents**

Our strategic focus 4.6

**Addressing the community's primary health needs**

In Africa, we are partnering with local governments to develop Community Life Centers with the aim of not only improving primary healthcare but also promoting community development.

In most countries in Sub-Saharan Africa, healthcare systems are having to contend with serious challenges. Primary health facilities in particular are facing difficulties in offering quality basic services to local communities and playing the role of gatekeeper to the rest of the healthcare system.

At Philips we believe that the strengthening of health systems has to start at the primary level. That's why, in partnership with local government, we have installed a Community Life Center at Langata in Kiambu County, Kenya. Community Life Centers are a total solution for primary healthcare facilities, combining an integrated set of appropriate technologies with design, implementation and support services.

Since the opening of the Langata Community Life Center the number of children treated has doubled and Ante Natal Care visits have increased 12-fold, supporting our commitment to the UN's Every Woman, Every Child initiative.

Annual Report 2015 27

## **Table of Contents**

Our strategic focus 4.6

### **Change your health for life**

In 2015, Philips announced the first in a series of personal health programs including connected health measurement devices, app-based personalized programs and cloud-based data analysis to help consumers take greater control of their health.

Philips personal health programs represent a new era in connected care for consumers, patients and health providers, as healthcare continues to move outside the hospital, and into our homes and everyday lives. They are built on the Philips HealthSuite digital platform, an open and secure, cloud-based platform that collects and analyzes health and other data from multiple devices and sources.

Consumers are increasingly engaged in their personal health and they want solutions that empower them to stay healthy and prevent illness, says Pieter Nota (CEO Philips Consumer Lifestyle in 2015). Philips personal health programs will help consumers develop healthier habits for life.

Leveraging Philips deep healthcare and consumer expertise, the personal health programs enable individuals to measure vital signs to understand how lifestyle choices affect their body, to set goals and monitor their progress, and to stay motivated with intelligent programs, developed with leading doctors and psychologists, that respond to individual progress and make personalized recommendations.

The Philips personal health programs and health measurement devices are not currently available for sale in the USA.

28 Annual Report 2015

**Table of Contents**

Our strategic focus 4.6

**Offering new parents peace of mind**

We believe that every baby deserves the best possible start in life. With the Philips Avent uGrow digital platform, parents can track progress, relish milestones and learn about their baby's development and needs.

Philips Avent uGrow is an innovative digital parenting platform in the form of a mobile application, plus connected digital products, which provides new parents with personalized advice and insights to help them understand and support each stage of their baby's development.

Based on professional guidance and pertinent localized content, and with a timeline that incorporates data ranging from how much baby has eaten to sleep patterns, uGrow gives new parents peace of mind in their baby's development. Interactive photos and virtual stickers can be used to mark occasions and celebrate milestones on baby's timeline. And the app remembers key dates in order to provide bespoke guidance, e.g. on baby's developing weight, or on weaning as baby grows.

Being a parent is a life-changing experience, during which we often rely on our intuition, says Aliette van der Wal, Business Leader Mother & Childcare, Health & Wellness. At Philips Avent we're harnessing the power of connected technology to empower parents with additional information, tailored to individual needs, which will help them make the best decisions for their baby.

Annual Report 2015 29

## **Table of Contents**

Our strategic focus 4.6

### **Connected lighting delivering value beyond illumination**

With Philips CityTouch, Los Angeles remotely manages more than 100,000 street lights to create a more livable city.

In 2015, Los Angeles became the first city in the world to control its street lighting through an advanced Philips management system that uses mobile and cloud-based technologies.

With Philips CityTouch, the LA Bureau of Street Lighting can remotely control street lighting fixtures, as well as monitor energy use and the status of each light. Using mobile chip technology embedded into each fixture, the street lights are able to identify themselves and network instantly.

This smart plug-and-play approach not only reduces the cost of programming each fixture, it also reduces the time required for commissioning from days to minutes and eliminates on-site commissioning completely. Furthermore, CityTouch offers system managers a real-time, map-based view of all connected light points via any standard web browser.

I call it priceless," says Ed Ebrahimian, Director of the LA Bureau of Street Lighting, "because if we can save one life by finding out if a light is out and fixing it right away, we've done our job."

30 Annual Report 2015

**Table of Contents**

Our strategic focus 4.6

**Creating a sustainable office environment**

Opened in 2015, innovative office building The Edge in Amsterdam received the highest-ever BREEAM score – the leading assessment method for sustainable buildings. A key aspect of the design is a connected lighting system from Philips.

The Edge's connected lighting system uses nearly 6,500 LED luminaires over the building's 15 stories. These fixtures are connected to the building's IT network by Power over Ethernet (PoE) technology. With PoE, Ethernet cables transmit both power and data, eliminating the need for separate power cabling and creating a sort of information pathway.

With integrated sensors in 3,000 of these luminaires, the connected lighting system captures anonymous data on room occupancy. The LED fixtures interface with other building systems such as heating and ventilation to provide facility managers with an integrated view of a building's occupancy patterns and energy usage. This enables more informed decision making, with unprecedented levels of energy and operational efficiency.

Supporting workplace productivity, employees at The Edge are also able to set the lighting and temperature to suit their personal preferences via an app on their smartphone.

Annual Report 2015 31

## **Table of Contents**

Our strategic focus 4.6

### **Lighting the steel heart**

Innovative lighting can help improve health and safety at work. Nowhere is this more apparent than in Ostrava, where Philips has helped to transform ArcelorMittal's steel plant with a new lighting system.

A steel plant can be a hazardous workplace. When employees work with molten steel, with loads exceeding 350 tons in weight and temperatures exceeding 1,500 degrees, it is important to have good lighting. At its steel plant in Ostrava, the steel heart of the Czech Republic, ArcelorMittal needed a lighting partner who understood their needs, could offer a suitable solution, and, of course, deliver that solution with a minimum of disruption.

With the steel plant in full operation, Philips implemented a complete modernization of the lighting. It was a complex project but ArcelorMittal and Philips worked closely together for the duration of the renovation. There has been a substantial improvement in health, safety, as well as productivity and energy benefits, says Anoop Nair, Chief Operating Officer, ArcelorMittal, Ostrava. This gave kind of an explosive or meteoric effect to the employees. And I think it was thanks to Philips.

**Table of Contents**

Group performance 5

5 Group performance

2015 saw Philips returning to growth and improving profitability in challenging macro-economic conditions as our Accelerate! program continued to deliver results. Abhijit Bhattacharya, CFO Royal Philips

5.1 Financial performance

**Management summary**

**The year 2015**

Comparable sales rose 4.5% in our HealthTech portfolio, which combines our Healthcare and Consumer Lifestyle businesses. This illustrates the progress we are making in capturing opportunities in this large and growing market. Overall, comparable sales for the Group increased by 2% to EUR 24.2 billion.

Our Healthcare business recorded 4% growth. More significantly, our order intake was up 5% for the year. This performance was supported by strong growth in North America and Western Europe and a substantial rebound in China in Q4.

Our Consumer Lifestyle business achieved a comparable sales increase of 6% year-on-year, driven by double-digit growth at Health & Wellness and high-single-digit growth at Personal Care.

Lighting recorded another year of operational improvements, resulting in a substantial increase in profitability. We strongly improved the performance of our LED business, which grew by 25% on a comparable basis and significantly improved profitability. On a full-year basis LED now accounts for 43% of total Lighting sales. In the conventional lamps business we continued to gain market share in a declining market and improved profitability combined with a solid cash flow. The expected decline in conventional lighting led to a comparable sales decrease of 3% for our Lighting business overall.

In line with our mission to improve people's lives, we have embedded sustainability at the heart of our business processes, and Green Product sales increased to 54% of total revenues in 2015. In recognition of our sustainability achievements, Philips was named industry leader in the Industrial Conglomerates category in the 2015 Dow Jones Sustainability Index.

Annual Report 2015 33



**Table of Contents**

## Group performance 5.1

Adjusted IFO totaled EUR 1.4 billion, compared to EUR 821 million a year earlier. Our three cost savings programs all delivered ahead of plan in 2015. We achieved EUR 290 million of gross savings in overhead costs, EUR 379 million of gross savings in procurement, and our End2End process improvement program delivered productivity savings of EUR 187 million.

Net income amounted to EUR 659 million, a 60% increase from EUR 411 million in 2014.

Free cash flow amounted to EUR 325 million in 2015, which was EUR 172 million lower than in 2014, mainly due to CRT litigation claims, higher outflows related to pension de-risking settlements, and net capital expenditures, partly offset by higher earnings.

By the end of the year we had also completed 74% of the EUR 1.5 billion- share buy-back program.

Philips Group

**Key data** in millions of EUR unless otherwise stated

2013 - 2015

	2013	2014	2015
<b>Condensed statement of income</b>			
<b>Sales</b>	<b>21,990</b>	<b>21,391</b>	<b>24,244</b>
<b>Adjusted IFO<sup>1)</sup></b>	<b>2,276</b>	<b>821</b>	<b>1,372</b>
<i>as a % of sales</i>	<i>10.4%</i>	<i>3.8%</i>	<i>5.7%</i>
<b>IFO</b>	<b>1,855</b>	<b>486</b>	<b>992</b>
<i>as a % of sales</i>	<i>8.4%</i>	<i>2.3%</i>	<i>4.1%</i>
Financial income and expenses	(330)	(301)	(369)
Income tax expense	(466)	(26)	(239)
Results of investments in associates	(25)	62	30
<b>Income from continuing operations</b>	<b>1,034</b>	<b>221</b>	<b>414</b>
Income from discontinued operations - net of income tax	138	190	245
<b>Net income</b>	<b>1,172</b>	<b>411</b>	<b>659</b>
<b>Other indicators</b>			
Net income attributable to shareholders per common share in EUR:			
basic	1.28	0.45	0.70
diluted	1.27	0.45	0.70
Net operating capital (NOC) <sup>1)</sup>	10,238	8,838	11,096
Free cash flow <sup>1)</sup>	82	497	325
Employees (FTEs)	116,082	113,678	112,959
continuing operations	105,637	105,365	104,204
discontinued operations	10,445	8,313	8,755

- 1) For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report

**The year 2014**

In 2014, we continued to improve operational performance in most businesses, yet saw significant headwinds - ranging from geo-political crises and exchange rate fluctuations, to legal matters and the voluntary suspension of production at the Cleveland facility. In 2014, the voluntary suspension of production at our Cleveland facility and the jury verdict in the Masimo litigation strongly impacted our 2014 performance.

At our Healthcare facility in Cleveland, Ohio, certain issues in the general area of manufacturing process controls were identified during an ongoing US Food and Drug Administration (FDA) inspection. To address these issues, on January 10, 2014 we started a voluntary, temporary suspension of new production at the facility, primarily to strengthen manufacturing process controls. The suspension negatively impacted Healthcare's sales and Adjusted IFO in 2014.

On October 3, 2014 Philips announced that it is appealing the jury verdict in the patent infringement lawsuit by Masimo Corporation (Masimo), in which Masimo was awarded compensation of USD 467 million (EUR 366 million). The jury verdict is part of extensive litigation, which started in 2009, between Masimo and Philips involving several claims and counterclaims related to a large number of patents.

Net income for the year amounted to EUR 411 million, as lower operational earnings were partly offset by lower income tax expense and higher results from investments in associates and discontinued operations.

Sales amounted to EUR 21,391 million, a 3% nominal decline for the year. Excluding unfavorable currency effects, comparable sales were 1% below the level of 2013, due to Healthcare and Lighting. Healthcare comparable sales declined by 2%, mainly due to Imaging Systems. Lighting comparable sales were 3% below the level of 2013, as declines at Light Sources & Electronics and Consumer Luminaires were tempered by growth at Professional Lighting Solutions. Comparable sales at Consumer Lifestyle were 6% above the level of 2013, mainly driven by double-digit growth at Health & Wellness.

Comparable sales in growth geographies were in line with 2013, while mature geographies declined by 1% as a result of the overall macroeconomic developments. In 2014, growth geographies accounted for 35% of total sales.

In 2014, IFO amounted to EUR 486 million, or 2.3% of sales, compared to EUR 1,855 million, or 8.4% of sales, in 2013. IFO declines at Healthcare, Lighting and IG&S were partly offset by an improvement at Consumer Lifestyle.

Operating activities generated cash flows of EUR 1,303 million, which was EUR 391 million higher than in 2013. The increase was mainly due to higher cash inflows and working capital reductions in 2014, as well as the payment of the European Commission fine in 2013. Cash flows before financing activities were EUR 269 million higher than in 2013, as an

**Table of Contents**

Group performance 5.1.1

increase in cash flows from operating activities was partly offset by higher outflows related to acquisitions of new businesses.

By the end of 2014, Philips had completed 41% of the EUR 1.5 billion share buy-back program.

**5.1.1 Sales****The year 2015**

The composition of sales growth in percentage terms in 2015, compared to 2014, is presented in the table below.

Philips Group

**Sales growth composition in %**

2015 versus 2014

	comparable growth	currency effects	consolidation changes	nominal growth
Healthcare	3.8	11.7	3.3	18.8
Consumer Lifestyle	5.8	7.2	0.0	13.0
Lighting	(2.8)	8.5	2.2	7.9
Innovation, Group & Services	5.4	1.7	(12.2)	(5.1)
<b>Philips Group</b>	<b>2.2</b>	<b>9.4</b>	<b>1.7</b>	<b>13.3</b>

Group sales amounted to EUR 24,244 million in 2015, which represents 13% nominal growth compared to 2014.

Adjusted for a 9% positive currency effect and 2% consolidation impact, comparable sales were 2% above 2014.

Healthcare sales amounted to EUR 10,912 million, which was EUR 1,726 million higher than in 2014 or 4% higher on a comparable basis. Imaging Systems achieved high-single-digit growth, Healthcare Informatics, Solutions & Services posted mid-single-digit growth, Customer Services reported low-single-digit growth, while Patient Care & Monitoring Solutions was in line with 2014. From a geographical perspective, comparable sales in growth geographies showed high-single-digit growth, and mature geographies recorded low-single-digit growth.

Consumer Lifestyle reported sales of EUR 5,347 million, which was EUR 616 million higher than in 2014, or 6% higher on a comparable basis. Health & Wellness achieved double-digit growth, Personal Care reported high-single-digit growth, while Domestic Appliances was in line with 2014. From a geographical perspective, growth geographies achieved high-single-digit growth and mature geographies registered low-single-digit growth.

Lighting sales amounted to EUR 7,411 million, which was EUR 542 million higher than in 2014 and 3% lower on a comparable basis. Both Light Sources & Electronics and Consumer Luminaires recorded a mid-single-digit decline, while Professional Lighting Solutions remained flat year-on-year. From a geographical perspective, comparable sales showed a mid-single-digit decline in growth geographies and a low-single-digit decline in mature geographies.

IG&S reported sales of EUR 574 million, which was EUR 31 million lower than in 2014. A decline in revenues as a result of the OEM remote controls divestment, was partly offset by higher sales from emerging business areas.

**The year 2014**

The composition of sales growth in percentage terms in 2014, compared to 2013, is presented in the table below.

Philips Group

**Sales growth composition in %**

2014 versus 2013

	comparable growth	currency effects	consolidation changes	nominal growth
Healthcare	(2.0)	(1.6)	(0.5)	(4.1)
Consumer Lifestyle	5.8	(3.1)	0.0	2.7
Lighting	(2.6)	(2.3)	1.0	(3.9)
Innovation, Group & Services	(11.8)	(0.1)	2.9	(9.0)
<b>Philips Group</b>	<b>(0.9)</b>	<b>(2.0)</b>	<b>0.2</b>	<b>(2.7)</b>

Group sales amounted to EUR 21,391 million in 2014, which represents a 3% nominal decline compared to 2013.

Adjusted for a 2% negative currency effect, comparable sales were 1% below the level of 2013. Comparable sales were up 6% at Consumer Lifestyle. Healthcare and Lighting saw comparable sales decline by 2% and 3% respectively.

Healthcare sales amounted to EUR 9,186 million, which was EUR 389 million lower than in 2013. Mid-single-digit growth at Customer Services and low-single-digit growth at Patient Care & Monitoring Solutions were offset by a double-digit decline at Imaging Systems. Healthcare Informatics, Solutions & Services sales were in line with 2013. Mature geographies recorded a low-single-digit decline, mainly due to North America and Western Europe. Growth geographies also recorded a low-single-digit decline, with solid growth in Latin America and Middle East & Turkey offset by a double-digit decline in China.

Consumer Lifestyle reported sales of EUR 4,731 million, which was EUR 126 million higher than in 2013, or 6% higher on a comparable basis. Health & Wellness achieved double-digit growth and Domestic Appliances high-single-digit growth, while Personal Care recorded low-single-digit growth. Growth geographies achieved high-single-digit growth, driven by strong growth in China, India and Middle East & Turkey. Mature geographies recorded low-single-digit growth, with mid-single-digit growth in Western Europe and other mature geographies and low-single-digit growth in North America.

**Table of Contents**[Group performance 5.1.2](#)

Lighting sales amounted to EUR 6,869 million, which was EUR 276 million lower than in 2013, or 3% lower on a comparable basis. A high-single-digit decline at Consumer Luminaires and mid-single-digit decline at Light Sources & Electronics were tempered by low-single-digit growth at Professional Lighting Solutions. A low-single-digit decline was seen in mature geographies, largely due to Western Europe and North America. Growth geographies recorded a mid-single-digit decline, mainly driven by China.

IG&S reported sales of EUR 605 million, which was EUR 60 million lower than in 2013, mainly due to lower royalty income.

**5.1.2 Earnings****The year 2015**

In 2015, Philips' gross margin was EUR 9,856 million, or 40.7% of sales, compared to EUR 8,206 million, or 38.4% of sales, in 2014. Gross margin in 2015 included EUR 176 million of restructuring and acquisition-related charges, whereas 2014 included EUR 249 million of restructuring and acquisition-related charges. 2015 also included charges of EUR 35 million related to the devaluation of the Argentine peso, a EUR 28 million currency revaluation of the provision for the Masimo litigation and EUR 3 million related to the separation of the Lighting business. Gross margin in 2014 included charges of EUR 366 million related to the provision for the Masimo litigation, EUR 68 million of impairment and other charges related to industrial assets at Lighting, EUR 46 million of mainly inventory write-downs related to the voluntary suspension of production at the Cleveland facility, and a past-service pension cost gain of EUR 17 million. Excluding these items, gross margin as a % of sales was broadly in line with 2014.

Selling expenses increased from EUR 5,124 million in 2014 to EUR 5,815 million in 2015. Selling expenses as a % of total sales remained in line with 2014 at 24.0%. 2015 included EUR 62 million of restructuring and acquisition-related charges, compared to EUR 128 million of restructuring charges in 2014. Selling expenses in 2015 included charges of EUR 31 million related to a legal provision and EUR 69 million related to the separation of the Lighting business, while 2014 included a past-service pension cost gain of EUR 20 million. Excluding these items, selling expenses as a % of sales were in line with 2014.

Research and development costs increased from EUR 1,635 million in 2014 to EUR 1,927 million in 2015. Research and development costs in 2015 included EUR 16 million of restructuring and acquisition-related charges, compared to EUR 34 million in 2014. Research and development costs 2014 also included a past-service pension gain of EUR 22 million and charges of EUR 3 million of mainly write-downs related to the voluntary suspension of production at the Cleveland facility. The year-on-year increase was mainly due to currency impact and higher spend at Healthcare and IG&S. As a percentage of sales, research and development costs increased from 7.6% in 2014 to 7.9% in 2015.

General and administrative expenses amounted to EUR 1,209 million, or 5.0% of sales, in 2015, compared to EUR 747 million, or 3.5% of sales, in 2014. 2015 included EUR 30 million of restructuring and acquisition related-charges, compared to EUR 23 million in 2014. 2015 also included charges of EUR 345 million mainly related to settlements for pension de-risking and EUR 111 million related to the separation of the Lighting business, while 2014 included a past-service pension cost gain of EUR 8 million. Excluding these items, the year-on-year decrease was driven by reductions in all operating sectors.

The overview below shows sales, IFO and Adjusted IFO according to the 2015 sector classifications.

Philips Group

**Sales, IFO and Adjusted IFO**

in millions of EUR unless otherwise stated

2014 - 2015

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	Sales	IFO	%	Adjusted IFO <sup>1)</sup>	%
<b>2015</b>					
Healthcare	10,912	819	7.5%	1,024	9.4%
Consumer Lifestyle	5,347	621	11.6%	673	12.6%
Lighting	7,411	486	6.6%	594	8.0%
Innovation, Group & Services	574	(934)		(919)	
<b>Philips Group</b>	<b>24,244</b>	<b>992</b>	<b>4.1%</b>	<b>1,372</b>	<b>5.7%</b>
<b>2014</b>					
Healthcare	9,186	456	5.0%	616	6.7%
Consumer Lifestyle	4,731	520	11.0%	573	12.1%
Lighting	6,869	185	2.7%	293	4.3%
Innovation, Group & Services	605	(675)		(661)	
<b>Philips Group</b>	<b>21,391</b>	<b>486</b>	<b>2.3%</b>	<b>821</b>	<b>3.8%</b>

1) For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report

In 2015, IFO increased by EUR 506 million year-on-year to EUR 992 million, or 4.1% of sales. Restructuring and acquisition-related charges amounted to EUR 283 million, which included the Volcano acquisition, compared to EUR 434 million in 2014. 2015 IFO also included charges of EUR 345 million mainly related to settlements for pension de-risking, EUR 183 million relating to the separation of the Lighting business, EUR 35 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 the provision for the Masimo litigation, and a EUR 37 million gain related to the sale of real estate assets. IFO in 2014 included charges of EUR 366 million related to the provision for the Masimo litigation, EUR 244 million related to the CRT antitrust litigation, EUR 68 million of impairment and other charges related to industrial

**Table of Contents**

Group performance 5.1.2

assets at Lighting, EUR 49 million of mainly inventory write-downs related to the Cleveland facility, and a EUR 67 million past-service pension cost gain.

Amortization and impairment of intangibles, excluding software and capitalized product development costs, amounted to EUR 380 million in 2015, compared to EUR 332 million in 2014. In 2015, goodwill impairment charges amounted to nil, while 2014 included charges of EUR 3 million consisting of impairments on divested businesses in Healthcare and Lighting, see note 11, Goodwill.

Adjusted IFO increased from EUR 821 million, or 3.8% of sales, in 2014 to EUR 1,372 million, or 5.7% of sales, in 2015. Adjusted IFO showed a year-on-year increase at all sectors except IG&S.

**Healthcare**

Adjusted IFO amounted to EUR 1,024 million, or 9.4% of sales, compared to EUR 616 million, or 6.7% of sales, in 2014. Adjusted IFO in 2015 included restructuring and acquisition-related charges of EUR 168 million, which included the Volcano acquisition, compared to EUR 70 million in 2014. 2015 Adjusted IFO also included charges of EUR 28 million related to the currency revaluation of the provision for the Masimo litigation, EUR 8 million related to the devaluation of the Argentine peso, and a EUR 31 million legal provision. Adjusted IFO in 2014 included charges of EUR 366 million related to the provision for the Masimo litigation, charges of EUR 49 million of mainly inventory write-downs related to Cleveland, and a EUR 16 million past-service pension cost gain. Excluding these items, the increase was largely driven by higher volumes, partly offset by an increase in Quality & Regulatory spend and higher planned expenditure for growth initiatives.

**Consumer Lifestyle**

Adjusted IFO amounted to EUR 673 million, or 12.6% of sales, a year-on-year increase of EUR 100 million. 2015 Adjusted IFO included restructuring and acquisition-related charges of EUR 36 million and charges related to the devaluation of the Argentine peso of EUR 13 million. 2014 Adjusted IFO included restructuring and acquisition-related charges of EUR 9 million and a EUR 11 million past-service pension cost gain. The year-on-year increase was largely driven by cost productivity, higher volumes, and product mix, partly offset by higher restructuring and acquisition-related charges.

**Lighting**

Adjusted IFO amounted to EUR 594 million, or 8.0% of sales, a year-on-year increase of EUR 301 million. 2015 Adjusted IFO included EUR 99 million of restructuring and acquisition-related charges and EUR 14 million of charges related to the devaluation of the Argentine peso. 2014 Adjusted IFO included EUR 245 million of restructuring and acquisition-related charges, EUR 68 million of impairment and other charges related to industrial assets, and a EUR 13 million past-service pension cost gain. The increase in Adjusted IFO was largely driven by cost productivity, improved LED margins and lower restructuring and acquisition-related charges.

**Innovation, Group & Services**

Adjusted IFO amounted to a net cost of EUR 919 million, compared to EUR 661 million in 2014. Adjusted IFO in 2015 included a EUR 20 million net release of restructuring charges, compared to EUR 113 million restructuring charges in 2014. Adjusted IFO in 2015 also included charges of EUR 183 million related to the separation of the Lighting business, EUR 345 million mainly related to settlements for pension de-risking, and a EUR 37 million gain related to the sale of real estate assets. Adjusted IFO in Q4 2014 also included EUR 244 million of charges related to the CRT antitrust litigation and a EUR 27 million past-service pension cost gain. Excluding these items, the decrease in Adjusted IFO was largely driven by higher Group and Regional Costs, mainly related to information security and Quality & Regulatory spend, investments in emerging business areas, and lower licensing revenue in IP Royalties.

**The year 2014**

In 2014, Philips gross margin was EUR 8,206 million, or 38.4% of sales, compared to EUR 9,337 million, or 42.5% of sales, in 2013. Gross margin in 2014 included EUR 249 million of restructuring and acquisition-related charges, whereas 2013 included EUR 48 million of restructuring and acquisition-related charges. 2014 also included charges of EUR 366 million related to the jury verdict in the Masimo litigation,

EUR 68 million of impairment and other charges, EUR 46 million of mainly inventory write-downs related to the voluntary suspension of production at the Cleveland facility and a past service pension cost gain of EUR 17 million. 2013 also included a past service pension cost gain of EUR 38 million. Excluding these items, the year-on-year decline was mainly driven by operational decline at Healthcare and Lighting as well as negative currency impacts.

Selling expenses increased from EUR 5,057 million in 2013 to EUR 5,124 million in 2014. 2014 included EUR 128 million of restructuring and acquisition-related charges, and a past service pension cost gain of EUR 20 million, while 2013 included EUR 45 million of restructuring charges and a past service pension cost gain of EUR 28 million. The year-on-year increase was mainly attributable to higher restructuring activities. Selling expenses increased from 23.0% of sales to 24.0%.

Research and development costs decreased from EUR 1,659 million in 2013 to EUR 1,635 million in 2014. Research and development costs in 2014 included EUR 34 million of restructuring and acquisition-related charges, EUR 3 million of charges related to mainly inventory write-downs at the Cleveland facility, and a EUR 22 million past-service pension cost gain, compared to EUR 2 million of restructuring and acquisition-related charges and a EUR 11 million past-service pension cost gain in 2013. The year-on-year



**Table of Contents**

## Group performance 5.1.2

decrease was mainly due to lower spend at IG&S, partly offset by higher restructuring costs in all sectors. As a percentage of sales, research and development costs increased from 7.5% in 2013 to 7.6% in 2014.

General and administrative expenses amounted to EUR 747 million in 2014, compared to EUR 825 million in 2013. As a percentage of sales, costs decreased from 3.8% in 2013 to 3.5% in 2014. 2014 included EUR 23 million of restructuring and acquisition related-charges, compared to EUR 5 million in 2013. 2014 also included a EUR 8 million net past-service pension cost gain in the Netherlands, while 2013 included a pension settlement loss of EUR 30 million.

The overview below shows sales, IFO and Adjusted IFO according to the 2014 sector classifications.

## Philips Group

**Sales, IFO and Adjusted IFO** in millions of EUR

2013

	Sales	IFO	%	Adjusted IFO <sup>1)</sup>	%
Healthcare	9,575	1,315	13.7%	1,512	15.8%
Consumer Lifestyle	4,605	429	9.3%	483	10.5%
Lighting	7,145	413	5.8%	580	8.1%
IG&S	665	(302)	0.0%	(299)	0.0%
<b>Philips Group</b>	<b>21,990</b>	<b>1,855</b>	<b>8.4%</b>	<b>2,276</b>	<b>10.4%</b>

1) For reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report.

In 2014, IFO decreased by EUR 1,369 million year-on-year to EUR 486 million, or 2.3% of sales. 2014 included EUR 434 million of restructuring and acquisition-related charges, compared to EUR 100 million in 2013. 2014 included EUR 366 million related to the jury verdict in the Masimo litigation, EUR 49 million mainly related to inventory write-downs in the Cleveland facility, charges of EUR 244 million related to legal matters, EUR 68 million of impairment and other charges related to industrial assets at Lighting, and a EUR 67 million past-service pension cost gain in the Netherlands. 2013 IFO was also impacted by a net gain of EUR 47 million from a past-service pension cost gain and related settlement loss in the US, as well as a EUR 21 million gain on the sale of a business in Healthcare.

Amortization and impairment of intangibles, excluding software and capitalized product development costs, amounted to EUR 332 million in 2014, compared to EUR 393 million in 2013. In 2014, goodwill impairment charges amount to EUR 3 million consisting of impairments on divested businesses in Healthcare and Lighting. In 2013, goodwill impairment charges amounted to EUR 28 million, including EUR 26 million as a result of reduced growth expectations in Consumer Luminaires, see note 11, Goodwill.

Adjusted IFO declined from EUR 2,276 million, or 10.4% of sales, in 2013 to EUR 821 million, or 3.8% of sales, in 2014. Adjusted IFO showed a year-on-year decrease at all sectors except Consumer Lifestyle.

**Healthcare**

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Adjusted IFO decreased from EUR 1,512 million, or 15.8% of sales, in 2013 to EUR 616 million, or 6.7% of sales, in 2014. Restructuring and acquisition-related charges in 2013 were close to zero, compared to EUR 70 million in 2014. 2014 included EUR 366 million related to the jury verdict in the Masimo litigation, EUR 49 million mainly related to inventory write-downs in the Cleveland facility, and a EUR 16 million past-service pension cost gain in the Netherlands. 2013 included a past-service pension cost gain of EUR 61 million and a gain on the sale of a business of EUR 21 million. The decline in Adjusted IFO was largely due to operational losses related to the voluntary suspension of production at the Cleveland facility and negative currency impacts.

### Consumer Lifestyle

Adjusted IFO improved from EUR 483 million, or 10.5% of sales, in 2013 to EUR 573 million, or 12.1% of sales, in 2014. 2014 included restructuring and acquisition-related charges of EUR 9 million and a EUR 11 million past-service pension cost gain in the Netherlands. 2013 included restructuring and acquisition-related charges of EUR 14 million and a past-service pension cost gain of EUR 1 million in the US. The increase was largely driven by higher sales and operational improvements.

### Lighting

Adjusted IFO declined from EUR 580 million, or 8.1% of sales, in 2013 to EUR 293 million, or 4.3% of sales, in 2014. Restructuring and acquisition-related charges amounted to EUR 245 million in 2014, compared to EUR 83 million in 2013. 2014 Adjusted IFO included EUR 68 million of impairment and other charges related to industrial assets and a EUR 13 million past-service pension cost gain in the Netherlands, while 2013 Adjusted IFO included a past-service pension cost gain of EUR 10 million in the US. The decrease in Adjusted IFO was largely driven by higher restructuring charges and lower sales volume.

### Innovation, Group & Services

Adjusted IFO declined from a loss of EUR 299 million in 2013 to a loss of EUR 661 million in 2014. 2014 Adjusted IFO included restructuring and acquisition-related charges of EUR 113 million, provisions of EUR 244 million related to legal matters and a EUR 27 million gain from a past-service pension cost gain in the Netherlands. 2013 included restructuring and acquisition-related charges of EUR 3 million and a pension settlement loss of EUR 25 million. Excluding these items, the year-on-year Adjusted IFO decline was mainly driven by higher investments in emerging business areas and lower IP income.

**Table of Contents**[Group performance 5.1.3](#)**5.1.3 Advertising and promotion****The year 2015**

Philips' total advertising and promotion expenses were EUR 1,000 million in 2015, an increase of 10% compared to 2014. The increase was mainly due to investments in key growth geographies, such as China and India, and mature geographies such as the United States and Japan. The total advertising and promotion investment as a percentage of sales was 4.1% in 2015, compared to 4.3% in 2014.

Philips brand value increased by 6% to over USD 10.9 billion as measured by Interbrand. In the 2015 listing, Philips is ranked the 47th most valuable brand in the world.

**The year 2014**

Philips' total advertising and promotion expenses were EUR 913 million in 2014, an increase of 5% compared to 2013. The increase was mainly due to investments in mature markets, such as the Netherlands, Germany and United States. The advertising and promotion spend in key growth geographies decreased by 5% compared to 2013, largely due to lower spend in China. The total advertising and promotion investment as a percentage of sales was 4.3% in 2014, compared to 4.0% in 2013.

Philips increased its brand value by 5% to over USD 10.3 billion in the 2014 ranking of the world's 100 most valuable brands, as measured by Interbrand. In the 2014 listing, Philips is now ranked the 42nd most valuable brand in the world.

**5.1.4 Research and development****The year 2015**

Research and development costs increased from EUR 1,635 million in 2014 to EUR 1,927 million in 2015. 2015 included EUR 16 million of restructuring and acquisition-related charges, compared to EUR 34 million in 2014. 2014 also included a past-service pension gain of EUR 22 million and charges of EUR 3 million of mainly inventory write-downs related to Cleveland. The year-on-year increase was mainly due to currency impact and higher spend at Healthcare and IG&S. As a percentage of sales, research and development costs increased from 7.6% in 2014 to 7.9%.

Philips Group

**Research and development expenses** in millions of EUR

2013 - 2015

	2013	2014	2015
Healthcare	810	822	1,073
Consumer Lifestyle	268	263	301
Lighting	313	330	315
Innovation, Group & Services	268	220	238
<b>Philips Group</b>	<b>1,659</b>	<b>1,635</b>	<b>1,927</b>

#### The year 2014

Research and development costs decreased from EUR 1,659 million in 2013 to EUR 1,635 million in 2014. 2014 included EUR 34 million of restructuring and acquisition-related charges, compared to EUR 2 million in 2013. 2014 also included a past-service pension gain of EUR 22 million and charges of EUR 3 million of mainly inventory write-downs related to Cleveland, compared to a past-service pension gain of EUR 11 million reported in 2013. The year-on-year decrease was driven by IG&S, partly offset by increases at Healthcare and Lighting. As a percentage of sales, research and development costs increased from 7.5% in 2013 to 7.6%.

#### 5.1.5 Pensions

##### The year 2015

In 2015, the total costs of post-employment benefits amounted to EUR 559 million for defined benefit plans and EUR 293 million for defined contribution plans, compared to EUR 241 million and EUR 144 million respectively in 2014. Excluding 2015 pension de-risking cost and the 2014 past service cost gain, defined benefit costs decreased by EUR 92 million compared to 2014.

## **Table of Contents**

### **Group performance 5.1.6**

The above costs are reported in Operating expenses except for the net interest cost component which is reported in Financial income and expense. The net interest cost for defined benefit plans was EUR 72 million in 2015 (2014: EUR 59 million).

2015 included settlement costs of EUR 329 million mainly related to the settlement of the UK plan, results of other de-risking actions in the UK prior to the settlement and the settlement of parts of the US pension plan. Past-service costs of EUR 14 million were recognized related to de-risking actions taken in the UK prior to the settlement of the plan, including a past-service cost for GMP Equalization in the same UK plan. Some smaller plan changes in other countries resulted in a small past service cost gain. Due to the above, and the change to defined contribution accounting for the Dutch pension plan, which is explained in the pension note, the Company's Defined Benefit Obligation in 2015 decreased from EUR 27 billion to EUR 4.5 billion at the end of 2015.

2014 included past-service cost gains in the Netherlands of EUR 67 million, which were mainly related to the mandatory plan change in the Netherlands, where a salary cap of EUR 100,000 must be applied to the pension salary with effect from January 1, 2015. This change lowers the Company's Defined Benefit Obligation, which is recognized as a past-service cost gain. Compensatory measures are given in wages for employees impacted.

The overall funded status in 2015 decreased as the surpluses of the Netherlands and the UK plan are no longer included due to their settlements in 2015. The pension deficits recognized in our balance sheet decreased mainly due to the above mentioned de-risking actions in the US. The surpluses of the Netherlands and the UK plan were not recognized in the balance sheet due to the asset ceiling test and therefore their settlement does not impact the pension balances as per the Company's accounting policy.

For further information, refer to note 20, Post-employment benefits.

### **The year 2014**

In 2014, the total costs of post-employment benefits amounted to EUR 241 million for defined-benefit plans and EUR 144 million for defined-contribution plans, compared to EUR 291 million and EUR 134 million respectively in 2013.

The above costs are reported in Operating expenses except for the net interest cost component which is reported in Financial income and expense. The net interest cost for defined-benefit plans was EUR 59 million in 2014 (2013: EUR 71 million).

2014 included past-service cost gains in the Netherlands of EUR 67 million, which were mainly related to the mandatory plan change in the Netherlands, where a salary cap of EUR 100,000 must be applied to the pension salary with effect from January 1, 2015. This change lowers the Company's Defined Benefit Obligation which is recognized as a past-service cost gain. Compensatory measures are given in wages for employees impacted.

2013 included past-service cost gains of EUR 81 million, which included EUR 78 million related to the announced freeze of accrual after December 31, 2015 for salaried workers in the Company's US defined-benefit pension plan. In the same US plan a settlement loss of EUR 31 million was recognized in 2013 following a lump-sum offering to terminated vested employees.

This offering resulted in settling the pension obligations towards these employees. The past-service cost gain is allocated to the respective sectors of the US employees involved, whereas the settlement loss is allocated fully to Pensions in IG&S as it related to inactive employees.

The overall funded status of our defined-benefit pension plans in 2014 decreased compared to 2013 due to a decrease in discount rates used to measure the defined benefit obligation. The deficits recognized on our balance sheet increased by approximately EUR 393 million due to lower discount rates in the US and Germany and a new adopted mortality table in the US.

In 2014, further progress was made in managing the financial exposure to defined-benefit plans by two further buy-ins in the UK plan.

For further information, refer to note 20, Post-employment benefits.

### **5.1.6 Restructuring and impairment charges**

**The year 2015**

In 2015, IFO included net charges totaling EUR 171 million for restructuring. 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 nil.

2014 included EUR 414 million of restructuring charges and a goodwill impairment of EUR 2 million at Lighting and EUR 1 million at Healthcare.

For further information on sensitivity analysis, please refer to note 11, Goodwill.

In 2015, the most significant restructuring projects related to Lighting and Healthcare and were driven by industrial footprint rationalization and the overhead cost reduction program. Restructuring projects at Lighting centered on the declining conventional lamps industry and Professional Lighting Solutions, the largest of which took place in France and Indonesia. Restructuring projects at Healthcare mainly took place in the US and France. Consumer Lifestyle restructuring projects were mainly related to Italy.

**Table of Contents**

Group performance 5.1.7

In 2014, the most significant restructuring projects related to Lighting and IG&S and were driven by industrial footprint rationalization and the Accelerate! transformation program. Restructuring projects at Lighting centered on Light Sources & Electronics and Professional Lighting Solutions, the largest of which took place in Belgium, the Netherlands and France. Innovation, Group & Services restructuring projects were mainly related to IT and group and country overheads and centered primarily on the Netherlands, the US and Belgium. Restructuring projects at Healthcare mainly took place in the US and the Netherlands. Consumer Lifestyle restructuring projects were mainly in the Netherlands.

For further information on restructuring, refer to note 19, Provisions.

Philips Group

**Restructuring and related charges** in millions of EUR

2013 - 2015

	2013	2014	2015
<b>Restructuring and related charges per sector:</b>			
Healthcare	(6)	68	61
Consumer Lifestyle	10	8	37
Lighting	77	225	93
Innovation, Group & Services	3	113	(20)
<b>Continuing operations</b>	<b>84</b>	<b>414</b>	<b>171</b>
<b>Discontinued operations</b>	<b>33</b>	<b>18</b>	<b>5</b>
<b>Cost breakdown of restructuring and related charges:</b>			
Personnel lay-off costs	95	354	194
Release of provision	(62)	(36)	(88)
Restructuring-related asset impairment	25	57	46
Other restructuring-related costs	26	39	19
<b>Continuing operations</b>	<b>84</b>	<b>414</b>	<b>171</b>
<b>Discontinued operations</b>	<b>33</b>	<b>18</b>	<b>5</b>

**The year 2014**

In 2014, IFO included net charges totaling EUR 414 million for restructuring. 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 at Healthcare and EUR 2 million at Lighting.

2013 included EUR 84 million of restructuring charges and a goodwill impairment of EUR 2 million at Healthcare and EUR 26 million at Consumer Luminaires, mainly as a consequence of reduced growth rates resulting from a slower-than-anticipated recovery of certain markets, as well as delays in the introduction of new product ranges.

For further information on sensitivity analysis, please refer to note 11, Goodwill.

In 2014, the most significant restructuring projects related to Lighting and IG&S and were driven by industrial footprint rationalization and the Accelerate! transformation program. Restructuring projects at Lighting centered on Light Sources & Electronics and Professional Lighting

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Solutions, the largest of which took place in the Belgium, Netherlands and France. Innovation, Group & Services restructuring projects mainly were related to IT and group and country overheads and centered primarily on the Netherlands, US and Belgium. Restructuring projects at Healthcare mainly took place in the US and the Netherlands. Consumer Lifestyle restructuring projects were mainly in the Netherlands.

In 2013, the more significant restructuring projects were related to industrial footprint rationalization at Lighting. The largest projects were centered at Consumer Luminaires and Light Sources & Electronics, mainly in the United States, France and Belgium. Innovation Group & Services restructuring projects were largely focused on the Financial Operations Service Units, primarily in Italy, France and the United States. Restructuring projects at Consumer Lifestyle were mainly seen at Personal Care in the Netherlands and Austria and Coffee in Italy.

For further information on restructuring, refer to note 19, Provisions.

### 5.1.7 Financial income and expenses

#### The year 2015

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

Philips Group

**Financial income and expenses** in millions of EUR

2013 - 2015

	2013	2014	2015
Interest expense (net)	(269)	(251)	(302)
Sale of securities		60	20
Impairments	(10)	(17)	(46)
Other	(51)	(93)	(41)
<b>Financial income and expenses</b>	<b>(330)</b>	<b>(301)</b>	<b>(369)</b>

Net interest expense in 2015 was EUR 51 million higher than in 2014, mainly due to a weaker euro against the US dollar in relation to interest expenses on USD bonds.

The gain from the sale of stakes in 2015 amounted to EUR 20 million, mainly from Assembléon Technologies B.V., Silicon & Software Systems and other equity interest.

Impairments amounted to EUR 46 million mainly due to valuation allowances.

Other financial expense amounted to EUR 41 million in 2015, primarily consisting of interest expense related to the jury verdict in the Masimo litigation, and accretion expense associated with other discounted provisions.

For further information, refer to note 7, Financial income and expenses.



**Table of Contents**

[Group performance 5.1.8](#)

**The year 2014**

The net interest expense in 2014 was EUR 18 million lower than in 2013, mainly as a result of lower average outstanding debt and interest related to pensions in 2014.

The gain from the sale of stakes in 2014 amounted to EUR 60 million, mainly from Neusoft, Chimei Innolux, Gilde III and Sapiens.

Other financial expense was a EUR 93 million in 2014, primarily consisting of interest expense related to the jury verdict in the Masimo litigation, and accretion expense associated with other discounted provisions and uncertain tax positions.

Other financial income was a EUR 51 million loss in 2013, primarily consisting of a EUR 25 million accretion expense (mainly associated with discounted provisions) and EUR 24 million of other financing charges.

For further information, refer to note 7, Financial income and expenses.

**5.1.8 Income taxes**

**The year 2015**

Income taxes amounted to EUR 239 million, compared to EUR 26 million in 2014. The effective income tax rate in 2015 was 38.4%, compared to 14.1% in 2014. The increase was mainly due to a significant change in the geographical mix of actual profits and the absence of various items that reduced the charge in the prior year, in particular favorable tax regulations relating to R&D investments in 2014.

For 2016, we expect our effective tax rate to be in the 30% to 35% range. However, the actual rate will depend on the geographical mix of actual profits.

For further information, refer to note 8, Income taxes.

**The year 2014**

Income taxes amounted to EUR 26 million, compared to EUR 466 million in 2013. The effective income tax rate was 14.1%. The decrease in 2014 was mainly due to lower income before tax and application of favorable tax regulations relating to R&D investments. The comparable effective income tax rate for 2013 was 30.6%.

**5.1.9 Results of investments in associates**

**The year 2015**

Philips Group

**Results of investments in associates** in millions of EUR

2013 - 2015

2013      2014      2015

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Company's participation in income	5	30	10
Investment impairment and other items	(30)		19
Dilution gain		32	1
<b>Results of Investments in associates</b>	<b>(25)</b>	<b>62</b>	<b>30</b>

Results related to investments in associates decreased from a gain of EUR 62 million in 2014 to a gain of EUR 30 million in 2015. 2015 included proceeds from the sale of Assembléon Technologies B.V., while 2014 included a EUR 32 million dilution gain related to Philips' stake in Corindus Vascular Robotics.

The Company's participation in income decreased from EUR 30 million in 2014 to EUR 10 million in 2015. The gain in 2015 was mainly attributable to the results of Philips Medical Capital.

For further information, refer to note 5, Interests in entities.

### **The year 2014**

The results related to investments in associates improved from a loss of EUR 25 million in 2013 to a gain of EUR 62 million in 2014. 2014 included a EUR 32 million dilution gain related to Philips' stake in Corindus Vascular Robotics, while 2013 included a provision for the net impact of expected payments related to the agreed transfer of the remaining 30% stake in the TP Vision joint venture.

The Company's participation in income increased from EUR 5 million in 2013 to a gain of EUR 30 million in 2014. The gain in 2013 was mainly attributable to the results of Philips Medical Capital.

For further information, refer to note 5, Interests in entities.

### **5.1.10 Non-controlling interests**

#### **The year 2015**

Net income attributable to non-controlling interests amounted to a gain of EUR 14 million in 2015, compared to a loss of EUR 4 million in 2014.

#### **The year 2014**

Net income attributable to non-controlling interests amounted to a loss of EUR 4 million in 2014, compared to a gain of EUR 3 million in 2013.

## **Table of Contents**

[Group performance 5.1.11](#)

### **5.1.11 Discontinued operations**

#### **The year 2015**

Discontinued operations consist primarily of the combined businesses of Lumileds and Automotive, the Audio, Video, Multimedia & Accessories business, and the Television business. The results related to these businesses are reported under Discontinued operations in the Consolidated statements of income and Consolidated statements of cash flows.

In 2014, Philips announced the start of the process to combine the Lumileds and Automotive Lighting businesses into a stand-alone company and explore strategic options to attract capital from third-party investors for this combined business.

As announced on January 22, 2016, Philips and GO Scale Capital have withdrawn their filing with the Committee of Foreign Investment in the United States (CFIUS) and terminated the agreement pursuant to which the consortium led by GO Scale Capital would acquire an 80.1% interest in the combined businesses of Lumileds and Automotive. Despite the parties' extensive efforts to mitigate CFIUS' concern, regulatory clearance has not been granted for this particular transaction. Philips is actively discussing the sale of the business with potential buyers and expects a transaction to be completed in the year 2016.

Income from discontinued operations increased by EUR 55 million to EUR 245 million in 2015. The year-on-year increase was mainly due to the positive impact from the treatment of depreciation and amortization of assets held for sale. Income from discontinued operations mainly consisted of net income of EUR 246 million related to the combined businesses of Lumileds and Automotive and a net loss of EUR 1 million, mainly related to the Audio, Video, Multimedia & Accessories and Television business.

For further information, refer to note 3, Discontinued operations and other assets classified as held for sale.

#### **The year 2014**

Discontinued operations consist primarily of the combined businesses of Lumileds and Automotive, the Audio, Video, Multimedia and Accessories (AVM&A) business, and the Television business. The results related to these businesses are reported under Discontinued operations in the Consolidated statements of income and Consolidated statements of cash flows.

On June 30, 2014, Philips announced the start of the process to combine the Lumileds and Automotive Lighting businesses into a stand-alone company and explore strategic options to attract capital from third-party investors for this combined business.

The AVM&A business, also known as WooX Innovations, was divested to Gibson Brands Inc. in June 2014. The Television business was divested as part of a strategic partnership agreement with TPV Technology Ltd (TPV) that was signed on April 1, 2012. Philips retained a 30% interest in TP Vision Holdings BV (TP Vision venture) and on May 29, 2014 transferred the remaining 30% stake in TP Vision to TPV. After completion, TPV fully owns TP Vision, which will enable further integration with TPV's TV business.

Income from discontinued operations increased by EUR 52 million to EUR 190 million in 2014. The year-on-year increase was mainly due to a net gain related to the divestment of our Television business. Income from discontinued operations mainly consisted of net income of EUR 141 million related to the combined businesses of Lumileds and Automotive, EUR 18 million related to AVM&A, and EUR 31 million mainly related to other discontinued operations mainly net income on the Television business, partly offset by the European Commission's Smartcard fine.

For further information, refer to note 3, Discontinued operations and other assets classified as held for sale.

### **5.1.12 Net income**

#### **The year 2015**

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Net income increased from EUR 411 million in 2014 to EUR 659 million in 2015. The increase was largely due to higher IFO of EUR 506 million and net income from discontinued operations of EUR 55 million, partly offset by higher income tax charges of EUR 213 million and lower results from investments in associates of EUR 32 million.

Basic earnings per common share from net income attributable to shareholders increased from EUR 0.45 per common share in 2014 to EUR 0.70 per common share in 2015.

### **The year 2014**

Net income decreased from EUR 1,172 million in 2013 to EUR 411 million in 2014. The decrease was largely due to lower IFO of EUR 1,369 million, partly offset by lower income tax charges of EUR 440 million and higher results from investment in associates of EUR 87 million.

Basic earnings per common share from net income attributable to shareholders decreased from EUR 1.28 per common share in 2013 to EUR 0.45 per common share in 2014.

### **5.1.13 Acquisitions and divestments**

#### **Acquisitions**

In 2015, Philips completed four acquisitions, the largest were Volcano Corporation, an image-guided therapy company based in the United States, and Blue Jay Consulting, a leading provider of hospital emergency

## **Table of Contents**

### **Group performance 5.1.13**

room consulting services. Acquisitions in 2015 and prior years led to post-merger integration charges of EUR 107 million in Healthcare and EUR 5 million in Lighting.

In 2014, Philips acquired Unisensor, a Danish healthcare company, and a 51% interest in General Lighting Company (GLC) based in the Kingdom of Saudi Arabia. Philips also purchased some minor magnetic resonance imaging (MRI) activities from Hologic, a US healthcare company. Acquisitions in 2014 and prior years led to post-merger integration charges of EUR 1 million in Healthcare, EUR 1 million in Consumer Lifestyle and EUR 19 million in Lighting.

In 2013, there were four minor acquisitions. Acquisitions in 2013 and prior years led to post-merger integration charges of EUR 6 million in Healthcare, EUR 4 million in Consumer Lifestyle EUR, and 6 million in Lighting.

### **Divestments**

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

In 2014, Philips completed the divestment of its Lifestyle Entertainment activities to Gibson Brands Inc. Philips also completed two other divestments of business activities which related to Healthcare and Lighting activities.

In 2013, Philips completed several divestments of business activities, mainly related to certain Healthcare activities.

For details, please refer to note 4, Acquisitions and divestments.

### **5.1.14 Performance by geographic cluster**

#### **The year 2015**

In 2015, sales increased 13% nominally, largely due to favorable foreign exchange impacts, and 2% on a comparable basis, driven by Healthcare and Consumer Lifestyle.

Sales in mature geographies were EUR 1,832 million higher than in 2014, or 1% higher on a comparable basis. Sales in Western Europe were 1% higher than in 2014, with growth at Healthcare and Consumer Lifestyle partly offset by a decline at Lighting. Sales in North America increased by EUR 1,417 million, or 1% on a comparable basis. Comparable sales in other mature geographies showed a 3% increase, with growth at Healthcare and Consumer Lifestyle, while Lighting was in line with 2014.

In growth geographies, sales increased by EUR 1,021 million, or 4% on a comparable basis, with high-single-digit growth at Consumer Lifestyle and Healthcare, partly offset by a mid-single digit decline at Lighting.

Double-digit growth in Central & Eastern Europe and high-single-digit growth in Asia Pacific and India were partly offset by flat growth year-on-year in China.

#### **The year 2014**

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In 2014, sales declined 1% on a comparable basis (-3% nominally largely due to unfavorable foreign exchange impacts) mainly driven by Healthcare and Lighting.

Sales in mature geographies were EUR 318 million lower than in 2013, or 1% lower on a comparable basis. Sales in Western Europe were 1% lower than in 2013, with declines at Healthcare and Lighting partly offset by growth at Consumer Lifestyle. Sales in North America declined by EUR 205 million, or 2% on a comparable basis. Comparable sales in other mature geographies showed a 1% decline, with growth at Healthcare and Consumer Lifestyle offset by a decline at Lighting and IG&S.

In growth geographies, sales declined by EUR 281 million mainly due to unfavorable foreign exchange impacts and were flat on a comparable basis, with high-single-digit growth at Consumer Lifestyle offset by a

**Table of Contents**

Group performance 5.1.15

decline at Healthcare and Lighting. Strong growth was achieved in India and Middle East & Turkey, while decline was seen in China and Russia & Central Asia.

**5.1.15 Cash flows provided by continuing operations****The year 2015****Cash flows from operating activities**

Net cash flows from operating activities amounted to EUR 1,167 million in 2015, which was EUR 136 million lower than in 2014, mainly due to pension settlement costs and CRT litigation claims, partly offset by higher earnings.

Condensed consolidated statements of cash flows for the years ended December 31, 2013, 2014 and 2015 are presented below:

Philips Group

**Condensed consolidated cash flow statements<sup>1)</sup>**

in millions of EUR

2013 - 2015

	2013	2014	2015
Net income	1,172	411	659
Adjustments to reconcile net income to net cash provided by operating activities	(260)	892	508
<b>Net cash provided by operating activities</b>	<b>912</b>	<b>1,303</b>	<b>1,167</b>
Net cash used for investing activities	(862)	(984)	(1,941)
<b>Cash flows before financing activities<sup>2)</sup></b>	<b>50</b>	<b>319</b>	<b>(774)</b>
Net cash used for financing activities	(1,241)	(1,189)	508
<b>Cash used for continuing operations</b>	<b>(1,191)</b>	<b>(870)</b>	<b>(266)</b>
Net cash (used for) provided by discontinued operations	(115)	193	79
Effect of changes in exchange rates on cash and cash equivalents	(63)	85	80
<b>Total change in cash and cash equivalents</b>	<b>(1,369)</b>	<b>(592)</b>	<b>(107)</b>
Cash and cash equivalents at the beginning of year	3,834	2,465	1,873
<b>Cash and cash equivalents at the end of year</b>	<b>2,465</b>	<b>1,873</b>	<b>1,766</b>

- 1) Please refer to section 12.7, Consolidated statements of cash flows, of this report  
2) Please refer to chapter 15, Reconciliation of non-GAAP information, of this report

**Cash flows from investing activities**

In 2015, cash flows from investing activities resulted in a net outflow of EUR 1,941 million. This was attributable to EUR 1,137 million used for acquisitions of businesses and non-current financial assets, EUR 842 million cash used for net capital expenditures, and EUR 72 million used for derivatives and current financial assets, partly offset by EUR 110 million of net proceeds from non-current financial assets and divestments.

In 2014, cash flows from investing activities resulted in a net outflow of EUR 984 million. This was attributable to EUR 806 million cash used for net capital expenditures, EUR 258 million used for acquisitions of businesses and non-current financial assets, and EUR 7 million used for derivatives and current financial assets, partly offset by EUR 87 million of net proceeds from non-current financial assets and divestments.

**Net capital expenditures**

Net capital expenditures amounted to a cash outflow of EUR 842 million, compared to an outflow of EUR 806 million in 2014. The year-on-year increase was mainly due to higher investments at Healthcare and Lighting.



## **Table of Contents**

### **Group performance 5.1.15**

#### **Acquisitions and non-current financial assets**

The net cash impact of acquisitions of businesses and non-current financial assets in 2015 was a total of EUR 1,137 million. There was a EUR 1,116 million outflow for acquisitions of businesses, mainly related to the acquisition of Volcano and a EUR 21 million outflow for non-current financial assets.

The net cash impact of acquisitions of businesses and non-current financial assets in 2014, was a total of EUR 258 million. There was a EUR 177 million outflow for acquisitions of businesses mainly related to the acquisition of a 51% interest in the General Lighting Company (GLC) in the Kingdom of Saudi Arabia, and a EUR 81 million outflow for non-current financial assets, mainly in the form of a EUR 60 million loan to TPV Technology Limited.

#### **Divestments, derivatives and current financial assets**

Cash proceeds of EUR 110 million were received, mainly from the divestment of the Assembléon Holding B.V., the OEM remote control business and Axsun Technologies LLC. Cash flows from derivatives and current financial assets led to a net cash outflow of EUR 72 million.

In 2014, cash proceeds of EUR 87 million were received, mainly from the divestment of the Shakespeare business and the sale of shares in Neusoft. Cash flows from derivatives and current financial assets led to a net cash outflow of EUR 7 million.

#### **Cash flows from financing activities**

Net cash provided by financing activities in 2015 was EUR 508 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 1,231 million. Additionally, net cash outflows for share buy-back and share delivery totaled EUR 425 million.

Net cash used for financing activities in 2014 was EUR 1,189 million. Philips' shareholders were given EUR 729 million in the form of a dividend, of which the cash portion of the dividend amounted to EUR 292 million. The net impact of changes in debt was a decrease of EUR 301 million. Additionally, net cash outflows for share buy-back and share delivery totaled EUR 596 million.

### **The year 2014**

#### **Cash flows from operating activities**

Net cash flow from operating activities amounted to EUR 1,303 million in 2014, which was EUR 391 million higher than in 2013, mainly due to higher inflows from working capital reductions.

#### **Cash flows from investing activities**

In 2014, cash flow from investing activities resulted in a net outflow of EUR 984 million. This was attributable to EUR 806 million cash used for net capital expenditures, EUR 258 million used for acquisitions of businesses and non-current financial assets, and EUR 7 million used for derivatives and current financial assets, partly offset by EUR 87 million of net proceeds from non-current financial assets and divestments.

In 2013, cash flows from investing activities resulted in a net outflow of EUR 862 million. This was attributable to EUR 830 million cash used for net capital expenditures, EUR 101 million cash used for derivatives and current financial assets, as well as a EUR 24 million used for acquisitions of businesses and non-current financial assets, partly offset by EUR 93 million of net proceeds from divestment.

#### **Net capital expenditures**

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Net capital expenditures amounted to a cash outflow of EUR 806 million, compared to an outflow of EUR 830 million in 2013. The year-on-year decrease was mainly due to lower investments at Healthcare and Lighting.

### **Acquisitions and non-current financial assets**

The net cash impact of acquisitions of businesses and non-current financial assets in 2014 was a total of EUR 258 million. There was a EUR 177 million outflow for acquisitions of businesses, mainly related to the acquisition of a 51% interest in the General Lighting Company (GLC) in The Kingdom of Saudi Arabia (KSA), and a EUR 81 million outflow for non-current financial assets, mainly in the form of a EUR 60 million loan to TPV Technology Limited.

The net cash impact of acquisitions of businesses and non-current financial assets in 2013 was a total of EUR 24 million. There was a EUR 11 million outflow for acquisitions of businesses and a EUR 13 million outflow for non-current financial assets.

**Table of Contents**

Group performance 5.1.16

**Divestments, derivatives and current financial assets**

Cash proceeds of EUR 87 million were received from divestment of the Shakespeare business and the sale of shares in Neusoft. Cash flows from derivatives and current financial assets led to a net cash outflow of EUR 7 million.

In 2013, cash proceeds of EUR 93 million were received from divestments, mainly of non-strategic businesses within Healthcare. Cash flows from derivatives and current financial assets led to a net cash outflow of EUR 101 million.

**Cash flows from financing activities**

Net cash used for financing activities in 2014 was EUR 1,189 million. Philips shareholders were given EUR 729 million in the form of a dividend, of which the cash portion of the dividend amounted to EUR 292 million. The net impact of changes in debt was a decrease of EUR 301 million. Additionally, net cash outflows for share buy-back and share delivery totaled EUR 596 million.

Net cash used for financing activities in 2013 was EUR 1,241 million. Philips shareholders were given EUR 678 million in the form of a dividend, of which the cash portion of the dividend amounted to EUR 272 million. The net impact of changes in debt was a decrease of EUR 407 million, including the redemption of a USD 143 million bond. Additionally, net cash outflows for share buy-back and share delivery totaled EUR 562 million.

**5.1.16 Cash flows from discontinued operations****The year 2015**

In 2015, cash inflow from discontinued operations as reported within operating activities amounted to EUR 79 million, mainly attributable to a cash inflow of EUR 115 million from the Automotive and Lumileds businesses, offset by a cash outflow from the Audio, Video, Multimedia & Accessories business of EUR 37 million.

In 2014, cash inflow from discontinued operations amounted to EUR 193 million. Cash flows from the businesses reported in operating activities amounted to a EUR 105 million cash inflow, mainly attributable to a cash inflow from the Automotive and Lumileds businesses of EUR 240 million, offset by cash outflow from the Audio, Video, Multimedia & Accessories business of EUR 107 million. The cash consideration received for the sale of Audio, Video, Multimedia & Accessories business amounted to EUR 88 million and was reported as cash flow from investing activities.

**The year 2014**

In 2014, cash from discontinued operations amounted to an inflow of EUR 193 million. The combined Automotive and Lumileds businesses had a cash inflow of EUR 240 million attributable to operating activities. The Television business used net cash of EUR 8, attributable to operating activities. The Audio, Video Multimedia and Accessories business used net cash of EUR 19 million, with cash outflows from operating activities of EUR 107 million, partly offset by EUR 88 million of cash inflows from investing activities.

In 2013, cash from discontinued operations amounted to an outflow of EUR 115 million. Cash flows from the businesses reported in operating activities caused by a cash outflow of EUR 68 million, mainly due to cash outflows of the Television business of EUR 91 million, and of the Audio, Video, Multimedia and Accessories business of EUR 72 million offset by a cash inflow of the Automotive and Lumileds businesses of EUR 94 million. A cash outflow of EUR 47 million related to the divestment of the Television business reported in cash flow from investing activities.

**5.1.17 Financing****The year 2015**

Condensed consolidated balance sheets for the years 2013, 2014 and 2015 are presented below:

Philips Group

**Condensed consolidated balance sheet<sup>1)</sup>** in millions of EUR

2013 - 2015

	2013	2014	2015
Intangible assets	9,766	10,526	12,216
Property, plant and equipment	2,780	2,095	2,322
Inventories	3,240	3,314	3,463
Receivables	4,892	5,040	5,287
Assets held for sale	507	1,613	1,809
Other assets	2,909	3,891	4,113
Payables	(5,435)	(5,293)	(5,652)
Provisions	(2,554)	(3,445)	(3,225)
Liabilities directly associated with assets held for sale	(348)	(349)	(407)
Other liabilities	(3,094)	(4,193)	(4,152)
<b>Net asset employed</b>	<b>12,663</b>	<b>13,199</b>	<b>15,774</b>
Cash and cash equivalents	2,465	1,873	1,766
Debt	(3,901)	(4,104)	(5,760)
<b>Net debt</b>	<b>(1,436)</b>	<b>(2,231)</b>	<b>(3,994)</b>
Non-controlling interests	(13)	(101)	(118)
Shareholders' equity	(11,214)	(10,867)	(11,662)
<b>Financing</b>	<b>(12,663)</b>	<b>(13,199)</b>	<b>(15,774)</b>

<sup>1)</sup> Please refer to section 12.6, Consolidated balance sheets, of this report  
Philips expects the financing in 2016 to be broadly in line with 2015.

### 5.1.18 Cash and cash equivalents

#### The year 2015

In 2015, cash and cash equivalents decreased by EUR 107 million to EUR 1,766 million at year-end. The decrease was mainly attributable to an outflow of EUR 1,137 on acquisitions mainly related to Volcano, cash outflows for treasury share transactions of EUR 425 million, and a cash dividend payout of EUR 298 million. This was partly offset by EUR 1,231 million from increases in debt, EUR 325 million free cash flow and EUR 110 million related to divestments.

**Table of Contents**[Group performance 5.1.19](#)**The year 2014**

In 2014, cash and cash equivalents decreased by EUR 592 million to EUR 1,873 million at year-end. The decrease was mainly attributable to an outflow on cash outflows for treasury share transactions of EUR 596 million, cash dividend payout of EUR 292 million, EUR 301 million from decreases in debt and a EUR 258 million outflow related to acquisitions. This was partly offset by a EUR 497 million free cash flow.

In 2013, cash and cash equivalents decreased by EUR 1,369 million to EUR 2,465 million at year-end. The decrease was mainly attributable to an outflow on net capital expenditures of EUR 830 million, cash outflow for treasury share transactions of EUR 562 million, cash dividend payout of EUR 272 million, EUR 407 million from decreases in debt and a EUR 115 million outflow related to discontinued operations. This was partly offset by a EUR 912 million inflow from operations.

**5.1.19 Debt position****The year 2015**

Total debt outstanding at the end of 2015 was EUR 5,760 million, compared with EUR 4,104 million at the end of 2014.

Philips Group

**Changes in debt** in millions of EUR

2013 - 2015

	2013	2014	2015
New borrowings	(64)	(69)	(1,335)
Repayments	471	370	104
Currency effects and consolidation changes	226	(504)	(425)
<b>Changes in debt</b>	<b>633</b>	<b>(203)</b>	<b>(1,656)</b>

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.

In 2014, total debt increased by EUR 203 million. New borrowings of EUR 69 million consisted mainly of replacements to lease contracts. Repayment of EUR 370 million included a EUR 250 million repayment of a five-year loan. Other changes resulting from consolidation and currency effects led to an increase of EUR 504 million.

At the end of 2015, long-term debt as a proportion of the total debt stood at 71% with an average remaining term of 10.7 years, compared to 90% and 11.6 years at the end of 2014.

For further information, please refer to note 18, Debt.

**The year 2014**

Total debt outstanding at the end of 2014 was EUR 4,104 million, compared with EUR 3,901 million at the end of 2013.

In 2014, total debt increased by EUR 203 million. New borrowings of EUR 69 million consisted mainly of replacements to lease contracts. Repayment of EUR 370 million included a EUR 250 million repayment of a five year loan. Other changes resulting from consolidation and currency effects led to an increase of EUR 504 million.

In 2013, total debt decreased by EUR 633 million. New borrowings of EUR 64 million consisted mainly of replacements to lease contracts. Repayment of EUR 471 million included a USD 143 million redemption on USD bonds as well as payments on short-term debt. Other changes resulting from consolidation and currency effects led to a decrease of EUR 226 million.

Long-term debt as a proportion of the total debt stood at 90% at the end of 2014 with an average remaining term of 11.6 years, compared to 85% and 12.8 years at the end of 2013.

For further information, please refer to note 18, Debt.

**5.1.20 Shareholders equity**

**The year 2015**

Shareholders equity increased by EUR 795 million in 2015 to EUR 11,662 million at December 31, 2015. The increase was mainly a result of EUR 645 million net income and EUR 791 million of other comprehensive income, partially 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.

**Table of Contents**[Group performance 5.1.21](#)

The number of outstanding common shares of Royal Philips at December 31, 2015 was 917 million (2014: 914 million). At the end of 2015, the Company held 11.8 million shares in treasury to cover the future delivery of shares (2014: 17.1 million shares). This was in connection with the 39.1 million rights outstanding at the end of 2015 (2014: 40.8 million rights) under the Company's long-term incentive plans. At the end of 2015, the Company held 2.2 million shares for cancellation (2014: 3.3 million shares).

**The year 2014**

Shareholders' equity decreased by EUR 347 million in 2014 to EUR 10,867 million at December 31, 2014. The decrease was mainly a result of EUR 714 million related to purchase shares for the share buy-back program and coverage for the LTI program, partially offset by EUR 415 million net income and EUR 50 million of other comprehensive income. The dividend payment to shareholders in 2014 reduced equity by EUR 293 million including tax and service charges, while the delivery of treasury shares increased equity by EUR 116 million and share-based compensation plans increased equity by EUR 88 million.

Shareholders' equity increased by EUR 63 million in 2013 to EUR 11,214 million at December 31, 2013. The increase was mainly a result of EUR 1,169 million net income, partially offset by EUR 476 million of currency translation losses and a EUR 669 million related to the purchase of treasury shares. The dividend payment to shareholders in 2013 reduced equity by EUR 272 million, while the delivery of treasury shares increased equity by EUR 118 million and share-based compensation plans increased equity by EUR 105 million.

The number of outstanding common shares of Royal Philips at December 31, 2014 was 914 million (2013: 913 million).

At the end of 2014, the Company held 17.1 million shares in treasury to cover the future delivery of shares (2013: 20.7 million shares). This was in connection with the 40.8 million rights outstanding at the end of 2014 (2013: 44.3 million rights) under the Company's long-term incentive plans. At the end of 2014, the Company held 3.3 million shares for cancellation (2013: 3.9 million shares).

**5.1.21 Net debt to group equity****The year 2015**

Philips ended 2015 in a net debt position (total debt less cash and cash equivalents) of EUR 3,994 million, compared to a net debt position of EUR 2,231 million at the end of 2014.

**The year 2014**

Philips ended 2014 in a net debt position (total debt less cash and cash equivalents) of EUR 2,231 million, compared to a net debt position of EUR 1,436 million at the end of 2013.

**5.1.22 Liquidity position****The year 2015**

Including the Company's cash position (cash and cash equivalents), as well as its EUR 1.8 billion committed revolving credit facility, the Company had access to available liquidity of EUR 3,566 million vs. Gross Debt (including short and long-term) of EUR 5,760 million as of December 31, 2015.

Including the Company's cash position (cash and cash equivalents), as well as its EUR 1.8 billion committed revolving credit facility, the Company had access to available liquidity of EUR 3,673 million vs. Gross Debt (including short and long-term) of EUR 4,104 million as of December 31, 2014.

Philips Group

**Liquidity position** in millions of EUR

2013 - 2015

	2013	2014	2015
Cash and cash equivalents	2,465	1,873	1,766
Committed revolving credit facility/CP program/Bilateral loan	1,800	1,800	1,800
<b>Liquidity</b>	<b>4,265</b>	<b>3,673</b>	<b>3,566</b>
Available-for-sale financial assets at fair value	65	75	75
Short-term debt	(592)	(392)	(1,665)
Long-term debt	(3,309)	(3,712)	(4,095)
<b>Net available liquidity resources</b>	<b>429</b>	<b>(356)</b>	<b>(2,119)</b>

Philips has a EUR 1.8 billion committed revolving credit facility that can be used for general group purposes and as a backstop of its commercial paper program and will mature in February 2018. The commercial paper program amounts to USD 2.5 billion, under which Philips can issue commercial paper up to 364 days in

Annual Report 2015 49



**Table of Contents**[Group performance 5.1.22](#)

tenor, both in the US and in Europe, in any major freely convertible currency. There is a panel of banks, in Europe and in the US, which service the program. The interest is at market rates prevailing at the time of issuance of the commercial paper. There is no collateral requirement in the commercial paper program. Also, there are no limitations on Philips' use of funds from the program. As at December 31, 2015, Philips did not have any loans outstanding under these facilities.

Philips' existing long-term debt is rated Baa1 (with stable outlook) by Moody's and BBB+ (with stable outlook) by Standard & Poor's. Our net debt position is managed in such a way that we expect to retain a strong investment grade credit rating. Furthermore, the Group's aim when managing the net debt position is dividend stability and a pay-out ratio of 40% to 50% of continuing net income. Following the intended separation of the Lighting business, the dividend pay-out ratio with respect to future years could be subject to change. The Company's outstanding long-term debt and credit facilities do not contain financial covenants or cross-acceleration provisions that are based on adverse changes in ratings or on material adverse change.

As at December 31, 2015, Philips had total cash and cash equivalents of EUR 1,766 million. Philips pools cash from subsidiaries to the extent legally and economically feasible. Cash not pooled remains available for local operational or investment needs.

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

**The year 2014**

Including the Company's cash position (cash and cash equivalents), as well as its EUR 1.8 billion committed revolving credit facility, the Company had access to available liquid resources of EUR 3,673 million vs Gross Debt (including short and long term) of EUR 4,104 million as of December 31, 2014.

**5.1.23 Cash obligations****Contractual cash obligations**

Presented below is a summary of the Group's contractual cash obligations and commitments at December 31, 2015.

Philips Group

**Contractual cash obligations<sup>1)</sup>** in millions of EUR

2015

	Payments due by period				
	total	less than 1 year	1-3 years	3-5 years	after 5 years
Long-term debt <sup>2)</sup>	4,034	84	1,152	1	2,797
Finance lease obligations	242	72	92	36	42
Short-term debt	1,515	1,515			
Operating leases	952	243	280	162	267
Derivative liabilities	995	253	383	156	203
Interest on debt <sup>3)</sup>	2,767	221	438	334	1,774

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Purchase obligations <sup>4)</sup>	175	68	69	30	8
Trade and other payables	2,673	2,673			
<b>Contractual cash obligations</b>	<b>13,353</b>	<b>5,129</b>	<b>2,414</b>	<b>719</b>	<b>5,091</b>

- 1) Obligations in this table are undiscounted
  - 2) Long-term debt includes short-term portion of long-term debt and excludes finance lease obligations
  - 3) Approximately 32% of the debt bears interest at a floating rate. The majority of the interest payments on variable interest rate loans in the table above reflect market forward interest rates at the period end and these amounts may change as the market interest rate changes
  - 4) Philips has commitments related to the ordinary course of business which in general relate to contracts and purchase order commitments for less than 12 months. In the table, only the commitments for multiple years are presented, including their short-term portion
- Philips has no material commitments for capital expenditures.

Additionally, Philips has a number of commercial agreements, such as supply agreements, which provide that certain penalties may be charged to the Company if it does not fulfill its commitments.

Certain Philips suppliers factor their trade receivables from Philips with third parties through supplier finance arrangements. At December 31, 2015 approximately EUR 395 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 note 20, Post-employment benefits.

The Company had EUR 297 million restructuring-related provisions by the end of 2015, of which EUR 228 million is expected to result in cash outflows in 2016. Refer to note 19, Provisions for details of restructuring provisions.

**Table of Contents**[Group performance 5.1.23](#)

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 740 million), in cash or shares at the option of the shareholder, against the net income for 2015 and retained earnings. Further details will be given in the agenda for the Annual General Meeting of Shareholders, to be held on May 12, 2016.

**Guarantees**

Philips' policy is to provide guarantees and other letters of support only in writing. Philips does not provide other forms of support. At the end of 2015, the total fair value of guarantees recognized on the balance sheet amounted to EUR nil million (December 31, 2014: EUR nil million). Remaining off-balance-sheet business and credit-related guarantees provided on behalf of third parties and associates increased by EUR 16 million during 2015 to EUR 37 million (December 31, 2014: EUR 21 million).

**5.1.24 Procurement****The year 2015**

Global growth remained moderate during 2015. While the advanced economies showed a modest recovery, the emerging markets showed further declines in their growth rates. Main themes in 2015 were further signs of weakening economic growth in emerging markets, especially in China, strongly declining oil prices, commodity prices trending down slightly, and currency volatility.

Growth within the US, Europe and Japan was supported by declining oil and material prices, monetary policies and, in the case of Europe, the euro currency depreciation – the euro fell approximately 15% against the US dollar. The emerging market currencies more generally saw sharp depreciation and volatility during 2015, and the Chinese renminbi devalued as well.

Commodity prices continued to weaken in 2015. After increasing in the spring from their January lows, oil prices declined sharply, reflecting a combination of weaker global demand and steady supply growth, both from conventional oil fields as well as from shale production. The supply outlook was even larger following the nuclear deal with the Republic of Iran, resulting in additional supply from Iran on the global market.

Metal prices also fell 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 continued to fall. Current price levels are in some cases below levels seen during the lows of 2009. No change is foreseen in the short-term as demand remains steady but weak, supply remains excessive and the cost of the raw materials iron ore and coking coal are low.

The lower commodity market prices created a tailwind for Philips Procurement in 2015. Depending on economic conditions this may remain so in 2016. On the other hand, the current low level of raw material and energy prices also creates the risk of new headwind once the supply/demand situation reverses.

Concerning shortages, neon gas supply was tight globally, leading to a price peak in the course of 2015. This situation has normalized in the meantime. The helium tightness is not over yet, but supply continuity is not at risk for Philips.

The rapid progress of the Procurement transformation has led to a continued improvement in overall Procurement results. This has had a major positive and structural impact on overall cost levels in all Philips businesses.

**The year 2014**

Throughout 2014, market prices for energy and raw materials showed diverse trends. These commodities represent approximately 15% of our direct and indirect spend. Within the metals commodity group, copper prices declined in the course of the year, whereas others, e.g. aluminum, showed an upward trend. Also, in steel and resins, differences were seen between grades and regions. In general, annual average market prices were around 2013 levels. The global slowdown in the economy, and more specifically slow growth in China, did not yet lead to lower commodity market prices in the first quarters of 2014. From Q4, prices for raw materials, and especially oil, started to significantly decline as a

consequence of the continuing macroeconomic weakness, resulting in oversupplied markets.

Rare earth element prices continued to slide, and this contributed to higher savings levels in 2014. Contingency measures are in place to delay and mitigate the impact of a possible new hike in the price of rare earths in the future. The tight availability of xenon for halogen lamps has relaxed, and also the price level has started to come down. This is partly caused by lower demand for halogen lamps in end-markets. The availability and price of helium continues to be a concern, but measures have been taken to mitigate the impact.

## 5.2 Social performance

Our businesses provide innovative solutions that address major trends affecting the world – the demand for affordable healthcare, the need for greater energy efficiency, resource scarcity, and the desire for personal well-being.

## **Table of Contents**

### **Group performance 5.2**

Philips further strengthened its focus on sustainability in 2015 through a number of initiatives described in the Social and Environmental performance sections, including the introduction of new products and solutions and partnerships with the Red Cross and UNICEF through the Philips Foundation.

#### **Our people**

At Philips, a key element of our vision is to offer the best place to work for people who share our passion. Our people are one of our unique strengths, and each one of our employees is instrumental to Philips' success. Our strategy is based on the belief that every employee at Philips has talent and can grow and contribute with increasing impact, so we support all individuals in driving their development. We believe that the best place to work is an inclusive place to work, and we celebrate and foster an inclusive culture where everyone feels valued, respected, and where all of our people can thrive.

Our company people strategy is directly linked to our business strategy. In 2015, we continued on our path to creating two winning stand-alone companies, including ensuring the timely allocation of our employees to either Royal Philips or to Philips Lighting. We also continued to drive our Accelerate! transformation through our growth and performance culture, where we take ownership, we are eager to win, we team up to excel, and we always act with integrity. Alongside these behaviors, we focus on nurturing six competences which accelerate our transformation, and we offer related learning and development opportunities to all employees through our Philips University.

*Philips people share a passion for improving people's lives through meaningful innovation, and this passion has kept us all working together towards our common mission and vision during the past year. Throughout 2015, our people have demonstrated that we are one Philips family, even if we know that we will ultimately be part of Royal Philips or of Philips Lighting. As CHRO, I am proud to belong to Philips, and proud to be one of our Philips people.*

#### **Denise Haylor**

Chief Human Resources Officer

##### **5.2.1 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. Products and solutions from our portfolio that directly support the curative (care) or preventive (well-being) side of people's health determine the contribution to the social dimension. 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 Product portfolio, such as our energy-efficient lighting.

Through Philips products and solutions that directly support the curative or preventive side of people's health, we improved the lives of 881 million people in 2015, driven by our Healthcare sector. Additionally, our well-being products that help people live a healthy life improved the lives of 304 million, and our Green Products that contribute to a healthy ecosystem 1.7 billion people. After the elimination of double counts – people touched multiple times – we arrived at 2.0 billion lives. This is an increase of around 140 million compared to 2014, mainly driven by Healthcare in Greater China and North America, Consumer Lifestyle in Greater China, ASEAN and North America, and Lighting in North America and the Indian subcontinent.

More information on this metric can be found in [Methodology for calculating Lives Improved](#).

##### **5.2.2 Employee engagement**

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Employee engagement is key to our competitive performance and at the heart of our vision, promoting the best place to work for people who share our passion. Engaged employees are emotionally committed to and proud of our company, they help us meet our business goals, and they contribute to making our workplace the best it can be. We can only truly offer an environment in which all our people can thrive when we maintain a dialogue with our people to understand their needs. Our employees take the time for this dialogue, directly shaping the work environment and our inclusive culture. As a result, high engagement levels not only help Philips to grow, but also help us to understand our employees' needs in depth and respond to these in turn.

52 Annual Report 2015

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**Table of Contents**

[Group performance 5.2.2](#)

Given that employee feedback and input is so critical, we actively track it via quarterly surveys with a set of targeted questions. In 2014, we implemented a complementary, team-focused survey called My Accelerate! Survey (MAS) with accompanying promotion of Team Performance Dialogues with People Managers and their teams. This proved to be a positive driver of employee action to increase team effectiveness, and, as a result, we ran MAS in each quarter of 2015 as our way of monitoring engagement.

In 2015, MAS had an average employee response rate of 50% across all four quarters, and we recorded an overall engagement score of 71% favorable across the Philips population. This was in line with 2014 results, and we were pleased to see a significant downward trend in the unfavorable score (decreasing from 17% in 2014 to 7% in 2015).

For more information on MAS, please refer to subsection 14.2.1, Engaging our employees, of this report.

**5.2.3 Inclusion**

At Philips, we believe that the best place to work is an inclusive place to work. This means celebrating and fostering a work environment in which all of our people's ideas, knowledge, perspectives, experiences and styles are valued. It also means that all individuals are treated fairly and respectfully, have equal access to opportunities and resources, and can contribute fully to Philips' success. In this report we publish data on international, gender and age diversity, as proxies for the wider inclusion we promote.

Philips is a global company, and our executives originate from more than 35 countries. We embrace a global mindset and actively promote and build capability in this area. The composition of our Executive Committee and Supervisory Board likewise reflects our global focus.

In terms of gender diversity, we recorded an increase in the share of female executives to 19% at year-end 2015 up from 18% in 2014. We are well on track to achieve our aspiration of 20% female executives by year-end 2016. This is driven both by our active engagement of senior female leaders globally, and also by the fact that our inclusion culture is embedded in our people practices, policies and processes. Overall, 35% of Philips employees in 2015 were female. Philips has 7 persons in the Executive Committee (1 female) and 9 in the Supervisory Board (3 females), which means that 4 out of 16 positions (or 25%) are held by women.

Our comprehensive approach to succession planning for all executives and other key positions ensures we remain on track in terms of our gender targets, and also in terms of our broader inclusion aspirations. This approach drives development and career planning for all individuals, and ensures we build an inclusive work environment not only for today but also for the future. In terms of promotions in 2015, 10% of new Executives promoted internally were women, and women represented 24% of all external Executive hires. The decrease in female Management and Executive new hires compared with 2014 did not impact our overall gender diversity in these categories, as this was mainly offset by the relatively smaller proportion of female Management and Executive exits. Indeed, compared to the percentage of women employed by Philips in 2014, we see a relatively higher outflow of women in the staff categories and a lower outflow of female managers and executives. Overall, gender diversity either increased or was stable across all categories, and we will continue to drive gender-inclusive practices in terms of talent attraction, engagement, development and retention in 2016.

**Table of Contents**

[Group performance 5.2.3](#)

In 2015, our age diversity was similar to that of 2014, with relatively larger shifts taking place in the categories of women under 25, between 45 and 55, and over 55. We will continue to monitor age diversity as part of our inclusive culture in 2016.



## 5.2.4 Employment

### The year 2015

The total number of Philips Group employees (continuing operations) was 104,204 at the end of 2015, compared to 105,365 at the end of 2014. Approximately 38% were employed in the Healthcare sector, 32% in the Lighting sector and 16% in the Consumer Lifestyle sector.

Philips Group

#### Employees per sector in FTEs at year-end

2013 - 2015

	2013	2014	2015
Healthcare	37,008	37,065	40,099
Consumer Lifestyle	17,255	16,639	16,254
Lighting	38,671	37,808	33,618
Innovation, Group & Services	12,703	13,853	14,233
<b>Continuing operations</b>	<b>105,637</b>	<b>105,365</b>	<b>104,204</b>
<b>Discontinued operations</b>	<b>10,445</b>	<b>8,313</b>	<b>8,755</b>
<b>Philips Group</b>	<b>116,082</b>	<b>113,678</b>	<b>112,959</b>

Compared to 2014, the number of employees in continuing operations decreased by 1,161. The decrease reflects industrial footprint rationalization at Lighting and a reduction in third-party workers at Consumer Lifestyle, partly offset by the consolidation of the Volcano acquisition at Healthcare.

Approximately 54% of the Philips workforce was located in mature geographies, and about 46% in growth geographies. In 2015, the number of employees in mature geographies increased by 1,081, mainly due to the Volcano acquisition at Healthcare. The number of employees in growth geographies decreased by 2,242 largely driven by footprint rationalization at Lighting.

Philips Group

#### Employees per geographic cluster in FTEs at year-end

2013 - 2015

	2013	2014	2015
Western Europe	28,944	29,105	28,590
North America	24,401	22,283	23,614
Other mature geographies	3,419	3,643	3,908
<b>Mature geographies</b>	<b>56,764</b>	<b>55,031</b>	<b>56,112</b>
<b>Growth geographies</b>	<b>48,873</b>	<b>50,334</b>	<b>48,092</b>
<b>Continuing operations</b>	<b>105,637</b>	<b>105,365</b>	<b>104,204</b>
<b>Discontinued operations</b>	<b>10,445</b>	<b>8,313</b>	<b>8,755</b>

<b>Philips Group</b>	<b>116,082</b>	<b>113,678</b>	<b>112,959</b>
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Philips Group

**Employment** in FTEs at year-end

2013 - 2015

	2013	2014	2015
<b>Balance as of January 1</b>	<b>118,087</b>	<b>116,082</b>	<b>113,678</b>
Consolidation changes:			
Acquisitions		1,506	1,865
Divestments	(705)	(247)	(300)
Changes in discontinued operations	(186)	(2,132)	442
Other changes	(1,114)	(1,531)	(2,726)
<b>Balance as of December 31</b>	<b>116,082</b>	<b>113,678</b>	<b>112,959</b>

54 Annual Report 2015

**Table of Contents**[Group performance 5.2.5](#)

In 2016, the number of employees is expected to be below the levels of 2015.

In 2015, employee turnover amounted to 16.6% (of which 9.7% was voluntary) compared to 14.9% (6.4% voluntary) in 2014. 2015 turnover was mainly due to the changing industrial footprint and our overhead reduction program.

Philips Group

**Employee turnover in %**

2015

	Staff	Professionals	Management	Executives	Total
Female	20.0	12.4	11.3	13.9	16.6
Male	24.0	11.3	10.2	15.2	16.6
<b>Philips Group</b>	<b>22.3</b>	<b>11.6</b>	<b>10.4</b>	<b>14.9</b>	<b>16.6</b>

Philips Group

**Voluntary turnover in %**

2015

	Staff	Professionals	Management	Executives	Total
Female	11.4	7.7	5.8	8.3	9.7
Male	13.9	6.8	5.1	5.9	9.7
<b>Philips Group</b>	<b>12.9</b>	<b>7.1</b>	<b>5.3</b>	<b>6.4</b>	<b>9.7</b>

**The year 2014**

The total number of Philips Group employees (continuing operations) was 105,365 at the end of 2014, compared to 105,637 at the end of 2013. Approximately 36% were employed in the Lighting sector, 35% in the Healthcare sector and approximately 16% in the Consumer Lifestyle sector.

Compared to 2013, the number of employees in continuing operations decreased by 272. The decrease reflects industrial footprint rationalization at Lighting, divestments at Healthcare, and a reduction in third-party workers at Consumer Lifestyle, partly offset by the consolidation of the General Lighting Company (GLC) acquisition at Lighting and an increase in temporary workers in the IT Service Units at IG&S.

Approximately 52% of the Philips workforce was located in mature geographies, and about 48% in growth geographies. In 2014, the number of employees in mature geographies decreased by 1,733, mainly due to the company's overhead reduction program and the industrial footprint

reduction at Lighting. Growth geographies headcount increased by 1,461, largely driven by the GLC acquisition in The Kingdom of Saudi Arabia (KSA).

### 5.2.5 Developing our people

Philips University was launched in Q4 2014, and our focus on leader-led learning and building a learning organization as part of our growth and performance culture continued in 2015. We believe that continuous learning maximizes the potential of all employees and consequently Philips potential to deliver for customers and consumers. Philips University embraces a philosophy of learning that balances learning carried out on the job, coaching and mentoring, and formal learning methods such as classroom teaching and e-learning. Presently, we are exploring new learning channels to improve capability building and focus on business-critical topics and key roles that will increase the impact of the University.

More than one million hours in total were spent on training through Philips University in 2015.

#### **Training spend**

Our external training spend in 2015 amounted to EUR 50.4 million, up from EUR 44.7 million in 2014. This reflects an increase in the number of courses offered through the Philips University, supporting the transformation process at Philips, as well as a strong increase in courses attended.

For more information on our people's development, please refer to sub-section 14.2.2, People development, of this report.

### 5.2.6 Health and Safety

Philips strives for an injury-free and illness-free work environment, with a sharp focus on reducing the number of injuries and improving processes. The Lost Workday Injury Cases (LWIC) rate is defined as a KPI, on which we set yearly targets for the company, our individual sectors and Business Groups.

In 2015, we recorded 213 LWIC, i.e. occupational injury cases where the injured person is unable to work one or more days after the injury. This represents a significant decrease compared with 227 in 2014, and continues the downward trend since 2010. The LWIC rate decreased to 0.21 per 100 FTEs, compared with 0.23 in 2014. The number of Lost Workdays caused by injuries decreased by 1,087 days (some 12%) to 7,981 days in 2015.

For more information on Health and Safety, please refer to sub-section 14.2.4, Health and Safety performance, of this report.

### 5.2.7 General Business Principles

The Philips General Business Principles (GBP) incorporate the fundamental principles for all Philips business. They set the standard for business conduct for both individual employees and for the company itself. They also provide a reference for the business conduct we expect from our business partners and suppliers. Translations are available in 32 languages, allowing almost every employee to read the GBP in their native language. The GBP form an integral part of labor contracts in virtually every country in which Philips operates. In addition, there are separate Codes of Ethics that apply to employees working in specific areas of our business, i.e. the Procurement Code of Ethics and the Financial Code of Ethics. Details can be found at [www.philips.com/gbp](http://www.philips.com/gbp).

## **Table of Contents**

### **Group performance 5.2.7**

Employees are actively encouraged to engage in dialogue with their colleagues about what constitutes acting with integrity in a given business situation and to speak up if they have any concerns. They can turn to either their manager or a GBP Compliance Officer for advice and support.

The Philips Ethics Line operates globally, allowing employees to dial a toll-free hotline number to report a concern in their local language or to raise a concern online via a web intake form. Since May 2015, third parties have access to the Philips Ethics Line so they can raise any concerns they might have in relation to Philips business. In 2015, 39 parties, among which former employees and contractors, used this option.

The types of concerns filed by external parties follow the overall trends, with most concerns relating to Treatment of employees followed by Business integrity. A standard for investigation is in place to promote consistency and due care in the way concerns are investigated.

For a description of GBP processes and policies, please refer to section 7.1, Our approach to risk management and business control, of this report.

### **Business Integrity Survey**

In 2013 the first survey was held among our employees to measure the effectiveness of GBP deployment. In June 2015 a follow-up survey was rolled out to all employees in the ten most relevant languages to check status. The overall conclusion that could be drawn from the survey is that the Philips culture continues to provide a sound basis for any GBP- or compliance-related program.

### **Role of management**

The Philips Executive Committee constantly reinforces the message that acting in line with the GBP is not something that is optional, but something that is vital to our business success. Managers at all levels are specifically given the responsibility to engage in dialogue with their teams on what responsible business conduct means for their daily practice. Management is supported in this by a network of GBP Compliance Officers who operate on different levels in the organization.

### **Training and awareness**

In October of this year all employees with an email account were invited to take the updated GBP e-learning. This training course will be made available in the 22 most relevant languages. At the end of the course employees are asked to confirm that they are committed to acting in line with the GBP. The series of face-to-face training courses for GBP Compliance Officers that was started in 2014 was continued.

More information on the Philips GBP can be found in chapter 7, Risk management, of this report. The results of the monitoring measures in place are given in subsection 14.2.5, General Business Principles, of this report.

### **5.2.8 Working with stakeholders**

In organizing ourselves around customers and markets, we create 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. Working with partners is crucial in delivering on our vision to make the world healthier and more sustainable through innovation. An overview of stakeholders and topics discussed is provided in chapter 14, Sustainability statements, of this report.

For more information on our stakeholder engagement activities in 2015, please refer to sub-section 14.2.7, Stakeholder Engagement, of this report.

### **5.2.9 Supplier sustainability**

Philips has a direct business relationship with approximately 10,000 product and component suppliers and 30,000 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 programs**

We have developed a number of strategic programs to help our suppliers improve their sustainability performance. These programs cover the assessment of supplier sustainability performance (audits), management of regulated substances, conflict minerals and other responsible sourcing initiatives. More detailed information about our programs is available [www.philips.com/suppliers](http://www.philips.com/suppliers).

#### **Supplier sustainability policies**

The Philips Supplier Sustainability policy consists of two core documents: Supplier Sustainability Declaration (SSD) and Regulated Substances List (RSL). Both these documents are an integral part of our supplier contracts.

The list of other applicable policies can be found [www.philips.com/suppliers](http://www.philips.com/suppliers).

#### [Regulated Substances List](#)

All suppliers and brand licensees must ensure that all products or parts and product packaging delivered to Philips, as well as some manufacturing processes used to make Philips parts and brand license products, comply with the applicable requirements in this list.

#### [Supplier Sustainability Declaration](#)

The Declaration is derived from the Electronic Industry Citizenship Coalition (EICC) Code of Conduct and sets out the standards and behaviors we require from our

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**Table of Contents**

[Group performance 5.2.9](#)

suppliers and their suppliers. We monitor supplier compliance with the Declaration through a system of regular audits.

**Supplier Sustainability Audit Program in 2015**

In 2015, we audited 195 of our current risk suppliers, including 120 continued conformance audits with suppliers that we had already audited in 2012. This represented some one third of the number of risk suppliers. On top of the audits with current risk suppliers, we also audited 26 potential suppliers during the supplier selection process. These potential suppliers need to close any zero-tolerance issues before they can start delivering to Philips. Below we report on the findings at existing suppliers only; findings at potential suppliers are not included in this report.

As in previous years, the majority of the audits were done in China. Additionally, audits were performed in Brazil, India and Mexico. A smaller number of audits took place also in Belarus, Dominican Republic, Indonesia, Philippines, Russia and Ukraine. These audits directly or indirectly relate to the working conditions of almost 116,000 workers at the production sites that were audited.

**Audit findings**

To track improvements, Philips measures the compliance rate for the identified risk suppliers, i.e. the percentage of risk suppliers that were audited within the last three years and do not have any or have resolved all major non-compliances. During 2015 we achieved a compliance rate of 86% (2014: 86%).

Please refer to sub-section 14.2.8, Supplier indicators, of this report for the detailed findings of 2015.

**Supplier development and capacity building**

In 2015, we continued our focus on capacity-building initiatives which are offered to help suppliers improve their practices. Our supplier sustainability experts in China organized training, visited suppliers for on-site consultancy, conducted pre-audit checks and helped suppliers to train their own employees.

**[5.2.10 Addressing issues deeper in the supply chain](#)**

Philips shares the concern about issues in the mining of minerals that are used in electronics industry products. Areas of concern include the situation in eastern DRC (Democratic Republic of the Congo), where proceeds from the mining sector are used to finance rebel conflicts in the region, environmental and safety concerns in tin mining in Indonesia, the wide array of issues related to gold mining, and child labor in mining in general.

Philips does not source the minerals directly and the mines are typically seven or more tiers away from our direct suppliers.

We were one of the first companies to survey our suppliers to identify smelters used in the supply chain that produce the metals of concern, and one of the few companies to have our SEC Conflict Minerals Report audited in 2014 and 2015.

For more details and results of our supplier sustainability program, please refer to sub-section 14.2.8, Supplier indicators, of this report.

**[5.3 Environmental performance](#)**

**EcoVision**

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



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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.

Philips publishes every year a full Integrated Annual Report with the highest (reasonable) assurance level on the financial, social and environmental performance. With that overall reasonable assurance level Philips is a frontrunner in this field. KPMG has provided reasonable assurance on whether the information in chapter 14, Sustainability statements, of this report, section 5.2, Social performance, of this report and section 5.3, Environmental performance, of this report presents fairly, in all material respects, the sustainability performance in accordance with the reporting criteria. Please refer to section 14.4, Independent Auditor's Assurance Report, of this report.

The main elements of the EcoVision program are:

Improving people's lives

Green Product sales

Green Innovation, including Circular Economy

Green Operations

Health and Safety

Supplier Sustainability

Annual Report 2015 57

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## **Table of Contents**

### [Group performance 5.3](#)

In 2015, our fifth EcoVision program ended. In this Environmental performance section an overview is given of the most important environmental parameters of the program. Improving people's lives, Health and Safety, and Supplier Sustainability are addressed in the Social performance section. Details of the EcoVision parameters can be found in the chapter 14, Sustainability statements, of this report. We plan to launch the next 5-year program in the second quarter of 2016.

#### **5.3.1 Green Innovation**

Green Innovation is the Research & Development spend related to the development of new generations of Green Products and Green Technologies. We announced in 2010 our plan to invest a cumulative EUR 2 billion in Green Innovation during the next 5 years. In 2014, Philips already achieved this EUR 2 billion target a year ahead of schedule. In 2015, we invested some EUR 495 million in Green Innovation, excluding Lumileds and Automotive. Lighting continued to be the largest contributor, mainly as a result of investments in LED. The impact of Lumileds and Automotive on Green Innovation is significant at EUR 93 million in 2015 and EUR 105 million in 2014.

#### **Healthcare**

Healthcare develops innovative solutions across the continuum of care in close collaboration with clinicians and customers, to improve patient outcomes, provide better value, and help secure access to high-quality care. Healthcare investments in Green Innovation in 2015 amounted to EUR 121 million, a EUR 31 million increase compared to 2014. All Philips Green Focal Areas are taken into account while 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. In 2015, we started to add an energy-efficient CryoCompressor to our MRI systems. Closing the materials loop is another area, where our focus on developing upgrading pathways has enabled extended product life and therefore reduced materials use and lower cost. Healthcare actively supports 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.

#### **Consumer Lifestyle**

Continuous high R&D investments at Consumer Lifestyle are also reflected in Green Innovation spend, which amounted to EUR 99 million in 2015, comparable to EUR 97 million in 2014. The continued green investments resulted in high Green Product sales in all Business Groups. The sector continued its work on improving the energy efficiency of its products, closing the materials loop (e.g. by using recycled materials in products and packaging) and the voluntary phase-out of polyvinyl chloride (PVC), brominated flame retardants (BFR), Bisphenol A (BPA) and phthalates from, among others, food contact products. In particular, more than 80% of the shaving, grooming and oral healthcare products are completely PVC/BFR-free. Green investments during the course of 2015 in Personal Health Solutions are expected to result in the launch of the first Green Products in this product segment in early 2016.

#### **Lighting**

At Lighting, we strive to make the world healthier and more sustainable through energy-efficient lighting systems. With a 2015 investment of EUR 254 million in Green Innovation (excluding Lumileds and Automotive), Lighting invested a similar amount as in 2014. Increasing investments in digital lighting solutions and cloud computing have led to further improvements in the area of energy efficiency. In 2015, Los Angeles became the first city in the world to control its street lighting through an advanced Philips management system that uses mobile and cloud-based technologies. Beyond significant energy efficiency benefits, this new Philips CityTouch gives citizens safer lit streets and reports faults and reduces commissioning time to minutes. This system also supports the transition to a more circular economy as the wireless plug-and-play connector nodes protect a city's existing investment by networking streetlights from any vendor.

#### **Philips Group Innovation**

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Philips Group Innovation invested EUR 21 million in Green Innovations, spread over projects focused on global challenges related to water, air, energy, food, Circular Economy, and access to affordable healthcare. The Research organization within Group Innovation used the Sustainable Innovations Assessment tool, in which innovation projects are evaluated and scored along the environmental and social dimensions, in order to identify those projects that most strongly drive sustainable innovation. As of 2015, transfers of innovation projects include a Lives Improved calculation to assess what the project's contribution will be to Philips' vision to improve the lives of 3 billion people a year by 2025.

**Table of Contents**[Group performance 5.3.1](#)**Philips Green Patent portfolio**

At the end of 2015, Philips' IP portfolio consisted of 6.7% green patent families. All families are labeled with at least one Green Focal Area. In 2015, 6% of our total new patent filings were flagged as green patent family. Energy efficiency is still the most frequently occurring Green Focal Area throughout the portfolio. As IP is an extension of Philips' innovation efforts, the portfolio percentage related to green patents is multiplied by our annual patent portfolio costs to determine Philips' yearly investment in Green IP.

While a product can be classified as green by incorporating an environmentally friendly technology, such technology cannot always be protected in a patent because of a lack of patentability over the state-of-the-art technology. Therefore, there is not necessarily a correlation between green patents and Green Technologies in Green Products.

**Energy efficiency of products**

Energy efficiency is a key Green Focal Area for our Green Products. According to our analysis, about 97% of the energy consumed during the use phase of our products is attributable to Lighting products. The remaining 3% is split over Consumer Lifestyle and Healthcare. Therefore, we focus on the energy efficiency of our Lighting products in the calculation. The annual energy consumption per product category is calculated by multiplying the power consumption of a product by the average annual operating hours and the annual pieces sold and then dividing the light output (lumens) by the energy consumed (watts). The average energy efficiency of our total product portfolio increased significantly in 2015 to 44.5 lumen per watt, or 10% compared to 2014. The exclusion of Lumileds and Automotive had a limited upward effect on the energy efficiency of the portfolio.

In 2015, LED sales advanced well, as demand for conventional lighting declined. Compared to 2009, the baseline year of our measurement, the average energy efficiency of our portfolio increased by 33%. We expect the energy efficiency to improve further in the coming years as the traditional incandescent lamp is banned in more countries. Our target for 2015 was a 50% improvement compared to the 2009 baseline. In this target setting, assumptions were made about the speed of the regulatory developments in this area, which fell short of expectations.

Further details on this parameter and the methodology can be found here:

[Improving energy efficiency of Philips products.](#)

**Circular Economy**

The transition from a linear to a circular economy is essential to create a sustainable world. A circular economy aims to decouple economic growth from the use of natural resources and ecosystems by using these resources more effectively. It is a driver of innovation in the areas of material, component and product re-use, as well as new business models such as system solutions and services. In a circular economy, more effective (re)use of materials enables the creation of more value, both by means of cost savings and by developing new markets or growing existing ones.

For more information on our Circular Economy activities, please refer to sub-section 14.3.1, EcoVision, of this report.

**Closing the materials loop**

The amount of collection and recycling for 2014 (reported in 2015) was calculated at 28,500 tonnes, a 10% decrease compared to 31,500 tonnes reported in 2014, driven by lower weight of products and components in all sectors. Our target was to double global collection and recycling by 2015 compared to 2009, when the baseline was set around 22,500 tonnes, based on the data retrieved from the Waste Electrical and Electronic Equipment (WEEE) collection schemes and from our own recycling and refurbishment services (mainly Healthcare).

**Recycled materials**

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We calculated the amount of recycled materials used in our products in 2015 at some 13,500 tonnes (2014: 13,000 tonnes) by focusing on the material streams plastics (Consumer Lifestyle), aluminum (Lighting), refurbished products, and spare parts harvesting (Healthcare) depending on their relevance in each sector.

Our target was to double the amount of recycled materials in our products by 2015 compared to 2009, when the baseline was set at 7,500 tonnes.

Further details on this parameter and the methodology can be found here: [Closing the materials loop](#).

### **5.3.2 Green Product sales**

Green Products offer a significant environmental improvement in one or more Green Focal Areas: Energy efficiency, Packaging, Hazardous substances, Weight, Recycling and disposal, and Lifetime reliability. Sales from Green Products, excluding the Lumileds and

## **Table of Contents**

### [Group performance 5.3.2](#)

Automotive business, increased to EUR 13.0 billion in 2015, or 54% of sales (52% in 2014), thereby reaching a record level for Philips.

The exclusion of Lumileds and Automotive had a 1% negative impact on the total Green Product sales percentage.

We aim to create products that have significantly less impact on the environment during their whole lifecycle through our EcoDesign process. Overall, the most significant improvements have been realized in our energy efficiency Green Focal Area, an important objective of our EcoVision program, although there was also growing attention for hazardous substances and recyclability in all sectors in 2015, the latter driven by our Circular Economy initiatives.

New Green Products from each sector include the following examples.

#### **Healthcare**

In 2015, Healthcare expanded the Green Product portfolio with 11 new products and redesigned various current Green Products with environmental improvements. These products improve patient outcomes, provide better value, and help secure access to high-quality care, while reducing environmental impact. Examples include a new packaging system for our PCMS medical supplies business, which has enabled a 90% reduction in air space in packaging and a 24% reduction in packaging material weight to support our customers in reducing their waste streams. Another example is our Home Monitoring business which operates by a performance-based service business model that enables 76% re-use of products and parts while maintaining the embedded labor and energy. The Efficia is a new Green Product in our value range of patient monitoring, which is an example of how we aim to support expanded access to care in under-resourced regions while lowering environmental impact as well. We started to add an energy-efficient CryoCompressor to our MRI systems, with energy savings in the various non-scanning modes of 30-40%. Both material (30%) and energy (20%) savings are achieved in our new Access CT system, a compact-designed CT for the value segment market. Sleep and Respiratory Care (SRC) launched the V680 ventilator which includes, besides better performance in uninterrupted invasive or noninvasive ventilation, a product and packaging material weight reduction of 60% and 75% respectively and a reduction in energy usage of 80%. Other new Green Products came from SRC (lightweight masks and sleep therapy devices), MCS group (lightweight battery chargers) and X-Ray systems for the Brazilian market without lead counter ballasts.

#### **Consumer Lifestyle**

Consumer Lifestyle focuses on Green Products which meet or exceed our minimum requirements in the areas of energy consumption, packaging, and substances of concern. The sales of Green Products in 2015 surpassed 58% of total sales. All our Green Products with rechargeable batteries (like toothbrushes, shavers, and grooming products) exceed the stringent California energy efficiency norm by at least 10%. We are making steady progress in developing PVC/BFR-free products. More than 65% of sales consist of PVC/BFR-free products, with the exception of the power cords, for which there are not yet economical viable alternatives available. In the remaining 35% of product sales, PVC/BFR has already been phased out to a significant extent, but the products are not yet completely free of these substances.

In 2015, more kitchen appliances, vacuum cleaners, coffee machines and irons were launched with parts made of recycled plastics. In total we have applied some 900 tons of recycled plastics in our products. An example is the new Perfect Care Eco Aqua Steam Generator, with more than 50% recycled plastics.

## Lighting

Green Product sales within Philips Lighting increased to 72% in 2015. Connected lighting systems contributed to Green Product sales with solutions in more applications and market segments. In August 2015 the new installation of the connected Philips LED lighting system in the Allianz Arena made it Germany's first and Europe's largest stadium to feature a dynamic and colorful light display on its entire façade. This new energy-efficient lighting system also saves approximately 60% on electricity and 362 tons of CO<sub>2</sub> per year. The maintenance and operating costs are also lower due to the cloud-based Philips ActiveSite platform. The LEDs have an average lifetime of 80,000 operating hours and the system is extremely robust, even under extreme weather conditions.

### 5.3.3 Green Operations

The Green Operations program focuses on the main contributors to climate change, recycling of waste, reduction of water consumption, and reduction of emissions of restricted and hazardous substances. Full details can be found in chapter 14, Sustainability statements, of this report.

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**Table of Contents**

Group performance 5.3.3

**Carbon footprint and energy efficiency**

After achieving our EcoVision4 carbon emissions reduction target in 2012, we continued our energy efficiency improvement programs across different disciplines. This year we have achieved our 2015 emission reduction target that was set at a 40% decrease in CO<sub>2</sub> reductions compared to our 2007 base year. Our carbon footprint decreased by 7% compared to 2014, resulting in a total of 1,417 kilotonnes CO<sub>2</sub>, a 41% decrease compared to 2007. This was mainly achieved by emissions reductions of 17% compared to 2014 in our manufacturing facilities, resulting from operational changes and decreased energy usage due to lower load at energy intensive Lighting factories. Additionally the energy intensity for our non-industrial operations decreased resulting in emission reductions of 16%. Business travel emissions showed a slight reduction of 1% compared to 2014. In order to further decrease our business travel emissions we will continue to promote video conferencing as an alternative to travel in 2016. These reductions were, however, offset by a 23% increase in emissions from air transport over the course of 2015, mainly at Healthcare to meet demand.

Our operational energy efficiency improved by 18%, from 1.29 terajoules per million euro sales in 2014 to 1.06 terajoules per million euro sales in 2015 as a result of energy efficiency programs in our industrial sites.

During 2015, the applied emission factors used to calculate our operational carbon footprint have been updated from the previously used DEFRA (UK Department for Environment, Food & Rural Affairs) 2007 and bespoke emission factors to the applicable DEFRA 2015 emission factors for each year respectively. This update affected all historical data and resulted in an overall average increase of our carbon emissions by 11% for all years. We implemented these new emission factors to ensure improved carbon disclosure. The emission factor update did not affect our performance against the base year.

From this year onward our scope 2 emissions reporting will include both the market based method as well as the location based method. Both methods are adopted according to the new Corporate Standard of the Greenhouse Gas (GHG) Protocol as further described in chapter 14, Sustainability statements, of this report. The market based method will serve as reference for calculating our total operational carbon footprint. As explained in chapter 14, the market based method includes reduction of our emissions resulting from purchasing renewable energy. In 2015, we procured 54% of our electricity from renewable sources. Approximately 60% of our renewable energy is standardly contracted via our energy providers. The remaining 40% was mainly sourced in the United States through procurement of renewable energy certificates.

The impact of the exclusion of Lumileds and Automotive is displayed as discontinued operations in the next graph; the size of which varies over the years, but averages around 10% over the past 5 years. Emissions from discontinued operations in our industrial activities have been identified exactly. Emissions from our non-industrial facilities and business travel have been estimated based on FTE data. For our logistics emissions the part of discontinued operations has been estimated using revenue share as a proxy where applicable.



Philips Group

**Operational carbon footprint by Greenhouse Gas Protocol scopes** in kilotonnes CO<sub>2</sub>-equivalent

2011 - 2015

	2011	2012	2013	2014	2015
Scope 1	381	355	361	320	261
Scope 2 (market based)	365	335	313	277	236
Scope 3	1,146	950	1,004	924	920
<b>Philips Group</b>	<b>1,892</b>	<b>1,640</b>	<b>1,678</b>	<b>1,521</b>	<b>1,417</b>
Scope 2 (location based)	579	584	583	546	496

**Water**

Total water intake in 2015 was 2.7 million m<sup>3</sup>, about 12% lower than in 2014. This decrease was mainly due to lower production volumes at multiple Lighting sites where water is used for cooling purposes, operational changes and water-saving actions at various sites.

Lighting represents around 64% of total water usage. In this sector, water is used in manufacturing as well as for domestic purposes. The other sectors use water mainly for domestic purposes. The exclusion of Lumileds and

**Table of Contents**

## Group performance 5.3.3

Automotive has a significant downward impact on the water consumption of Philips. In 2015, Lumileds and Automotive accounted for 1.7 million m<sup>3</sup> of water.

Philips Group

**Water intake** in thousands of m<sup>3</sup>

2011 - 2015

	2011	2012	2013	2014	2015
Healthcare	308	421	454	514	439
Consumer Lifestyle	338	303	586	537	537
Lighting	2,249	2,413	2,249	2,052	1,751
Innovation, Group & Services					
<b>Continuing operations</b>	<b>2,895</b>	<b>3,137</b>	<b>3,289</b>	<b>3,103</b>	<b>2,727</b>
<b>Discontinued operations</b>	<b>1,433</b>	<b>1,720</b>	<b>1,755</b>	<b>1,700</b>	<b>1,684</b>
<b>Philips Group</b>	<b>4,328</b>	<b>4,857</b>	<b>5,044</b>	<b>4,803</b>	<b>4,411</b>

In 2015, 72% of water was purchased and 28% was extracted from groundwater wells.

**Waste**

In 2015, total waste decreased by some 9% compared to 2014 to 68.5 kilotonnes, mainly due to operational changes, lower production volumes and less packing waste at Lighting sites. Lighting contributed 66% of total waste, Consumer Lifestyle 17% and Healthcare 17%. The exclusion of Lumileds and Automotive had a 9% downward impact on total waste.

Philips Group

**Total waste** in kilotonnes

2011 - 2015

	2011	2012	2013	2014	2015
Healthcare	9.3	10.4	9.6	9.8	11.6
Consumer Lifestyle	19.6	12.7	11.4	11.3	11.6
Lighting	58.1	57.5	54.9	53.9	45.3
Innovation, Group & Services					
<b>Continuing operations</b>	<b>87.0</b>	<b>80.6</b>	<b>75.9</b>	<b>75.0</b>	<b>68.5</b>

<b>Discontinued operations</b>	<b>7.0</b>	<b>7.0</b>	<b>16.1</b>	<b>5.4</b>	<b>6.4</b>
<b>Philips Group</b>	<b>94.0</b>	<b>87.6</b>	<b>92.0</b>	<b>80.4</b>	<b>74.9</b>

Total waste consists of waste that is delivered for landfill, incineration or recycling. Materials delivered for recycling via an external contractor comprised 57 kilotonnes, which equals 83% of total waste, an improvement compared to 80% in 2014, as our manufacturing sites continued their recycling programs.

Of the 17% remaining waste, 72% comprised non-hazardous waste and 28% hazardous waste; 8.2 kilotonnes of waste was sent to landfill.

## Emissions

Emissions of restricted substances totaled 26 kilos in 2015, mainly caused by one site in China reporting a thinner containing benzene. For the third year in a row, mercury emissions at Lighting were as low as reasonably achievable, according to our assessment. The level of emissions of hazardous substances decreased from 28,310 kilos to 25,101 kilos (-11%), driven by a reduction in xylene emissions at Consumer Lifestyle, due to lower production of products where these specific lacquers and thinners are used as well as a decrease in styrene emissions at two Lighting sites. Lighting and Consumer Lifestyle have reduction programs for restricted and hazardous substances.

Philips Group

## Ratios relating to carbon emissions and energy use

2011 - 2015

	2011	2012	2013	2014	2015
<b>Operational CO<sub>2</sub> emissions</b> in kilotonnes CO <sub>2</sub> -equivalent	1,892	1,640	1,678	1,521	1,417
<b>Operational CO<sub>2</sub> efficiency</b> in tonnes CO <sub>2</sub> -equivalent per million EUR sales	95	74	76	71	58
<b>Operational energy use</b> in terajoules	31,682	28,886	29,586	27,579	25,614
<b>Operational energy efficiency</b> in terajoules per million EUR sales	1.59	1.30	1.35	1.29	1.06

Philips Group

## Restricted and hazardous substances in kilos

2011 - 2015

	2011	2012	2013	2014	2015
Restricted substances	111	67 <sup>1)</sup>	37 <sup>1)</sup>	29 <sup>1)</sup>	26
Hazardous substances	63,604	67,530	35,118	28,310	25,101

<sup>1)</sup> Numbers have been restated

For more details on restricted and hazardous substances, please refer to sub-section 14.3.3, Green Operations, of this report.

**5.4 Proposed distribution to shareholders**

Pursuant to article 34 of the articles of association of Royal Philips, a dividend will first be declared on preference shares out of net income. The remainder of the net income, after reservations made with the

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**Table of Contents**[Group performance 5.4](#)

approval of the Supervisory Board, shall be available for distribution to holders of common shares subject to shareholder approval after year-end. As of December 31, 2015, the issued share capital consists only of common shares; no preference shares have been issued. Article 33 of the articles of association of Royal Philips gives the Board of Management the power to determine what portion of the net income shall be retained by way of reserve, subject to the approval of the Supervisory Board.

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 740 million), in cash or in shares at the option of the shareholder, against the net income for 2015 and retained earnings.

Shareholders will be given the opportunity to make their choice between cash and shares between May 18, 2016 and June 10, 2016. If no choice is made during this election period the dividend will be paid in shares. On June 10, 2016 after close of trading, the number of share dividend rights entitled to one new common share will be determined based on the volume weighted average price of all traded common shares Koninklijke Philips N.V. at Euronext Amsterdam on June 8, 9 and 10, 2016. The Company will calculate the number of share dividend rights entitled to one new common share (the ratio), such that the gross dividend in shares will be approximately equal to the gross dividend in cash. On June 14, 2016 the ratio and the number of shares to be issued will be announced. Payment of the dividend and delivery of new common shares, with settlement of fractions in cash, if required, will take place from June 15, 2016. The distribution of dividend in cash to holders of New York Registry shares will be made in USD at the USD/EUR rate fixed by the European Central Bank on June 13, 2016.

Dividend in cash is in principle subject to 15% Dutch dividend withholding tax, which will be deducted from the dividend in cash paid to the shareholders. Dividend in shares paid out of net income and retained earnings is subject to 15% dividend withholding tax, but only in respect of the par value of the shares (EUR 0.20 per share).

In 2015, a dividend of EUR 0.80 per common share was paid in cash or shares, at the option of the shareholder. For 59.2% of the shares, the shareholders elected for a share dividend resulting in the issue of 17,671,990 new common shares, leading to a 1.9% dilution. EUR 298 million was paid in cash. For additional information, see chapter 17, Investor Relations, of this report.

The balance sheet presented in this report, as part of the Company financial statements for the period ended December 31, 2015, is before appropriation of the result for the financial year 2015.

**5.5 Outlook**

For 2016, we continue to expect modest comparable sales growth and we will build on our 2015 operational performance improvement. Taking into account ongoing macro-economic headwinds and the phasing of costs and sales, we expect improvements in the year to be back-end loaded.

Annual Report 2015 63

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**Table of Contents**[Group performance 5.6](#)[5.6 Critical accounting policies](#)**Critical accounting policies**

The preparation of Philips' financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities at the date of our financial statements. The policies that management considers both to be most important to the presentation of Philips' financial condition and results of operations and to make the most significant demands on management's judgments and estimates about matters that are inherently uncertain, are discussed below. Management cautions that future events often vary from forecasts and that estimates routinely require adjustment. A more detailed description of Philips' accounting policies appears in the note 1, Significant accounting policies section.

**Accounting for income taxes**

As part of the process of preparing consolidated financial statements, the Company is required to estimate income taxes in each of the jurisdictions in which it conducts business. This process involves estimating actual current tax expense and temporary differences between tax and financial reporting. Temporary differences result in deferred tax assets and liabilities, which are included in the consolidated balance sheet. The Company regularly reviews the deferred tax assets for recoverability and will only recognize these if it is believed that sufficient future taxable profit is available, including income from forecasted operating earnings, the reversal of existing taxable temporary differences and established tax planning relating to the same taxation authority and the same taxable entity. For a discussion of the fiscal uncertainties, please refer to the information under the heading "Tax risks" in note 8, Income taxes.

**Multi-element sales transactions**

From time to time the Company is engaged in complex sales transactions relating to multi-element deliveries (for example a single sales transaction that combines the delivery of goods and rendering of services). The process of revenue recognition of such multi-element sales transactions involves the identification of the different sales components, the allocation of revenue to these different components and the timing of revenue recognition per component. Each of these process steps can be complex and requires judgment. In order to identify different components in a single sales contract, the Company verifies if a component has a stand-alone value to the customer and whether the fair value of the component can be measured reliably. Allocation of revenue to the different components is performed based on either a relative fair value approach or by means of a residual or fair value method, depending on which method is deemed most appropriate to the transaction. Eventually, revenue for each component is recognized when meeting the revenue recognition criteria in accordance with IAS 18 or IAS 11.

**Provisions and Contingent liabilities**

The Company and certain of its group companies and former group companies are involved as a party in legal proceedings, including regulatory and other governmental proceedings, and discussions on potential remedial actions, relating to such matters as antitrust laws, competition issues, commercial transactions, product liabilities, participations and environmental pollution. Since the ultimate disposition of asserted claims and proceedings and investigations cannot be predicted with certainty, an adverse outcome could have a material adverse effect on the Company's Consolidated financial statements.

The Company recognizes a liability when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the outflow will take place can be measured reliably. If the likelihood of the outcome is less than probable and more than remote or a reliable estimate is not determinable, the matter is disclosed as a contingent liability if management concludes that it is material.

In determining the provision for losses associated with environmental remediation obligations, significant judgments are necessary. The Company utilizes experts in the estimation process. The Company accrues for losses associated with environmental obligations when such losses are probable and can be estimated reliably. The provisions are adjusted as new information becomes available and they are remeasured at the end of each period using the current discount rate.

Provisions on restructuring represents estimated costs of initiated reorganizations, the most significant of which have been approved by the Board of Management. A liability is recognized for those costs only when the Company has a detailed formal plan for the restructuring and has raised a valid expectation with those affected that it will carry out the restructuring by starting to implement that plan or announcing its main

features to those affected by it.

The Company provides for warranty costs based on historical trends in product return rates and the expected material and labor costs to provide warranty services. The provision is based on historical warranty data and a weighing of possible outcomes against their associated probabilities.

**Impairment of non-financial assets**

Goodwill is not amortized, but tested for impairment annually and whenever impairment indicators require so. The Company reviews non-financial assets, other than goodwill for impairment, when events or circumstances indicate that carrying amounts may not be recoverable.

In determining impairments of non-current assets like intangible assets, property, plant and equipment, investments in associates and goodwill, management



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**Table of Contents**[Group performance 5.6](#)

must make significant judgments and estimates to determine whether the recoverable amount is lower than the carrying value. Changes in assumptions and estimates included within the impairment reviews and tests could result in significantly different results than those recorded in the consolidated financial statements.

Goodwill is allocated to the cash generating units. The basis of the recoverable amount used in the annual impairment test (performed in Q2) and trigger-based impairment tests is generally the value in use. Key assumptions used in the impairment tests were sales growth rates, income from operations and the rates used for discounting the projected cash flows. These cash flow projections were determined using management's internal forecasts that cover an initial period from 2015 to 2019 that matches the period used for our strategic review. Projections were extrapolated with stable or declining growth rates for a period of five years, after which a terminal value was calculated. For terminal value calculation, growth rates were capped at a historical long term average growth rate.

The sales growth rates and margins used to estimate cash flows are based on past performance, external market growth assumptions and industry long-term growth averages. Income from operations in all units is expected to increase over the projection period as a result of volume growth and cost efficiencies. Please refer to note 11, Goodwill.

**Discontinued operations and non-current assets held for sale**

Non-current assets (disposal groups comprising assets and liabilities), that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. A discontinued operation is a component of an entity that either has been disposed of, or that is classified as held for sale, and (a) represents a separate major line of business or geographical area of operations; and (b) is a part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations; or (c) is a subsidiary acquired exclusively with a view to sell. Non-current assets held for sale and discontinued operations are carried at the lower of carrying amount or fair value less costs to sell.

Determining whether a non-current asset will be primarily recovered through sale rather than through continuing use requires judgment. The Company assesses whether such asset is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets or disposal groups, and its sale is assessed to be highly probable. Furthermore, in order to determine if that component qualifies as a discontinued operations, judgment is required when the Company assesses whether a component of an entity represents a major line of business or geographical area compared to the whole of the Company and whether the sale is a part of a single coordinated plan.

**New Accounting Standards**

For a description of the new pronouncements, please refer to the information under the heading IFRS accounting standard adopted as from 2015 in note 1, Significant accounting policies.

**Off-balance sheet arrangements**

Please refer to the information under the heading Guarantees in sub-section 5.1.23, Cash obligations, of this report and in note 26, Contingent assets and liabilities.

Annual Report 2015 65

## **Table of Contents**

### Sector performance 6

#### 6 Sector performance

#### **Our structure in 2015**

Koninklijke Philips N.V. (Royal Philips or the Company) is the parent company of the Philips Group (Philips or the Group). The Company is managed by the members of the Board of Management and Executive Committee under the supervision of the Supervisory Board. The Executive Committee operates under the chairmanship of the Chief Executive Officer and shares responsibility for the deployment of Philips strategy and policies, and the achievement of its objectives and results.

In 2015, Philips activities in the field of health and well-being were organized on a sector basis, with each operating sector Healthcare, Consumer Lifestyle and Lighting being responsible for the management of its businesses worldwide.

The Innovation, Group & Services sector includes the activities of Group Innovation and Group and regional management organizations. Additionally, the global shared business services for procurement, finance, human resources, IT and real estate are reported in this sector, as well as certain pension costs.

At the end of 2015, Philips had 95 production sites in 25 countries, sales and service outlets in approximately 100 countries, and 112,959 employees.

#### **2016 and beyond**

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. We have established a stand-alone structure for Philips Lighting within the Philips Group, effective February 1, 2016. We expect to be able to announce the separation of the Lighting business in the first half of 2016, subject to market conditions and other relevant circumstances. Accordingly, Innovation, Group & Services will be split and allocated to Philips and Philips Lighting.

In light of its focus on health technology, Philips has eliminated the Healthcare and Consumer Lifestyle sector layers in order to drive the convergence of consumer health and professional healthcare as well as to reduce overhead costs. We plan to change the reporting of Philips health technology activities to three segments (Personal Health, Diagnosis & Treatment, Connected Care & Health Informatics) with effect from Q1 2016.

Further updates will be provided in the course of 2016.

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**Table of Contents**

Sector performance 6.1

**6.1 Healthcare**

By leveraging our world-class innovation capability, deep clinical and consumer insights, long-standing customer relationships with healthcare providers, and our integrated solutions portfolio, we provide greater value while helping lower the cost of care across the health continuum. Frans van Houten, CEO Royal Philips

We are gaining momentum in delivering large-scale end-to-end healthcare solutions globally with clients like Westchester Medical Center (USA), Mackenzie Health (Canada) and the Kenyan Ministry of Health.

Our Accelerate! program continues to drive improvements in healthcare, resulting in enhanced customer centricity and service levels, faster time-to-market for our innovations, strengthened quality and compliance systems, and better cost productivity. We increased our investments in, among others, healthcare informatics, personal health solutions and our quality systems. We also strengthened our ability to offer integrated solutions in the growing image-guided therapy market through the acquisition of Volcano.

We continue to expand the capabilities of Philips HealthSuite digital platform, which enables connected health propositions to improve the delivery of care at lower cost, which allow us to build recurring revenue streams.

**6.1.1 Healthcare landscape**

Healthcare systems around the world are under increasing economic pressure. More people are living longer, and more are living with chronic conditions driving healthcare spending to unsustainable levels. Shortages of healthcare professionals are also adding to the relentless challenge of delivering better care at lower cost to growing patient populations.

Fundamental transformative changes are already taking place in the healthcare industry to enable the provision of affordable, quality care to those who need it. A shift is under way towards value-based healthcare, which places greater emphasis on results, driving the reduction of waste and inefficiency, increasing access and improving outcomes, while at the same time reducing costs.

Consumers are becoming increasingly engaged in managing their own health, with greater attention being focused on the benefits of healthy living and home care. Mobile and digital technologies are significant enablers of this trend, leading to new care delivery models

Annual Report 2015 67

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## Table of Contents

### Sector performance 6.1.1

founded upon integrated care, real-time analytics and value-added solutions and services that give patients greater control over and responsibility for their health.

### 6.1.2 About Healthcare in 2015

At Philips, we deliver innovative, integral technology solutions designed to create value by improving the quality and delivery of care while lowering cost. Our broad and deep clinical expertise and technology leadership across the health continuum and commitment to customer collaboration are core to our business and truly differentiate us.

Philips is one of the world's leading healthcare companies (based on sales) along with General Electric and Siemens. The competitive landscape in the healthcare industry is evolving with the emergence of a considerable number of new market players. The United States, our largest market, represented 43% of Healthcare's global sales in 2015, followed by China, Japan and Germany. Growth geographies accounted for 25% of Healthcare sales. In 2015, Philips Healthcare had approximately 40,000 employees worldwide.

In 2015, our Healthcare business (which was organized in six business groups) reported on four segments:

**Imaging (comprising the business groups Diagnostic Imaging, Image-Guided Therapy, Ultrasound):** Diagnostic imaging solutions, including computed tomography (CT), magnetic resonance imaging (MRI), advanced molecular imaging (AMI) and diagnostic X-ray, which includes digital X-ray and mammography; integrated clinical solutions, which include radiation oncology planning, disease specific oncology solutions and X-Ray dose management; image-guided therapy solutions including interventional X-ray systems, encompassing cardiology, radiology and surgery, and interventional imaging and therapy devices that include Intravascular Ultrasound (IVUS), Fractional Flow Reserve (FFR) and atherectomy; and ultrasound, a modality with diverse customers and broad clinical presence.

**Patient Care & Monitoring Solutions:** Enterprise-wide patient monitoring solutions, from value solutions to sophisticated connected solutions, for real-time clinical information at the patient's bedside; patient analytics, patient monitoring and clinical decision support systems; therapeutic care, including cardiac resuscitation, emergency care solutions, invasive and non-invasive ventilators for acute and sub-acute hospital environments, and respiratory monitoring devices; consumables across the patient monitoring and therapeutic care businesses; and customer service, including clinical, IT, technical, and remote customer propositions.

**Customer Services:** Product and solution services and support, including clinical support and performance services; education and value-added services; installation; remote proactive monitoring; and customer service agreements.

**Healthcare Informatics, Solutions & Services:** Advanced Healthcare IT, clinical and imaging informatics for radiology and cardiology departments, Picture Archiving and Communication systems (PACS) and fully integrated Electronic Medical Record (EMR) systems; technology-enabled services including telehealth, remote patient monitoring, care coordination to make aging and chronic condition experiences better; a professional services business (Healthcare Transformation Services) spanning consulting, education, clinical and business performance improvement, program management, system integration services. All solutions and software businesses will be supported by the Philips HealthSuite digital platform to enable interoperability, Big Data analytics, optimized workflows and care pathways, rapid application development, enhanced patient centricity and engagement.

Sales at Philips' health systems businesses are generally higher in the second half of the year, largely due to the timing of new product availability and customer spending patterns.

**Commitment to quality**

The implementation of the Philips Business System is embedding a fundamental commitment to quality across all our processes, products, systems and services. This commitment is of vital importance in the extensively regulated health equipment and system business. We are committed to compliance with regulatory product approval and quality system requirements in every market we serve, by addressing specific terms and conditions of local and national regulatory authorities including the US FDA, the CFDA in China and comparable agencies in other countries. Obtaining regulatory approval is costly and time-consuming, but a prerequisite for market introduction.

Further progress was made in 2015 in the remediation of the quality management systems at our Healthcare facility in Cleveland, Ohio, with the ramp-up of production and shipments continuing through the year.

**Table of Contents**

[Sector performance 6.1.2](#)

With regard to sourcing, please refer to sub-section 14.2.8, Supplier indicators, of this report.

Annual Report 2015 69

**Table of Contents**

## Sector performance 6.1.3

**6.1.3 2015 business highlights**

Leveraging our portfolio, insights and capabilities across the health continuum, Philips Healthcare continued to create value for healthcare providers and consumers around the world in 2015, with a strong focus on collaborative innovation, including large-scale partnerships, co-created solutions, and strategic alliances.

We strengthened our leadership position in the fast-growing image-guided therapy market by completing the acquisition of Volcano Corporation, a global leader in catheter-based imaging and measurement solutions for cardiovascular applications. Volcano's complementary portfolio and expertise will create opportunities to accelerate revenue growth for our image-guided therapy business.

Philips and Westchester Medical Center entered into a multi-year, USD 500 million managed services partnership to transform and improve healthcare for 3 million patients. The agreement includes consulting services, medical technologies and clinical informatics solutions, and aims to improve all care areas, including radiology, cardiology, neurology, oncology and pediatrics.

We introduced our Lumify app-based ultrasound solution in the US. Combining a dedicated Philips ultrasound transducer, a compatible smart device and app, and secure cloud-enabled services, Lumify has been designed to enable faster diagnosis, improve patient satisfaction and reduce costs, while generating recurring revenues.

With more than 800,000 patient monitors installed and 275 million patients tracked every year, we are leveraging our installed base for expansion of our services and efficient roll-out of our innovations. For example, CareEvent, an enterprise event management solution, which includes a mobile application to send informative alerts directly to a caregiver's smartphone for informed decision making and timely interventions when required.

Philips acquired Blue Jay Consulting, a leading provider of consulting services to hospital emergency departments in the US. Blue Jay's offering complements Philips' enterprise-wide consulting services to help improve clinical care and operational effectiveness across the health continuum.

We expanded the capabilities of our HealthSuite digital platform, a secure cloud infrastructure for health data and devices, and strengthened the associated ecosystem through our collaborations with Amazon Web Services, Radboud University Medical Center and Salesforce.

In 2015, we entered the fifth year of our Accelerate! journey, which continued to drive improvements in operational performance, as we focused on strengthening our innovation pipeline while making progress on cost savings.

**6.1.4 2015 financial performance**

## Philips Healthcare

**Key data** in millions of EUR unless otherwise stated

2013 - 2015

	2013	2014	2015
Sales	9,575	9,186	10,912
Sales growth			
% increase (decrease), nominal	(4)%	(4)%	19%
% increase (decrease), comparable <sup>1)</sup>	1%	(2)%	4%
Adjusted IFO <sup>1)</sup>	1,512	616	1,024
as a % of sales	15.8%	6.7%	9.4%
IFO	1,315	456	819
as a % of sales	13.7%	5.0%	7.5%
Net operating capital (NOC) <sup>1)</sup>	7,437	7,565	9,212

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Cash flows before financing activities <sup>1)</sup>	1,292	910	81
Employees (in FTEs)	37,008	37,065	40,099

<sup>1)</sup> For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report

In 2015, sales amounted to EUR 10,912 million, 19% higher than in 2014 on a nominal basis. Excluding a 12% positive currency effect and a 3% positive effect from portfolio changes, mainly related to Volcano, comparable sales increased by 4%. Healthcare Informatics, Solutions & Services achieved mid-single-digit growth, Imaging Systems posted high-single-digit growth, Customer Services reported low-single-digit growth, while Patient Care & Monitoring Solutions was in line with 2014. Green Product sales amounted to EUR 4,580 million, or 42% of sector sales.

From a geographical perspective, comparable sales in growth geographies showed high-single-digit growth, and mature geographies recorded low-single-digit growth.

Adjusted IFO amounted to EUR 1,024 million, or 9.4% of sales, compared to EUR 616 million, or 6.7% of sales, in 2014. Adjusted IFO in 2015 included restructuring and acquisition-related charges of EUR 168 million, which included the Volcano acquisition, compared to EUR 70 million in 2014. 2015 Adjusted IFO also included charges of EUR 28 million related to the currency revaluation of the provision for the Masimo litigation, EUR 8 million related to the devaluation of the Argentine peso, and a EUR 31 million legal provision.

Adjusted IFO in 2014 included charges of EUR 366 million related to the provision for the Masimo litigation, charges of EUR 49 million of mainly inventory write-downs related to Cleveland and a EUR 16 million past-service pension cost gain.

IFO amounted to EUR 819 million, or 7.5% of sales, and included EUR 205 million of charges related to acquired intangible assets.

Net operating capital increased by EUR 1,647 million to EUR 9,212 million, mainly driven by the Volcano acquisition and currency impacts.



**Table of Contents**

[Sector performance 6.1.4](#)

Cash flows before financing activities decreased from EUR 910 million in 2014 to EUR 81 million in 2015, largely due to higher cash outflows for investments at Imaging Systems.

## 2014 financial performance

In 2014, sales amounted to EUR 9,186 million, 4% lower than in 2013 on a nominal basis. Excluding a 2% negative currency effect, comparable sales decreased by 2%. Customer Services achieved mid-single-digit growth and Patient Care & Monitoring Solutions posted low-single-digit growth, while HealthCare Informatics, Services & Solutions sales were in line with 2013. Imaging Systems recorded a double-digit decline. Green Product sales amounted to EUR 3,508 million, or 38% of sector sales.

Geographically, comparable sales in growth geographies showed a low-single-digit decline, with strong growth in Latin America and Middle East & Turkey offset by a double-digit decline in China. In mature geographies, comparable sales also showed a low-single-digit decline. The year-on-year sales decrease was largely attributable to North America and Western Europe, as sales in other mature geographies showed a low-single-digit increase, led mainly by Japan.

Adjusted IFO decreased from EUR 1,512 million, or 15.8% of sales, in 2013 to EUR 616 million, or 6.7% of sales, in 2014. Restructuring and acquisition-related charges amounted to EUR 70 million in 2014, while in 2013 they were close to zero. 2014 Adjusted IFO included charges of EUR 366 million related to the jury verdict in the Masimo litigation, EUR 49 million of mainly inventory write-downs related to the Cleveland facility, and a EUR 16 million past-service pension cost gain in the Netherlands.

In 2014, the voluntary suspension of production at our Cleveland facility and the jury verdict in the Masimo litigation strongly impacted our 2014 performance. At our Healthcare facility in Cleveland, Ohio, certain issues in the general area of manufacturing process controls were identified during an ongoing US Food and Drug Administration (FDA) inspection. To address these issues, on January 10, 2014 we started a voluntary, temporary suspension of new production at the facility, primarily to strengthen manufacturing process controls. The suspension negatively impacted Healthcare's sales and Adjusted IFO in 2014.

On October 3, 2014 Philips announced that it would appeal the jury verdict in the patent infringement lawsuit by Masimo Corporation (Masimo), in which Masimo was awarded compensation of USD 467 million (EUR 366 million). The jury verdict is part of extensive litigation, which started in 2009, between Masimo and Philips involving several claims and counterclaims related to a large number of patents.

Adjusted IFO in 2013 also included EUR 61 million from a past-service pension gain and a EUR 21 million gain on the sale of a business excluding these items. The decrease in Adjusted IFO was mainly driven by

## **Table of Contents**

### **Sector performance 6.1.5**

operational losses related to the voluntary suspension of production at the Cleveland facility and negative currency impacts.

IFO amounted to EUR 456 million, or 5.0% of sales, and included EUR 159 million of charges related to intangible assets.

Net operating capital increased by EUR 128 million to EUR 7,565 million. Higher provisions and lower fixed assets were offset by currency impacts.

Cash flows before financing activities decreased from EUR 1,292 million in 2013 to EUR 910 million in 2014, largely due to lower earnings.

### **6.1.5 Delivering on EcoVision sustainability commitments**

A growing and aging population, the rise of chronic and lifestyle-related diseases and global resource constraints pose a number of challenges, including pollution and stressed healthcare systems. Philips continues to improve lives around the globe by developing solutions that help secure access to care, while at the same time respecting the boundaries of natural resources.

In 2015, Green Product sales in Healthcare amounted to EUR 4,580 million and we introduced 11 new Green Products to support energy efficiency, materials reduction and other sustainability goals. We also actively collaborate with care providers around the globe to look for ways to minimize the environmental impact of healthcare, for example by reducing the energy use of medical equipment. Supporting the transition to a circular economy, we have continued to focus on expanding the Diamond Select refurbishment program and also the SmartPath upgrading program.

Philips was presented with the *Champion for Change* Award by Practice Greenhealth for the second consecutive year. This award honors businesses that go beyond taking steps to improve their own green practices, but also help their clients and associates to expand their sustainable practices.

### **6.1.6 2016 and beyond**

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. Philips has transferred its Lighting business into a stand-alone structure effective February 1, 2016 and has moved from a holding company model to an operating company model.

In light of its focus on health technology, Philips has eliminated the Healthcare and Consumer Lifestyle sector layers in order to drive the convergence of consumer health and professional healthcare as well as to reduce overhead costs. We plan to change the reporting of Philips health technology activities to three segments (Personal Health, Diagnosis & Treatment, Connected Care & Health Informatics) with effect from Q1 2016. For more details on the new segment reporting in 2016 and onwards, please refer to the introduction of Sector performance.

Further updates will be provided in the course of 2016.

**Table of Contents**

[Sector performance 6.2](#)

[6.2 Consumer Lifestyle](#)

Across the world people are increasingly engaged in their personal health and are looking for solutions to stay healthy and prevent illness. We are leveraging our deep consumer expertise and extensive healthcare know-how to drive the consumerization of health. We're supporting people to live a healthy life in a healthy home environment; enabling them to proactively manage their own health. Pieter Nota, CEO Philips Consumer Lifestyle

We are executing our strategy, with locally relevant innovation delivering strong growth and driving profitability.

Future growth drivers are clearly set: grow the core businesses through local and global innovation platforms, and geographical expansion of proven propositions; further expand in the domain of personal health by exploring new business adjacencies and new business areas; leverage connectivity as a further growth driver.

In 2015, Consumer Lifestyle made further strong progress to reposition towards healthy living and prevention across the health continuum in more attractive markets, with better margins.

Our multi-year Accelerate! program has transformed the sector into a market-driven organization, by changing our operating model and instilling a strong performance culture and end-to-end approach.

**[6.2.1 Consumer landscape](#)**

Across the world, consumers are looking for solutions that help them to be healthy, live well and enjoy life. They are increasingly tracking their personal health through a combination of hardware and software devices and services, which they expect will deliver insights that are real-time, highly personal and direct them towards better health.

In a connected, digital world, consumers are looking for smart, personalized solutions. Purchase decisions are increasingly made or influenced online. In 2015, economic headwinds, especially in growth markets, created pressure on consumer spending. However, living a healthy life remained a high priority for consumers.

Annual Report 2015 73

## **Table of Contents**

### Sector performance 6.2.2

#### **6.2.2 About Consumer Lifestyle in 2015**

Through our various businesses, we aim to make a difference to people's lives by enabling them to make healthy choices every day based on locally relevant innovation. In recent years we have been responding to the need and desire of consumers to take charge of their personal health journey. We service our customers across the health continuum, delivering innovation in healthy living and disease prevention. In doing so, we target more attractive markets with better margins.

We are focused on value creation through category leadership and operational excellence, driving global leadership positions. We are increasing the quality and local relevance of product innovation, the speed with which we innovate, and expanding our distribution to capture increasing spending power in growth geographies.

Through 2015, Consumer Lifestyle has been built around businesses and markets, enabling us to direct investments to where the growth is, addressing locally relevant consumer needs. We create global platforms that can be adapted for local relevance.

Our end-to-end approach is accelerating specialist capability development in mature markets, to enable effective partnerships with customers and consumers, and in growth geographies, to enable development of go-to-market strategies.

In 2015, the Consumer Lifestyle sector consisted of the following areas of business:

Health & Wellness: mother and child care, oral healthcare, pain management

Personal Care: male grooming, beauty

Domestic Appliances: kitchen appliances, coffee, air purification, garment care, floor care

Through our personal health businesses, we offer a broad range of products from high to low price/value quartiles, necessitating a diverse distribution model. We continue to expand our portfolio and increase its accessibility, particularly in lower-tier cities in growth geographies. We are well positioned to increasingly capture growth in online sales and are building our digital and e-commerce capabilities across the company. We are adapting our web functionality to offer consumers a better user experience via smaller screens, driving improvements from conversion to sales.

We are leveraging connectivity to engage consumers in new and impactful ways through social media and digital innovation. For example, in 2015 we launched Philips Avent uGrow, a new digital parenting platform which supports the healthy development of babies, and also the latest Philips Sonicare for Kids Connected toothbrush.

Under normal economic conditions, Philips' personal health businesses experience seasonality, with higher sales in the fourth quarter.

In 2015, Consumer Lifestyle employed approximately 16,000 people worldwide. The global sales and service organization covered more than 50 developed and growth geographies. In addition, we operated manufacturing and business creation organizations in Argentina, Austria, Brazil, China, India, Indonesia, Italy, the Netherlands, Romania, the UK and the US.

#### **Commitment to quality**

The implementation of the Philips Business System is embedding a fundamental commitment to quality across all our processes, products, systems and services. Philips personal health businesses are subject to regulatory requirements in the markets where it operates. This includes the European Union's Waste from Electrical and Electronic Equipment (WEEE), Restriction of Hazardous Substances (RoHS), Registration, Evaluation, Authorization and Restriction of Chemicals (REACH), Energy-use of Products (EuP) requirements and Product Safety Regulations. We have a growing portfolio of medically regulated products in our Health & Wellness and Personal Care businesses. For these products we are subject to the applicable requirements of the US FDA, the European Medical Device Directive, the CFDA in China and comparable regulations in other countries. Through our growing beauty, oral healthcare and mother and child care product portfolio the range of applicable regulations has been extended to include requirements relating to cosmetics and, on a very small scale, pharmaceuticals.

With regard to sourcing, please refer to sub-section 14.2.8, Supplier indicators, of this report.

### **6.2.3 2015 business highlights**

The success of established propositions like the Philips Sonicare DiamondClean and the Philips Sonicare AirFloss Ultra, along with new innovations like Philips Sonicare for Kids Connected, drove continued growth across the world, in particular in China, Japan, Germany and North America.

Continuing the geographical expansion of Philips product innovations, we reached the milestone of 5 million Philips Airfryers sold. Philips is the market leader in the world's low-fat fryer market.

Delivering on its male grooming growth strategy to drive loyalty and create more value among existing users, Philips launched the Philips Smart Shaver Series 7000.

**Table of Contents**

Sector performance 6.2.3

The new Philips Smart Air Purifier 8000i series is a high-performing air purifier that helps to quickly improve indoor air quality even in larger rooms.

At Kind + Jugend, the leading international baby and toddler trade fair in Germany, Philips reinforced its industry leadership, showcasing the Philips Avent uGrow Platform, a new digital parenting platform which supports the healthy development of babies.

Empowering consumers to take greater control of their health, Philips personal health programs were announced at IFA Berlin, one of the world's leading trade shows for home appliances. Built upon the Philips HealthSuite digital platform, each program comprises connected health measurement devices, an app-based personalized program with coaching, and secure, cloud-based data analysis.

**6.2.4 2015 financial performance**

Philips Consumer Lifestyle

**Key data** in millions of EUR unless otherwise stated

2013 - 2015

	2013	2014	2015
Sales	4,605	4,731	5,347
Sales growth			
% increase, nominal	7%	3%	13%
% increase, comparable <sup>1)</sup>	10%	6%	6%
Adjusted IFO <sup>1)</sup>	483	573	673
as a % of sales	10.5%	12.1%	12.6%
IFO	429	520	621
as a % of sales	9.3%	11.0%	11.6%
Net operating capital (NOC) <sup>1)</sup>	1,261	1,353	1,453
Cash flows before financing activities <sup>1)</sup>	480	553	589
Employees (in FTEs)	17,255	16,639	16,254

<sup>1)</sup> For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report

Sales amounted to EUR 5,347 million, a nominal increase of 13% compared to 2014. Excluding a 7% positive currency impact, comparable sales were 6% higher year-on-year. Health & Wellness achieved double-digit growth, Personal Care reported high-single-digit growth, while Domestic Appliances was in line with 2014. Green Product sales amounted to EUR 3,091 million, or 58% of total sector sales.

From a geographical perspective, growth geographies achieved high-single-digit growth and mature geographies registered low-single-digit growth. In growth geographies, the increase was mainly driven by Central & Eastern Europe, Asia Pacific and India, primarily in the Health & Wellness and Personal Care businesses. Growth geographies' share of sector sales was 48%, compared to 47% in 2014.

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Adjusted IFO increased from EUR 573 million, or 12.1% of sales, in 2014 to EUR 673 million, or 12.6% of sales, in 2015. Restructuring and acquisition-related charges amounted to EUR 36 million in 2015, compared to EUR 9 million in 2014. Adjusted IFO in 2015 also included charges related to the devaluation of the Argentine peso of EUR 13 million. Adjusted IFO in 2014 also included a EUR 11 million past-service pension cost gain. The year-on-year Adjusted IFO increase was mainly driven by improved earnings at Health & Wellness and Personal Care.

IFO amounted to EUR 621 million, or 11.6% of sales, which included EUR 52 million of amortization charges, mainly related to acquired intangible assets at Health & Wellness and Domestic Appliances.

Net operating capital increased from EUR 1,353 million in 2014 to EUR 1,453 million in 2015, due to higher working capital, partly offset by a reduction in intangible fixed assets.

Cash flows before financing activities increased from EUR 553 million in 2014 to EUR 589 million in 2015, mainly due to higher earnings.



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## **Table of Contents**

### Sector performance 6.2.4

#### **2014 financial performance**

Sales amounted to EUR 4,731 million, a nominal increase of 3% compared to 2013. Excluding a 3% negative currency impact, comparable sales were 6% higher year-on-year. Health & Wellness achieved double-digit-growth and Domestic Appliances recorded high-single-digit growth, while Personal Care recorded low-single-digit growth. Green Product sales amounted to EUR 2,605 million, or 55% of total sector sales.

From a geographical perspective, comparable sales showed an 8% increase in growth geographies and 3% growth in mature geographies. In growth geographies, increase was mainly driven by China and Middle East & Turkey, primarily in the Health & Wellness and Domestic Appliances businesses. Growth geographies' share of sector sales was in line with 2013 at 47%.

Adjusted IFO increased from EUR 483 million, or 10.5% of sales, in 2013 to EUR 573 million, or 12.1% of sales, in 2014. Restructuring and acquisition-related charges amounted to EUR 9 million in 2014, compared to EUR 14 million in 2013. Adjusted IFO also included a post-service pension cost gain of 11 million in 2014, compared to EUR 1 million in 2013. The year-on-year Adjusted IFO increase was driven by improved earnings in all businesses and more than offset currency headwinds.

IFO amounted to EUR 520 million, or 11.0% of sales, which included EUR 53 million of amortization charges, mainly related to intangible assets at Health & Wellness and Domestic Appliances.

Net operating capital increased from EUR 1,261 million in 2013 to EUR 1,353 million in 2014, due to higher working capital and a reduction in provisions.

Cash flows before financing activities increased from EUR 480 million in 2013 to EUR 553 million in 2014, mainly attributable to higher earnings.

#### **6.2.5 Delivering on EcoVision sustainability commitments**

Sustainability continued to play an important role at Consumer Lifestyle in 2015, with the main focus on optimizing the sustainability performance of our products and operations. Green Products, which meet or exceed our minimum requirements in the area of energy consumption, packaging and/or substances of concern, accounted for 58% of total sales in 2015. All Green Products with rechargeable batteries exceed the stringent California energy efficiency standard by at least 10%. And over 65% of total sales are PVC- and/or BFR-free products (excluding power cords). In 2015, we continued to increase the use of recycled materials in our products. Over 900 tons of recycled plastics were used in kitchen appliances, vacuum cleaners, irons and coffee machines, compared to 625 tons in 2014.

As concrete examples of our commitment to sustainability we launched the new Perfect Care Eco Aqua Steam Generator, of which the plastic parts consist of 50% recycled material, and the Performer Expert vacuum cleaner, which is free of PVC/BFR, has an A-class energy label and contains 50% recycled plastics.

In our operations we continue to use most of our electricity from renewable sources, with the ultimate aim of having CO<sub>2</sub>-neutral production sites by 2020. In 2015, 65% of the electricity used in manufacturing sites came from renewable sources and 82% of the industrial waste was recycled.

#### **6.2.6 2016 and beyond**

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. Philips has transferred its Lighting business into a stand-alone structure effective February 1, 2016 and has moved from a holding company model to an operating company model.

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In light of its focus on health technology, Philips has eliminated the Healthcare and Consumer Lifestyle sector layers in order to drive the convergence of consumer health and professional healthcare as well as to reduce overhead costs. We plan to change the reporting of Philips health technology activities to three segments (Personal Health, Diagnosis & Treatment, Connected Care & Health Informatics) with effect from Q1 2016. For more details on the new segment reporting in 2016 and onwards, please refer to the introduction of Sector performance.

Further updates will be provided in the course of 2016.

**Table of Contents**

Sector performance 6.3

6.3 Lighting

We are successfully leading the industry transformation from conventional lighting to innovative LED and connected lighting systems that unlock new value and experiences for our customers and partners. Embedding lighting into the Internet of Things, we will capture growth opportunities and adjacent value from new services-based business models. Our leadership positions, innovations and strong brand present a catalyst for value creation, growth and a solid foundation on which to become a stand-alone lighting company. Eric Rondolat, CEO Philips Lighting

The lighting industry is undergoing a radical transformation.

The lighting market is being driven by the transition to LED and connected lighting applications.

Recognizing that the growth and profit pool will shift to digitally connected lighting products, systems and services, our goal is to become a lighting solutions company capturing superior growth and profitability.

We continue on our Accelerate! journey to achieve operational excellence across our businesses.

The separation process is fully under way and is expected to be completed in the first half of 2016.

**6.3.1 Lighting landscape**

We are witnessing a number of trends and transitions that are affecting the lighting industry and changing the way people use and experience light.

We serve a large and attractive market that is driven by the need for more light, the need for energy-efficient lighting, and the need for digital and connected lighting. The world's population is forecast to grow from 7 billion today to over 9 billion by 2050. At the same time, we are witnessing rapid urbanization, with over 70% of the world's population expected to live in urban areas by 2050. These trends will increase demand for light. In addition, in the face of resource constraints and climate change, the world needs that light to be energy-

Annual Report 2015 77

## **Table of Contents**

### Sector performance 6.3.1

efficient. At the same time, the lighting industry is moving from conventional to LED lighting, which is changing the way people use, experience and interact with light. Digital technologies enable connectivity and seamless integration in software architectures, systems and services. Connected lighting allows light points to be used as information pathways opening up new functionalities and services based on the transmission and analysis of data.

The lighting market is expected to grow by 2-4% per annum between 2015 and 2019 (source: BCG). The majority of this growth will be driven by LED-based solutions and applications heading towards a 60-65% share by 2018.

### 6.3.2 About Lighting in 2015

Philips Lighting is a global market leader with recognized expertise in the development, manufacture and application of innovative, energy-efficient lighting products, systems and services that improve people's lives. We have pioneered many of the key breakthroughs in lighting over the past 125 years, laying the basis for our current strength and leading position in the digital transformation.

We have a firm strategy which is based upon six priorities:

Optimize value from conventional products to support growth

Innovate in LED products commercially and technologically to outgrow the market

Lead the shift to systems, building the largest connected installed base

Capture adjacent value through new services business models

Be our customers' best business partner locally, leveraging our global scale

Use our Accelerate! program to improve our operational excellence

We aim to further invest to support our leadership in LED and connected lighting systems and services while at the same time capitalizing on our broad portfolio, distribution and brand in conventional lighting by flexibly anticipating and managing the phase-out and declining sales of conventional products.

We address people's lighting needs across a full range of market segments. Indoors, we offer lighting products, systems and services for homes, shops, offices, schools, hotels, factories and hospitals. Outdoors, we offer products, systems and services for roads, streets, public spaces, residential areas and sports arenas, as well as solar-powered LED off-grid lighting. In addition, we address the desire for light-inspired experiences through architectural projects. Finally, we offer specific applications of lighting in specialized areas, such as entertainment, horticulture, and water purification.

In 2015, Philips Lighting spanned a full-service lighting value chain from lamps, luminaires, electronics and controls to connected and application-specific systems and services through the following businesses:

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Light Sources & Electronics: LED, eco-halogen, (compact) fluorescent, high-intensity discharge and incandescent light sources, plus electronic and electromagnetic gear, modules and drivers

Consumer Luminaires: functional, decorative, lifestyle, scene-setting luminaires

Professional Lighting Solutions: controls and luminaires for city beautification, road lighting, sports lighting, office lighting, shop/hospitality lighting, industry lighting

In 2015, the Light Sources & Electronics business conducted its sales and marketing activities through the professional, OEM and consumer channels, the latter also being used by our Consumer Luminaires business. Professional Lighting Solutions was organized in a project solutions business (project luminaires, systems and services).

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The conventional lamps industry has been highly consolidated, with GE and Osram as main key competitors. The LED lighting market, on the other hand, is very dynamic. We face new competition from Asia and new players from the semiconductor and building management sectors. The luminaires industry is fragmented, with our competition varying per region and per market segment.

Under normal economic conditions, Lighting's sales are generally not materially affected by seasonality.

Philips Lighting has manufacturing facilities in some 25 countries in all major regions of the world, and sales organizations in more than 60 countries. Commercial activities in other countries are handled via distributors working with our International Sales organization. Lighting has approximately 34,000 employees worldwide.

### **Commitment to quality**

The implementation of the Philips Business System is embedding a fundamental commitment to quality across all our processes, products, systems and services. Lighting is subject to significant regulatory requirements in the markets where it operates. These include the European Union's Waste from Electrical and Electronic Equipment (WEEE), Restriction of

**Table of Contents**

Sector performance 6.3.2

Hazardous Substances (RoHS), Registration, Evaluation, Authorization and Restriction of Chemicals (REACH), Energy-using Products (EuP) and Energy Performance of Buildings (EPBD) directives.

With regard to sourcing, please refer to sub-section 14.2.8, Supplier indicators, of this report.

**6.3.3 2015 business highlights**

In 2015, our lighting innovations supported our six strategic priorities aimed at delivering even greater value for our customers and other stakeholders. These highlights showcase our leading innovations in connected lighting, systems and services, our aspiration to be *the* lighting company for the Internet of Things for both professional and consumer markets.

Philips expanded its portfolio of connected lighting products for the home by introducing Philips Hue Phoenix, a luminaire providing tunable white light, Philips Hue Go, a portable wireless luminaire, Philips Lightstrip Plus, a flexible LED light strip, and a new bridge enabling Philips Hue to interact with other Apple HomeKit devices and become voice-controlled.

Philips and Cisco formed a global strategic alliance that will help enable facilities managers, building owners and office workers to reap the benefits of the Internet of Things in offices. The alliance combines Philips' connected office lighting system with Cisco's highly secure network technology, to increase energy efficiency, provide data to optimize user comfort and improve the office environment.

Philips made further inroads with its Philips CityTouch lighting system, with Los Angeles adopting an advanced Philips management system that uses wireless and cloud-based technologies to control its street lighting. Philips' CityTouch connected lighting management system is now used in more than 262 projects in over 30 countries across the world.

In Lille, France, Carrefour installed 2.5 kilometers of Philips LED lighting that uses light to transmit a location signal to a shopper's smartphone, triggering an app to provide location-based services. This enables Carrefour to provide new services to its shoppers, such as helping them to navigate and find promotions across the 7,800 m<sup>2</sup> shop floor. It is the world's largest connected lighting indoor positioning system for retail and has reduced the total lighting-based electricity consumption of the hypermarket by 50%.

Philips provided a connected LED lighting system for the New NY Bridge in New York. It will combine roadway and architectural lighting, an industry first, on what will be the most technologically advanced bridge in North America. The system will feature remotely programmed lights that produce dynamic colorful effects and use Philips ActiveSite and Philips CityTouch cloud-based monitoring and management systems.

Philips continues to light up iconic buildings around the world with colorful and dynamic connected LED lighting. New illuminations in 2015 include Europe's largest mosque located in Moscow, Le Meurice hotel in Paris, the Cairo Opera House, the Accra Theater in Ghana, the Big Four Bridge in Louisville, US, the Nanjing Tower in China, and the Edirne Bridge and Butterfly Valley in Turkey.

Philips launched LifeLight, a solar-powered LED lighting range for homes in Kenya and other African countries. The range eliminates the need to use kerosene lamps, with their harmful fumes, in homes in off-grid areas, and also increases productivity and community life by enabling activities to continue after dark.

**6.3.4 2015 financial performance**

Philips Lighting  
**Key data** in millions of EUR unless otherwise stated  
 2013 - 2015

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	2013	2014	2015
Sales	7,145	6,869	7,411
Sales growth			
% increase (decrease), nominal	(2)%	(4)%	8%
% increase (decrease), comparable <sup>1)</sup>	1%	(3)%	(3)%
Adjusted IFO <sup>1)</sup>	580	293	594
<i>as a % of sales</i>	8.1%	4.3%	8.0%
IFO	413	185	486
<i>as a % of sales</i>	5.8%	2.7%	6.6%
Net operating capital (NOC) <sup>1)</sup>	4,462	3,638	3,813
Cash flows before financing activities <sup>1)</sup>	418	442	642
Employees (in FTEs)	38,671	37,808	33,618

<sup>1)</sup> For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report

In 2015, sales amounted to EUR 7,411 million, 8% higher on a nominal basis. Excluding a 9% positive currency effect and a 2% positive effect from portfolio changes, comparable sales decreased by 3%. Both Light Sources & Electronics and Consumer Luminaires recorded a mid-single-digit decline, partly due to the anticipated decline in conventional lighting, while Professional Lighting Solutions remained flat year-on-year.

From a geographical perspective, comparable sales in growth geographies showed a mid-single-digit decrease, largely driven by declines across all businesses in China and at Light Sources & Electronics and Professional Lighting in Middle East & Turkey. Sales in growth geographies increased from 39% of total sales in 2014 to 40% in 2015. Comparable sales in mature geographies showed a low-single-digit decline, with Western Europe and North America recording a low-single-digit decline and other mature geographies remaining flat year-on-year.



## **Table of Contents**

### Sector performance 6.3.4

Sales of LED-based products grew to 43% of total sales, up from 34% in 2014, driven by Light Sources & Electronics and Professional Lighting Solutions. Sales of energy-efficient Green Products exceeded EUR 5,343 million, or 72% of sector sales.

Adjusted IFO increased from EUR 293 million, or 4.3% of sales, in 2014 to EUR 594 million, or 8.0% of sales in 2015. Restructuring and acquisition-related charges amounted to EUR 99 million in 2015, compared to EUR 245 million in 2014. Adjusted IFO in 2015 also included EUR 14 million of charges related to the devaluation of the Argentine peso, while 2014 included a EUR 13 million past-service pension cost gain and EUR 68 million of impairment and other charges related to industrial assets. The increase in Adjusted IFO was mainly attributable to lower restructuring and acquisition-related charges, cost productivity and improved LED gross margins.

IFO amounted to EUR 486 million, or 6.6% of sales, which included EUR 108 million of amortization charges, mainly related to acquired intangible assets at Professional Lighting Solutions.

Net operating capital increased by EUR 175 million to EUR 3.8 billion. The current-year increase was mainly due to currency translation effects.

Cash flows before financing activities increased from EUR 442 million in 2014 to EUR 642 million due to higher earnings and a decrease in working capital.

### **2014 financial performance**

In 2014, sales amounted to EUR 6,869 million, 4% lower on a nominal basis. Excluding a 1% negative currency effect, comparable sales decreased by 3%. Light Sources & Electronics recorded mid-single-digit growth and Consumer Luminaires posted a high-single-digit decline, while Professional Lighting Solutions recorded low-single-digit growth.

From a geographical perspective, comparable sales in growth geographies showed a mid-single-digit decline, largely driven by decline across all businesses in China. As a result, sales in growth geographies decreased from 40% of total sales in 2013 to 39% in 2014. Comparable sales in mature geographies showed a low-single-digit decline, with Western Europe and North America recording a low-single-digit decline and other mature geographies registering a mid-single-digit decline.

Sales of LED-based products grew to 34% of total sales, up from 25% in 2013, driven by Light Sources & Electronics and Professional Lighting Solutions. Sales of energy-efficient Green Products exceeded EUR 4,952 million, or 72% of sector sales.

**Table of Contents**

[Sector performance 6.3.5](#)

Adjusted IFO declined from EUR 580 million, or 8.1% of sales, in 2013 to EUR 293 million, or 4.3% of sales in 2014. Restructuring and acquisition-related charges amounted to EUR 245 million in 2014, compared to EUR 83 million in 2013. 2014 also included a EUR 13 million past-service pension cost gain in the Netherlands and EUR 68 million of impairment and other charges related to industrial assets, while 2013 included a EUR 10 million past-service pension cost gain. The decrease in Adjusted IFO was mainly attributable to higher restructuring and acquisition-related charges and lower sales volume.

IFO amounted to EUR 185 million, or 2.7% of sales, which included EUR 106 million of amortization charges, mainly related to intangible assets at Professional Lighting Solutions.

Net operating capital decreased by EUR 824 million to EUR 3.6 billion. The decrease was mainly due to the reclassification of Lumileds and Automotive as assets held for sale in 2014, partly offset by positive currency impacts.

Cash flows before financing activities increased from EUR 418 million in 2013 to EUR 442 million, as lower earnings were partly offset by a reduction in working capital.

**6.3.5 Delivering on EcoVision sustainability commitments**

Early in 2015, Philips Lighting engaged in a Light as a Service business arrangement with Amsterdam Airport Schiphol. Under the terms of this agreement Philips will retain ownership of the lighting equipment and Schiphol will pay for the light used. The project will utilize LED-based products that will deliver 50% energy savings relative to legacy lighting. Light as a Service is starting to gain traction in the market as a new business model, because it offers state-of-the-art lighting hassle-free, does not require any customer investment, provides energy efficiency (lower CO<sub>2</sub> emissions), and supports the circular economy (less waste to landfill).

Annual Report 2015 81

## **Table of Contents**

### [Sector performance 6.3.5](#)

Within the framework of the Green Operations 2015 program, Philips Lighting has reduced its carbon footprint in manufacturing (scope 1 and 2 emissions) by approximately 58% since the baseline year of 2007. In 2015, 85% of our total industrial waste was re-used as a result of recycling. In December 2015, while speaking at COP 21 in Paris, Eric Rondolat announced Philips' commitment to making its operations carbon-neutral by 2020, both for Royal Philips and for Philips Lighting.

### **6.3.6 2016 and beyond**

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. We have established a stand-alone structure for Philips Lighting within the Philips Group, effective February 1, 2016. We expect to be able to announce the separation of the Lighting business in the first half of 2016, subject to market conditions and other relevant circumstances. As previously stated, we are reviewing all strategic options for Philips Lighting, including an initial public offering and a private sale.

From an external financial reporting perspective, it should be noted that Royal Philips will introduce new segment reporting, from Q1 2016 onwards. The Lighting segment will represent the Philips Lighting businesses and include the relevant allocation of the current Innovation, Group & Services. For more details on the new segment reporting in 2016 and onwards, please refer to the introduction of Sector performance.

Further updates will be provided in the course of 2016.

**Table of Contents**

Sector performance 6.4

**6.4 Innovation, Group & Services**

Philips moved its North American Research organization to the Cambridge, Mass. area to benefit from the vibrant innovation ecosystem and to facilitate collaboration with Massachusetts Institute of Technology (MIT), academic hospitals, and business partners. Also the new site will be truly interdisciplinary, co-locating various functions like upstream marketing, strategy, design, digital accelerator, and early-stage ventures.

Philips became the second-largest patent applicant in the world for patents filed at the European Patent Office (EPO).

Philips Design celebrated 90 years of design legacy with a record-breaking 156 design awards.

**Introduction**

In 2015, Innovation, Group & Services comprised the activities of Philips Group Innovation, Group headquarters, including country and regional management, and certain costs of pension and other post-retirement benefit plans. Additionally, the global shared business services for procurement, finance, human resources, IT and real estate are reported in this sector.

**6.4.1 About Innovation, Group & Services in 2015****Philips Group Innovation**

At Philips, our innovation efforts are closely aligned with our business strategy. Philips Group Innovation (PGI) feeds the innovation pipeline, enabling its business partners – the Philips operating businesses – to create new business options through new technologies, new business creation, and intellectual property management and development. Focused research and development improvement activities drive time-to-market efficiency and increased innovation effectiveness.

PGI boosts innovation from idea to product as co-creator and strategic partner for the Philips businesses and complementary Open Innovation ecosystem partners. It does so through cooperation between research, design, marketing, strategy and businesses in interdisciplinary teams along the innovation chain, from front-end to first-of-a-kind product development. In addition, PGI opens up new value spaces beyond the direct scope of current businesses (Emerging Business Areas), manages the Company-funded R&D portfolio, and creates synergies for cross-sector initiatives.

PGI encompasses Philips Research, Philips Innovation Services, the Philips Innovation Campus in Bangalore, the Philips Innovation Center Shanghai, the Philips Innovation Labs in Cambridge (USA), the Philips Africa Innovation Hub, Philips Design, the Philips HealthTech Incubator, and the Emerging Business Areas. In total, PGI employs some 5,000 professionals around the globe.

PGI actively participates in Open Innovation through relationships with academic and industrial partners, as well as via European and regional projects, in order to improve innovation effectiveness and efficiency, capture and generate new ideas, enhance technology partnering capabilities, and share the related financial exposure. The High Tech Campus in Eindhoven (Netherlands), the Philips Innovation Campus in Bangalore (India), the Philips Innovation Center in Shanghai (China) and the Philips Cambridge Innovation Labs (USA) are prime examples of environments enabling Open Innovation.

Through Open Innovation, Philips seeks to apply new thinking to solving major societal issues. A great example is the five-year alliance between Philips Research and Massachusetts Institute of Technology (MIT) aimed at speeding up advancements in health technology solutions to help address society's most pressing challenges in healthcare, as well as digital connected lighting systems to address the need to make cities more livable and sustainable. With a total budget of USD 25 million for the five-year term, this is the largest research alliance undertaken by the company in the region. Philips researchers will be collaborating intensely with MIT faculty and PhD students on jointly defined research programs and Open Innovation projects.

## Philips Research

Philips Research is the main partner of Philips' operating businesses for technology-enabled innovation. It creates new technologies and the related intellectual property, which enables Philips to grow in businesses and markets. Together with the businesses and the markets, Philips Research co-creates innovations to strengthen the core businesses as well as to open up new opportunities in adjacent business areas. Research's innovation pipeline is aligned with Philips' vision and strategy and inspired by unmet customer needs as well as major societal challenges.

In the area of Healthcare, we continue to engage with customers in novel ways to discover unmet needs and co-create solutions with our partners. The Digital Accelerator and the recently opened HealthSuite Lab at the High Tech Campus in Eindhoven, for example, enable us to fast-track the development and execution of new care models and solutions, together with partners and customers such as hospital networks, supported by the latest digital technologies and rapid prototyping. Through research partnerships, such as our agreements with Stockholm County Council and Karolinska University Hospital, researchers from different industries, hospitals and academia are brought together to facilitate closer links between the delivery of care and clinical research.

## **Table of Contents**

### [Sector performance 6.4.1](#)

In the area of Lighting, we remain highly focused on offering solutions across the lighting value chain, including software, controls, luminaires, light sources and modules. We are shifting our lighting portfolio from individual products towards connected LED lighting systems and services, LED luminaires and LED lamps for the professional and consumer markets. In close collaboration with the US Department of Defense/US Army Base Fort Sill (Oklahoma) in North America, Philips Research demonstrated how the use of advanced LED light sources and smart lighting controls can result in substantial energy and cost savings while improving the quality of light in terms of color rendering and brightness. The initiative was honored with the ESTCP (Environmental Security Technology Certification Program) 2015 Project of the Year Award for Energy and Water.

### **Philips Innovation Services**

Philips Innovation Services offers a wide range of expert services in development, realization & consulting. Innovation Services skills are leveraged by Philips Businesses, Markets and Philips Group Innovation in all regions.

Together with Research and a new dedicated Connected Digital Proposition team, Innovation Services has helped realize various connected products as part of personal health programs launched at IFA in Berlin – the health watch, blood pressure monitor, body analysis scale and ear thermometer – as well as the recently announced cooperation with Charité – Universitätsmedizin Berlin on preventing delirium in critical care with lighting and acoustics concepts.

Philips Innovation Services also supported projects such as Philips LifeLight, the new zero-energy, solar-powered LED lighting range designed for homes in off-grid rural and semi-urban communities, as part of Philips' drive to deliver innovations that are locally relevant.

### **Philips Innovation Campus Bangalore**

Philips Innovation Campus Bangalore (PIC) hosts activities from most of our operating businesses, Philips Research, Design, IP&S, and IT. Healthcare is the largest R&D organization at PIC, with activities in Imaging Systems, Patient Care & Monitoring Solutions, and Healthcare Informatics, Solutions & Services. While PIC originally started as a software center, it has since developed into a broad product development center (including mechanical, electronics, and supply chain capabilities). Several Healthcare businesses have also located business organizations focusing on growth geographies at PIC.

### **Philips Innovation Center Shanghai**

Philips Research China is Philips' second-largest research lab globally. The organization has staff working in the Healthcare, Consumer Lifestyle and Lighting programs and cooperates extensively with Philips labs across the world. Research China anchors our broader commitment to our Shanghai R&D campus as an innovation hub.

### **Philips Cambridge Innovation Labs (USA)**

The new Philips Cambridge Innovation Labs that opened in October 2015 are situated in the hub of the Cambridge/Boston ecosystem. The labs are the new home to approximately 100 Philips Research North America employees and another 150 Philips employees from other innovation functions and ventures. Being within close proximity to the MIT campus allows researchers to collaborate easily with MIT faculties and PhD students on jointly defined research programs, as well as to participate in Open Innovation projects. The joint teams are working on advancements in healthcare and connected lighting systems.

### **Philips Africa Innovation Hub**

The Philips Africa Innovation Hub in Nairobi, Kenya, creates locally relevant innovations in Africa, for Africa, with particular focus on improving access to lighting and affordable healthcare. The Africa Innovation Hub is a collaboration between Philips Group Innovation and Philips' Africa market organization.

### **Philips Design**

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Celebrating its 90<sup>th</sup> anniversary in 2015, Philips Design is the global design function for the company, ensuring that innovations are meaningful, people-focused and locally relevant. The Design group is also tasked with ensuring that the Philips brand experience is differentiating, consistently expressed and drives customer preference.

Philips Design partners with the Philips businesses, Group Innovation and functions, championing a multidisciplinary co-create approach that brings teams together to understand the different factors that influence how a new product or solution will appear, perform and behave. Philips Design is widely recognized as a world leader in design and in 2015 alone received 156 design awards, including the IDSA silver award for the Connected NICU (Neo-Natal Intensive Care Unit), a concept aimed at supporting family-centered and developmental care, improved parental experience, long-term development and quality of life for pre-term babies.

Increasingly we are leveraging our design capabilities and processes to work directly with our customers and our customer-facing teams. For example, the long-term deals announced in 2015 with Mackenzie Health in Canada and Westchester Medical Center include innovation and design consulting. Innovating directly with our customers enables Philips Design to deliver people-focused improvements that optimize the patient experience and overall performance of their healthcare systems across the health continuum.

**Table of Contents**

Sector performance 6.4.1

**Philips Healthcare Incubator**

The Philips Healthcare Incubator is a group dedicated to identifying, developing and bringing breakthrough products and services to market that will drive the future of healthcare. One of the ventures is Digital Pathology Solutions, which empowers pathologists with a complete connected digital pathology solution that is designed to optimize productivity and workflow, and ultimately to improve the quality of diagnosis.

Another venture is Handheld Diagnostics, with its Minicare proposition, which provides direct diagnostic information at the patients' bedside, enabling physicians to make medical decisions on the spot. Based on innovative technologies, we have designed easy-to-use, patient-centric IVD (in-vitro diagnostics)-enabled solutions and connected services that have the potential to revolutionize health management and improve existing workflows. The Home Clinical Monitoring venture performs remote monitoring to support patients during chemotherapy. Finally, the acquisition of the Danish medical technology company Unisensor led to the establishment of Philips Biocell, which has released the oCelloScope System, an analytical instrument that is, among other applications, used within microbiological studies on a research application basis.

**Philips Emerging Business Areas**

Philips Emerging Business Areas identify, create and grow new activities that are outside the scope of the current operating businesses. The portfolio is managed on a venturing basis. The opportunities and business models identified by the individual new business activities determine the approach to commercial partnerships, sourcing of technology, and platforms to reach customers. Current examples of successful new solution businesses or enablers for these include Horticulture LED Solutions\*, Light for Health, Photonics, Wearable Sensing Technologies, Elder Care Solutions and Mental Vitality.

Philips Horticulture LED Solutions stands for solutions that improve growers' business performance. With customized light recipes we can help optimize crop yield and quality. We combine crop growth knowledge and technology, and value long-term partnerships in business and research. Hundreds of projects have been realized in different regions in different segments. In July 2015, Philips CEO Frans van Houten opened the state-of-the-art GrowWise Center at the High Tech Campus in Eindhoven, the Netherlands. Research being conducted by Philips will provide tailor-made LED light recipes, making it possible for producers to increase their yields and grow tasty and healthy food indoors all year round, while reducing waste, limiting food miles and using practically no land or water.

Leveraging its advanced understanding of the biological effects of light, a team of Philips Light for Health researchers, collaborating with leading research institutions and hospitals, has developed a number of products like Philips BlueControl, which feature LED light and offer proven medical benefits.

Philips Photonics is a global leader in VCSEL technology and designs, manufactures, markets and sells VCSEL-based solutions for data communications, consumer and industrial applications. VCSELs are LED-like lasers enabling applications like gesture control, environmental sensing, precise scene illumination for surveillance cameras, and ultra-fast data communication. Philips Photonics has enabled the introduction of laser-based PC mice and high-bit-rate active optical cables, as well as introducing VCSEL-based solutions for industrial processing of plastic materials.

\* Philips Horticulture LED Solutions will move to Philips Lighting in 2016.

**Philips Intellectual Property & Standards**

Philips IP&S proactively pursues the creation of new Intellectual Property (IP) in close co-operation with Philips' operating businesses and Philips Group Innovation. IP&S is a leading industrial IP organization providing world-class IP solutions to Philips' businesses to support their growth, competitiveness and profitability.

Philips' IP portfolio currently consists of 76,000 patent rights, 47,000 trademarks, 91,000 design rights and 5,000 domain names. Philips filed 1,750 patents in 2015, with a strong focus on the growth areas in health and well-being.



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IP&S participates in the setting of standards to create new business opportunities for the Philips operating businesses. A substantial portion of revenue and costs is allocated to the operating businesses. Philips believes its business as a whole is not materially dependent on any particular patent or license, or any particular group of patents and licenses.

Annual Report 2015 85

**Table of Contents**

## Sector performance 6.4.1

**Group and Regional Costs**

Group and Regional organizations support the creation of value, connecting Philips with key stakeholders, especially our employees, customers, governments and society. These organizations include the Executive Committee, Brand Management, Sustainability, New Venture Integration, the Group functions related to strategy, human resources, legal and finance, as well as country and regional management.

**Accelerate! investments**

Innovation, Group & Services plays an important role in the Accelerate! program, notably by helping to improve the end-to-end value chain. The End2End approach consists of three core processes: Idea-to-Market, Market-to-Order, and Order-to-Cash. Innovation, Group & Services supports a more efficient and effective Idea-to-Market process in five focal areas: speeding up time-to-market, portfolio optimization, driving breakthrough innovation, improving innovation competencies, and strengthening the position of Philips as an innovation leader.

**Pensions**

Pensions manage and oversee post-employment benefits of all Philips employees.

**Service Units and Other**

Service Units and Other provide shared functional services to businesses in areas such as IT, Real Estate and Accounting, thereby helping to drive global cost efficiencies.

**6.4.2 2015 financial performance**

Philips Innovation, Group & Services  
**Key data** in millions of EUR unless otherwise stated  
 2013 - 2015

	2013	2014	2015
Sales	665	605	574
Sales growth			
% increase (decrease), nominal	6%	(9)%	(5)%
% increase (decrease), comparable <sup>1)</sup>	0%	(12)%	5%
Adjusted IFO of:			
Group Innovation	(134)	(197)	(222)
IP Royalties	312	299	284
Group and regional costs	(175)	(205)	(569)
Accelerate! investment	(137)	(131)	(113)
Pensions	(41)	(12)	(355)
Service units and other	(124)	(415)	56
Adjusted IFO <sup>1)</sup>	(299)	(661)	(919)
IFO	(302)	(675)	(934)
Net operating capital (NOC) <sup>1)</sup>	(2,922)	(3,718)	(3,382)
Cash flows before financing activities <sup>1)</sup>	(2,140)	(1,586)	(2,086)

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Employees (in FTEs)	12,703	13,853	14,233
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<sup>1)</sup> For a reconciliation to the most directly comparable GAAP measures, see chapter 15, Reconciliation of non-GAAP information, of this report

In 2015, sales amounted to EUR 574 million, and were mainly related to IP Royalties. Sales were EUR 31 million lower than in 2014, mainly due to the divestment of the OEM remote control business, partly offset by higher sales at Philips emerging businesses such as Digital Pathology and Photonics.

Adjusted IFO amounted to a net cost of EUR 919 million, compared to EUR 661 million in 2014. Adjusted IFO in 2015 included a EUR 20 million net release of restructuring charges, compared to EUR 113 million restructuring charges in 2014. Adjusted IFO in 2015 also included charges of EUR 183 million related to the separation of the Lighting business, EUR 345 million mainly related to settlements for pension de-risking, and a EUR 37 million gain related to the sale of real estate assets. Adjusted IFO in 2014 included EUR 244 million of charges related to the CRT settlement and a EUR 27 million past-service pension cost gain.

Adjusted IFO at Group Innovation was a EUR 25 million higher net cost than in 2014, mainly due to higher investments in emerging business areas.

Adjusted IFO at Group and Regional costs were EUR 364 million lower than in 2014, reflecting EUR 183 million related to the separation of the Lighting business and higher charges mainly related to information security and Quality & Regulatory.

Accelerate! investments amounted to EUR 113 million in 2015 and included investments in IT infrastructure, internal departments and external consultancy dedicated to the Accelerate! program.

Adjusted IFO at Pensions amounted to a net cost of EUR 355 million and represents costs related to deferred pensioners covered by company plans. 2015 included charges of EUR 345 million related to pension de-risking settlements.

Adjusted IFO at Service Units and Other increased from a loss of EUR 415 million in 2014 to a gain of EUR 56 million in 2015. The increase of EUR 471 million was largely due to lower restructuring costs and CRT antitrust litigation charges reported in 2014.

Net operating capital improved to negative EUR 3.4 billion, mainly due to a decrease in provisions.

Cash flows before financing activities decreased from an outflow of EUR 1,586 million in 2014 to an outflow of EUR 2,086 million.

### 2014 financial performance

In 2014, sales amounted to EUR 605 million, and were mainly related to IP Royalty income and our OEM Remote Control business. Sales were EUR 60 million lower than in 2013, mainly due to lower income from Group Innovation and IP Royalties.

Adjusted IFO amounted to a loss of EUR 661 million, compared to a loss of EUR 299 million in 2013. In 2014, Adjusted IFO included EUR 113 million of restructuring and acquisition-related charges, EUR 244

**Table of Contents**

[Sector performance 6.4.3](#)

million of provisions related to various legal matters and a EUR 27 million past-service pension gain in the Netherlands. 2013 Adjusted IFO included EUR 3 million of restructuring and acquisition-related charges and a pension settlement loss of EUR 25 million.

Adjusted IFO at Group Innovation was a EUR 63 million higher net cost than in 2013, mainly due to higher restructuring charges and higher investments in emerging business areas.

Adjusted IFO at Group and Regional Overhead costs were EUR 30 million lower than in 2013, mainly due to higher restructuring costs.

Accelerate! investments amounted to EUR 131 million in 2014, and include investments in IT infrastructure, internal departments and external consultancy dedicated to the Accelerate! program.

Adjusted IFO at Pensions amounted to a net cost of EUR 12 million, and represent costs related to deferred pensioners covered by company plans. In 2013, Pensions amounted to a net cost of EUR 41 million and was impacted by a EUR 31 million settlement loss arising from a lump-sum offering to terminated vested employees in our US pension plan.

Adjusted IFO at Service Units and Other decreased from a loss of EUR 124 million in 2013 to a loss of EUR 415 million in 2014. The decrease was largely driven by EUR 243 million of charges related to legal matters.

Net operating capital decreased to negative EUR 3.7 billion, mainly due to an increase in working capital.

Cash flows before financing activities improved from an outflow of EUR 2,140 million in 2013 to an outflow of EUR 1,586 million.

**6.4.3 2016 and beyond**

From an external financial reporting perspective, it should be noted that Royal Philips will introduce new segment reporting from Q1 2016 onwards. The current Innovation, Group & Services will be split and allocated to the segments of Royal Philips and Philips Lighting. The remaining unallocated corporate items will contain certain legacy items and separation costs. For more details on the new segment reporting in 2016 and onwards, please refer to the introduction of chapter 6, Sector performance, of this report.

Further updates will be provided in the course of 2016.

**Table of Contents**

## Risk management 7

## 7 Risk management

**7.1 Our approach to risk management and business control**

The following section presents an overview of Philips' approach to risk management and business controls and a description of the nature and the extent of its exposure to risks. Philips' risk management focuses on the following risk categories: Strategic, Operational, Compliance and Financial risks. These categories are further described in section 7.2, Risk categories and factors, of this report. The risk overview highlights the main risks known to Philips, which could hinder it in achieving its strategic and financial business objectives. The risk overview may, however, not include all the risks that may ultimately affect Philips. Some risks not yet known to Philips, or currently believed not to be material, could ultimately have a major impact on Philips' businesses, objectives, revenues, income, assets, liquidity or capital resources.

All forward-looking statements made on or after the date of this Annual Report and attributable to Philips are expressly qualified in their entirety by the factors described in the cautionary statement included in Forward-looking statements, of this report and the overview of risk factors described in section 7.2, Risk categories and factors, of this report.

Risk management and controls forms an integral part of the business planning and review cycle. The company's risk and control policy is designed to provide reasonable assurance that objectives are met by integrating management control into the daily operations, by ensuring compliance with legal requirements and by safeguarding the integrity of the company's financial reporting and its related disclosures. It makes management responsible for identifying the critical business risks and for the implementation of fit-for-purpose risk responses. Philips' risk management approach is embedded in the areas of corporate governance, Philips Business Control Framework and Philips General Business Principles.

**Corporate governance**

Corporate governance is the system by which a company is directed and controlled. Philips believes that good corporate governance is a critical factor in achieving business success. Good corporate governance derives from, among other things, solid internal controls and high ethical standards.

The quality of Philips' systems of business controls and the findings of internal and external audits are reported to and discussed by the Audit Committee of the Supervisory Board. Internal auditors monitor the quality of the business controls through risk-based operational audits, inspections of financial reporting controls and compliance audits. Audit & Risk committees at group level (Group, Finance and IT) and at Business Group, Market and Function level meet quarterly to address weaknesses in the business controls infrastructure as reported by internal and external auditors or revealed by self-assessment of management, and to take corrective action where necessary. These Audit & Risk committees are also involved in determining the desired company-wide internal audit planning as approved by the Audit Committee of the Supervisory Board. Whilst recognizing the responsibilities of the Audit Committee, the Supervisory Board also established the Quality and Regulatory Committee in 2015. The Q&R Committee assist the Supervisory Board in fulfilling its oversight responsibilities particularly in respect of the quality of the Company's products, systems, services and software and the development, testing, manufacturing, marketing and servicing thereof, and regulatory requirements relating thereto. As such, the establishment of the Q&R Committee supports the Company's risk management in the relevant risk areas. An in-depth description of Philips' corporate governance structure can be found in chapter 11, Corporate governance, of this report.

**Philips Business Control Framework**

The Philips Business Control Framework (BCF) sets the standard for risk management and business control in Philips. The objectives of the BCF are to maintain integrated management control of the company's operations, in order to ensure the integrity of the financial reporting, as well as compliance with laws and regulations. Philips has designed its BCF based on the Internal Control-Integrated Framework (2013) established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Philips continuously evaluates and improves BCF to align with business dynamics and good practice.

As part of the BCF, Philips has implemented a global standard for internal control over financial reporting (ICS). The ICS, together with Philips established accounting procedures, is designed to provide reasonable assurance that assets are safeguarded, that the books and records properly reflect transactions necessary to permit preparation of financial statements, that policies and procedures are carried out by qualified personnel

and that published financial statements are properly prepared and do not contain any material misstatements. ICS has been deployed in all material reporting units, where business process owners perform an extensive number of controls, document the results each quarter, and take corrective action where necessary. ICS supports business and functional management in a quarterly cycle of assessment and monitoring of its control environment.

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## **Table of Contents**

[Risk management 7.1](#)

The findings of management's evaluation are reported to the Executive Committee and the Supervisory Board quarterly.

As part of the Annual Report process, management's accountability for business controls is enforced through the formal issuance of a Statement on Business Controls and a Letter of Representation by Business Group, Market and Functional management to the Executive Committee. Any deficiencies noted in the design and operating effectiveness of controls over financial reporting which were not completely remediated are evaluated at year-end by the Board of Management. The Board of Management's report, including its conclusions regarding the effectiveness of internal control over financial reporting, can be found in section 12.1, Management's report on internal control, of this report.

### **Philips General Business Principles**

The Philips General Business Principles (GBP) incorporate the fundamental principles for all Philips businesses. They set the standard for business conduct, both for individual employees and for the company itself. They also provide a reference for the business conduct we expect from our business partners and suppliers. Translations 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 the GBP in their day-to-day work.

In addition, there are separate Codes of Ethics that apply to employees working in specific areas of our business, i.e. the Procurement Code of Ethics and the Financial Code of Ethics. Details can be found at: [www.philips.com/gbp](http://www.philips.com/gbp).

In a continued effort to raise GBP awareness and create engagement, every year a GBP communications and training plan is deployed. In 2015, over the course of several communication waves, employees were informed about a variety of GBP topics, the Philips Ethics Line, the Business Integrity Survey, and the deployment of e-learning on the GBP and related legal compliance topics. The mandatory GBP e-learning, which was launched in October, has been sent to all employees with a Philips e-mail account.

The GBP form an integral part of labor contracts in virtually every country in which Philips operates. It is the responsibility of each employee to live up to our GBP, and employees are requested to state their commitment after having completed the GBP e-training. In addition, each year the relevant employees are asked to sign off on the Financial and the Supply Management Codes of Ethics, and all executives are asked to sign off on the General Business Principles to confirm their awareness and compliance with the respective codes.

The GBP Review Committee is responsible for the effective deployment of the GBP. The GBP Review Committee is a virtual body chaired by the Chief Legal Officer, and its members include the Chief HR Officer, the Chief Market Leader and the Chief Financial Officer. They are supported by a secretariat and a network of GBP compliance Officers in all countries and at all major sites where Philips has operations. Related roles and responsibilities are laid down in the Charter of the GBP Review Committee. In December 2015 the GBP Review Committee adopted a revised charter. These revisions were deemed necessary in view of the external regulatory developments in business ethics and compliance and they have an impact on the composition of the GBP Review Committee, the roles and responsibilities of its members as well as the composition, roles and responsibilities of the GBP Compliance function. Deployment of this revised charter will follow in 2016.

The GBP are supported by mechanisms that ensure standardized reporting and escalation of concerns. These mechanisms are based on the GBP Reporting policy that urges employees to report any concerns they may have regarding business conduct in relation to the GBP either through a GBP Compliance Officer or through the Philips Ethics Line. The Philips Ethics Line enables employees and, as of March 2015, also third parties to report a concern either by telephone or online via a web intake form. All concerns raised are registered consistently in a single database and are investigated in accordance with standardized investigation procedures.

As part of the Philips Business Control Framework, a GBP self-assessment process is fully embedded in an automated workflow application, which helps management to monitor the internal controls. With the GBP self-assessment forming part of ICS, GBP compliance necessarily forms part of management's quarterly ICS/SOx (Sarbanes-Oxley) monitoring process. Management of each business unit signs off on compliance with the GBP, with this confirmation forming part of the annual Statement on Business Controls. Non-compliance issues are highlighted and, if significant, they are reported to the Executive Committee through the Quarterly Certification Statement process.

The results from the monitoring facilities that are in place are given in chapter 14, Sustainability statements, of this report.

### **Financial Code of Ethics**

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The Company recognizes that its businesses have responsibilities within the communities in which they operate. The Company has a Financial Code of Ethics which applies to the CEO (the principal executive officer) and CFO (the principal financial and principal accounting officer), and to the senior management in the Philips Finance Leadership Team who head the Finance departments of the Company. The Company

Annual Report 2015 89



**Table of Contents**

[Risk management 7.1](#)

has published its Financial Code of Ethics within the investor section of its website located at [www.philips.com](http://www.philips.com). No changes were considered necessary and no changes have been made to the Financial Code of Ethics since its adoption and no waivers have been granted therefrom to the officers mentioned above in 2015.

For more information, please refer to sub-section 5.2.7, General Business Principles, of this report.

90 Annual Report 2015

**Table of Contents**

Risk management 7.2

**7.2 Risk categories and factors****Risks categories**

Taking risks is an inherent part of entrepreneurial behavior. A structured risk management process allows management to take risks in a controlled manner. In order to provide a comprehensive view of Philips' business activities, risks and opportunities are identified in a structured way combining elements of a top-down and bottom-up approach. Risks are reported on a regular basis as part of the Business Performance Management process. All relevant risks and opportunities are prioritized in terms of impact and likelihood, considering quantitative and/or qualitative aspects. The bottom-up identification and prioritization process is supported by workshops with the respective management at Business, Market and Group Function level. During 2015, several risk management workshops were held. The top-down element allows potential new risks and opportunities to be discussed at management level and included in the subsequent reporting process, if found to be applicable. Reported risks and opportunities are analyzed for potential cumulative effects and are aggregated at Business, Market and Group level. In line with the above, amongst others, the following actions were performed during 2015:

In 2015 the Supervisory Board established the Quality and Regulatory Committee. The establishment of the Q&R Committee further strengthens Philips' risk management efforts in respect of the quality of Philips' products, systems, services and software and the development, testing, manufacturing, marketing and servicing thereof.

As per February 2015, Philips acquired 100% of US-based Volcano Corporation. Similarly, in the second half of 2014 the Philips acquired 51% of Saudi-based General Lighting Company (GLC). Philips successfully integrated Volcano and GLC into the Philips Business Control Framework in the course of 2015.

As a next phase in the Accelerate! program, Philips announced in 2014 its plan to establish two stand-alone companies focused on the HealthTech and the Lighting opportunities respectively. The separation risk was described as from 2014 (refer to section 7.7, Separation risk, of this report) and in 2015 we have paid particular attention to risks related to the separation as this is a very complex process.

Philips had substantial defined benefit pension plans which carry financial risk. During 2015 the Company further de-risked pension exposure by means of settling the Dutch, UK and (partly) US defined benefit pension plans.

The challenging global economic developments had an impact on our results. Even though the managing of risks related to these developments did not change compared to 2014, we continuously monitor the impact on our risk profile.

Philips has a structured risk management process to address different risk categories: Strategic, Operational, Compliance and Financial risks. Risk appetite is different for the various risk categories:

Strategic risks and opportunities may affect Philips' strategic ambitions. Strategic risks include economic and political developments and anticipating and timely responding to market circumstances. Philips is prepared to take considerable strategic risks given the necessity to invest in research & development and manage the portfolio of businesses, including acquisitions and divestments, in a highly uncertain global political and economic environment.

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Operational risks include adverse unexpected developments resulting from internal processes, people and systems, or from external events that are linked to the actual running of each business (examples are solution and product creation, and supply chain management). Philips aims to minimize downside risks due to the need for high quality of its products and services, reliable IT systems and sustainability commitments.

Compliance risks cover unanticipated failures to implement, or comply with, appropriate laws, regulations, policies and procedures. Philips has a zero tolerance policy towards non-compliance in relation to breaches of its GBP.

Within the area of Financial risks, Philips identifies risks related to Treasury, Accounting and reporting, Pensions and Tax. Philips does not classify these risk categories in order of importance. Separation risk is

Annual Report 2015 91

## **Table of Contents**

### **Risk management 7.2**

covered in section 7.7, Separation risk, of this report. Philips is prudent with regard to financial risks and the risk appetite is embedded in various chapters of this annual report, including note 31, Details of treasury / other financial risks.

Philips describes the risk factors within each risk category in order of Philips' current view of expected significance, to give stakeholders an insight into which risks and opportunities it considers more prominent than others at present. The risk overview highlights the main risks and opportunities known to Philips, which could hinder it in achieving its strategic and financial business objectives. The risk overview may, however, not include all the risks that may ultimately affect Philips. Describing risk factors in their order of expected significance within each risk category does not mean that a lower listed risk factor may not have a material and adverse impact on Philips' business, strategic objectives, revenues, income, assets, liquidity, capital resources or achievement of Philips' 2016 goals. Furthermore, a risk factor described after other risk factors may ultimately prove to have more significant adverse consequences than those other risk factors. Over time Philips may change its view as to the relative significance of each risk factor.

### **7.3 Strategic risks**

As Philips' business is global, its operations are exposed to economic and political developments in countries across the world that could adversely impact its revenues and income.

Philips' business environment is influenced by political and economic conditions in the domestic and global markets. Philips experienced the impact from changes in macro-economic development in various geographies during 2015 in particular in China where economic growth was at the lowest level in the last 25 years. This has triggered interventions by the Chinese government on the official exchange rate of the Chinese Renminbi. Also the economic growth of countries highly dependent on revenues from energy, raw materials and commodities has been adversely affected by the slowdown of growth in China, most strongly in emerging market countries. Monetary interventions by the European Central Bank have not yet resulted in an increase of inflation nor in stronger economic growth in the European Union. The disparate macroeconomic outlook for the main geographies, political conflicts and the unknown impact of Eurozone monetary policy continues to provide uncertainty on the levels of capital expenditures in general, unemployment levels and consumer and business confidence, which could adversely affect demand for products and services offered by Philips. These economic conditions may have an adverse effect on financial markets which could affect the ability of Philips to sell off strategic divestments at reasonable price levels or within a reasonable period of time.

The general global political environment remains unfavorable for the business environment due to a rise in political conflicts and terrorism. Numerous other factors, such as sustained lower levels of energy and raw material prices, regional political conflicts in the Middle East, Russia and Ukraine and other regions, as well as large-scale (in)voluntary migration and profound social instability could continue to impact macroeconomic factors and the international capital and credit markets. Economic growth and the business environment in the European Union may be adversely affected by potential exits from the Eurozone (Greece), exits from the European Union (Great Britain) or secession of regions from European countries (e.g. Cataluña and Scotland). Economic and political uncertainty may have a material adverse impact on Philips' financial condition or results of operations and can also make it more difficult for Philips to budget and forecast accurately. Philips may encounter difficulty in planning and managing operations due to the lack of adequate infrastructure and unfavorable political factors, including unexpected legal or regulatory changes such as foreign exchange import or export controls, increased healthcare regulation, nationalization of assets or restrictions on the repatriation of returns from foreign investments. Given that growth geographies are increasingly important in Philips' operations, the above-mentioned risks are also expected to grow and could have a material adverse effect on Philips' financial condition and operating results.

Philips may be unable to adapt swiftly to changes in industry or market circumstances, which could have a material adverse impact on its financial condition and results.

Fundamental shifts in the industry, like the transition from traditional lighting to LED lighting, may drastically change the business environment. If Philips is unable to recognize these changes in good time, is late in adjusting its business models, or if circumstances arise such as pricing actions by competitors, then this could have a material adverse effect on Philips' growth ambitions, financial condition and operating result.

Philips' overall performance in the coming years is dependent on realizing its growth ambitions in growth geographies.

Growth geographies are becoming increasingly important in the global market. In addition, Asia is an important production, sourcing and design center for Philips. Philips faces strong competition to attract the best talent in tight labor markets and intense competition from local companies as well as other global players for market share in growth geographies. Philips needs to maintain and grow its position in growth geographies,

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invest in local talents, understand developments in end-user preferences and localize the portfolio in order to stay competitive. If Philips fails to achieve this, then this could have a material adverse effect on growth ambitions, financial condition and operating result.

**Table of Contents**[Risk management 7.3](#)

The growth ambitions of Philips may be adversely affected by economic volatility inherent in growth geographies and the impact of changes in macroeconomic circumstances on growth economies.

[Philips may not control joint ventures or associated companies in which it invests, which could limit the ability of Philips to identify and manage risks.](#)

Philips has invested or will invest in joint ventures and associated companies in which Philips will have a non-controlling interest. In these cases, Philips has limited influence over, and limited or no control of, the governance, performance and cost of operations of joint ventures and associated companies. Some of these joint ventures and associated companies may represent significant investments. The joint ventures and associated companies that Philips does not control may make business, financial or investment decisions contrary to Philips' interests or decisions different from those, which Philips itself may have made. Additionally, Philips partners or members of a joint venture or associated company may not be able to meet their financial or other obligations, which could expose Philips to additional financial or other obligations, as well as have a material adverse effect on the value of its investments in those entities or potentially subject Philips to additional claims.

[Acquisitions could expose Philips to integration risks and challenge management in continuing to reduce the complexity of the company.](#)

Philips' acquisitions may continue to expose Philips in the future to integration risks in areas such as sales and service force integration, logistics, regulatory compliance, information technology and finance. Integration difficulties and complexity may adversely impact the realization of an increased contribution from acquisitions. Philips may incur significant acquisition, administrative and other costs in connection with these transactions, including costs related to the integration of acquired businesses.

Furthermore, organizational simplification and resulting cost savings may be difficult to achieve. Acquisitions may also lead to a substantial increase in long-lived assets, including goodwill. Write-downs of these assets due to unforeseen business developments may have a material adverse effect on Philips' earnings, particularly in Healthcare and Lighting, which have significant amounts of goodwill (see also note 11, Goodwill).

[Philips' inability to secure and retain intellectual property rights for products, whilst maintaining overall competitiveness, could have a material adverse effect on its results.](#)

Philips is dependent on its ability to obtain and retain licenses and other intellectual property (IP) rights covering its products and its design and manufacturing processes. The IP portfolio is the result of an extensive patenting process that could be influenced by a number of factors, including innovation. The value of the IP portfolio is dependent on the successful promotion and market acceptance of standards developed or co-developed by Philips. This is particularly applicable to Consumer Lifestyle where third-party licenses are important and a loss or impairment could have a material adverse impact on Philips' financial condition and operating results.

**7.4 Operational risks**[Transformation programs](#)

In 2011 Philips started a very extensive transformation program (Accelerate!) to unlock Philips' full potential. Accelerate! spans a time period of several years. In 2014 as a next phase in the Accelerate! transformation program Philips announced its plan to sharpen its strategic focus by establishing two stand-alone companies focused on the HealthTech and Lighting opportunities respectively. Failure to achieve the objectives of the transformation programs may have a material adverse effect on the mid-term and long-term financial targets.

In addition, the transformation program of the Finance function may expose Philips to adverse changes in the quality of its systems of internal control.

[Failure to achieve improvements in Philips' solution and product creation process and/or increased speed in innovation-to-market could hamper Philips' profitable growth ambitions.](#)

Further improvements in Philips' solution and product creation process, ensuring timely delivery of new solutions and products at lower cost and upgrading of customer service levels to create sustainable competitive advantage, are important in realizing Philips' profitable growth ambitions. The emergence of new low-cost competitors, particularly in Asia, further underlines the importance of improvements in the product creation process. The success of new solution and product creation, however, depends on a number of factors, including timely and successful completion of development efforts, market acceptance, Philips' ability to manage the risks associated with new products and production ramp-up issues, the ability of Philips to attract and retain employees with the appropriate skills, the availability of products in the right quantities and at appropriate costs to meet anticipated demand and the risk that new products and services may have quality or other defects in the early stages of introduction. Accordingly, Philips cannot determine in advance the ultimate effect that new solutions and product creations will have on its financial condition and operating results. If Philips fails to accelerate its innovation-to-market processes and fails to ensure that end-user insights are fully captured and translated into solution and product creations that improve product mix and consequently contribution, it

## **Table of Contents**

### [Risk management 7.4](#)

may face an erosion of its market share and competitiveness, which could have a material adverse effect on its financial condition and operating results.

#### [Risk of unauthorized use of intellectual property rights](#)

Philips produces and sells products and services which incorporates technology protected by intellectual property rights. Philips develops and acquires intellectual property rights on regular basis. Philips is exposed to the risk that intellectual property rights on technology applied in its products and services is claimed to be owned by third parties, who, in case their claims of infringement of such intellectual property rights are awarded, would be entitled to damages and fines.

[If Philips is unable to ensure effective supply chain management, e.g. facing an interruption of its supply chain, including the inability of third parties to deliver parts, components and services on time, and if it is subject to rising raw material prices, it may be unable to sustain its competitiveness in its markets.](#)

Philips is continuing the process of creating a leaner supply base with fewer suppliers, while maintaining dual / multiple sourcing strategies where possible. This strategy very much requires close cooperation with suppliers to enhance, among other things, time to market and quality. In addition, Philips is continuing its initiatives to reduce assets through outsourcing. These processes may result in increased dependency on external suppliers and providers. Although Philips works closely with its suppliers to avoid supply-related problems, there can be no assurance that it will not encounter supply problems in the future or that it will be able to timely replace a supplier that is not able to meet its demand.

Shortages or delays could materially harm its business. Most of Philips' activities are conducted outside of the Netherlands, and international operations bring challenges. For example, production and procurement of products and parts in Asian countries are increasing, and this creates a risk that production and shipping of products and parts could be interrupted by regional conflicts or a natural disaster. A general shortage of materials, components or subcomponents as a result of natural disasters also bears the risk of unforeseeable fluctuations in prices and demand, which could have a material adverse effect on its financial condition and operating results.

Businesses purchase raw materials including so called rare earth metals, copper, steel, aluminum, noble gases and oil-related products, which exposes them to fluctuations in energy and raw material prices. In recent times, commodities have been subject to volatile markets and such volatility is expected to continue. If Philips is not able to compensate for increased costs or pass them on to customers, price increases could have a material adverse impact on Philips' results. In contrast, in times of falling commodity prices, Philips may not fully benefit from such price decreases as Philips attempts to reduce the risk of rising commodity prices by several means, such as including long-term contracting or physical and financial hedging.

[Diversity in information technology \(IT\) could result in ineffective or inefficient business management. IT outsourcing and off-shoring strategies could result in complexities in service delivery and contract management.](#)

Philips is engaged in a continuous drive to create a more open, standardized and consequently, more cost-effective IT landscape. This is leading to an approach involving further outsourcing, off-shoring, commoditization and ongoing reduction in the number of IT systems. This could introduce additional risk with regard to the delivery of IT services, the availability of IT systems and the scope and nature of the functionality offered by IT systems.

[Philips observes a global increase in IT security threats and higher levels of sophistication in computer crime, posing a risk to the confidentiality, availability and integrity of data and information.](#)

The global increase in security threats and higher levels of professionalism in computer crime have increased the importance of effective IT security measures, including proper identity management processes to protect against unauthorized systems access. Nevertheless, Philips systems, networks, products, solutions and services remain potentially vulnerable to attacks, which could potentially lead to the leakage of confidential information, improper use of its systems and networks or defective products, which could in turn materially adversely affect Philips financial condition and operating results. In recent years, the risks that we and other companies face from cyber-attacks have increased significantly. The objectives of these cyber-attacks vary widely and may include, among things, disruptions of operations including provision of services to customers or theft of intellectual property or other sensitive information belonging to us or other business partners. Successful cyber-attacks may result in substantial costs and other negative consequences, which may include, but are not limited to, lost revenues,



reputational damage, remediation costs, and other

94 Annual Report 2015

**Table of Contents**

Risk management 7.4

liabilities to customers and partners. Furthermore, enhanced protection measures can involve significant costs. Although we have experienced cyber-attacks but to date have not incurred any significant damage as a result and did not incur significant monetary cost in taking corrective action, there can be no assurance that in the future Philips will be as successful in avoiding damages from cyber-attacks. Additionally, the integration of new companies and successful outsourcing of business processes are highly dependent on secure and well controlled IT systems.

Due to the fact that Philips is dependent on its personnel for leadership and specialized skills, the loss of its ability to attract and retain such personnel would have an adverse effect on its business.

The attraction and retention of talented employees in sales and marketing, research and development, finance and general management, as well as of highly specialized technical personnel, especially in transferring technologies to low-cost countries, is critical to Philips' success. This is particularly valid in times of economic recovery. The loss of specialized skills could also result in business interruptions. There can be no assurance that Philips will continue to be successful in attracting and retaining all the highly qualified employees and key personnel needed in the future.

Warranty and product liability claims against Philips could cause Philips to incur significant costs and affect Philips' results as well as its reputation and relationships with key customers.

Philips is from time to time subject to warranty and product liability claims with regard to product performance and effects. Philips could incur product liability losses as a result of repair and replacement costs in response to customer complaints or in connection with the resolution of contemplated or actual legal proceedings relating to such claims. In addition to potential losses arising from claims and related legal proceedings, product liability claims could affect Philips' reputation and its relationships with key customers (both customers for end products and customers that use Philips' products in their production process). As a result, product liability claims could materially impact Philips' financial condition and operating results.

Any damage to Philips' reputation could have an adverse effect on its businesses.

Philips is exposed to developments which could affect its reputation. Such developments could be of an environmental or social nature, or connected to the behavior of individual employees or suppliers and could relate to adherence to regulations related to labor, health and safety, environmental and chemical management. Reputational damage could materially impact Philips' financial condition and operating results.

**7.5 Compliance risks**

Legal proceedings covering a range of matters are pending in various jurisdictions against Philips and its current and former group companies. Due to the uncertainty inherent in legal proceedings, it is difficult to predict the final outcome.

Philips, including a certain number of its current and former group companies, is involved in legal proceedings relating to such matters as competition issues, commercial transactions, product liability, participations and environmental pollution. Since the ultimate outcome of asserted claims and proceedings, or the impact of any claims that may be asserted in the future, cannot be predicted with certainty, Philips' financial position and results of operations could be affected materially by adverse outcomes.

Please refer to note 26, Contingent assets and liabilities, for additional disclosure relating to specific legal proceedings.

Philips is exposed to governmental investigations and legal proceedings with regard to possible anti-competitive market practices.

Philips is facing increased scrutiny by national and European authorities of possible anti-competitive market practices. Philips' financial position and results could be materially affected by an adverse final outcome of governmental investigations and litigation, as well as any potential related claims.

Philips' global presence exposes the company to regional and local regulatory rules, changes to which may affect the realization of business opportunities and investments in the countries in which Philips operates.

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Philips has established subsidiaries in over 80 countries. These subsidiaries are exposed to changes in governmental regulations and unfavorable political developments, which may affect the realization of business opportunities or impair Philips' local investments. Philips' increased focus on the healthcare sector increases its exposure to highly regulated markets, where obtaining clearances or approvals for new products is of great importance, and where there is a dependency on the available funding for healthcare systems. In addition, changes in reimbursement policies may affect spending on healthcare.

### [Philips is exposed to non-compliance with General Business Principles.](#)

Philips' attempts to realize its growth ambitions could expose it to the risk of non-compliance with the Philips General Business Principles, such as anti-bribery provisions. This risk is heightened in growth geographies as the legal and regulatory environment is less developed in growth geographies compared to mature geographies.

Annual Report 2015 95

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## **Table of Contents**

### [Risk management 7.5](#)

Examples include commission payments to third parties, remuneration payments to agents, distributors, consultants and the like, and the acceptance of gifts, which may be considered in some markets to be normal local business practice (See also note 26, Contingent assets and liabilities).

#### [Defective internal controls would adversely affect our financial reporting and management process.](#)

The reliability of reporting is important in ensuring that management decisions for steering the businesses and managing both top-line and bottom-line growth are based on top-quality data. Flaws in internal control systems could adversely affect the financial position and results and hamper expected growth.

The correctness of disclosures provides investors and other market professionals with significant information for a better understanding of Philips' businesses. Imperfections or lack of clarity in the disclosures could create market uncertainty regarding the reliability of the data presented and could have a negative impact on the Philips share price.

The reliability of revenue and expenditure data is key for steering the business and for managing top-line and bottom-line growth. The long lifecycle of healthcare sales, from order acceptance to accepted installation, together with the complexity of the accounting rules for when revenue can be recognized in the accounts, presents a challenge in terms of ensuring there is consistency of application of the accounting rules throughout Philips Healthcare's global business.

#### [Philips is exposed to non-compliance with data privacy and product safety laws.](#)

Philips' brand image and reputation would be adversely impacted by non-compliance with various data protection and product safety laws. In light of Philips' digital strategy, data privacy laws are increasingly important. Also, Philips Healthcare is subject to various (patient) data protection and safety laws. In Philips Healthcare, privacy and product safety and security issues may arise, especially with respect to remote access or monitoring of patient data or loss of data on our customers' systems. Philips is exposed to the risk that its products, including components or materials procured from suppliers, may prove to be not compliant with safety laws, e.g. chemical safety regulations. Such non-compliance could result in a ban on the sale or use of these products.

Philips operates in a highly regulated product safety and quality environment. Philips' products are subject to regulation by various government agencies, including the FDA (US) and comparable foreign agencies. Obtaining their approval is costly and time consuming, but a prerequisite for market introduction. A delay or inability to obtain the necessary regulatory approvals for new products could have a material adverse effect on business. The risk exists that product safety incidents or user concerns could trigger FDA business reviews which, if failed, could lead to business interruption which in turn could adversely affect Philips' financial condition and operating results. E.g. the voluntary, temporary suspension in 2014 of new production at our Healthcare facility in Cleveland, Ohio targeted to further strengthen manufacturing process controls after certain issues in this area were identified during an ongoing FDA inspection.

### **7.6 Financial risks**

#### [Philips is exposed to a variety of treasury risks and other financial risks including liquidity risk, currency risk, interest rate risk, commodity price risk, credit risk, country risk and other insurable risk.](#)

Negative developments impacting the global liquidity markets could affect the ability of Philips to raise or refinance debt in the capital markets or could lead to significant increases in the cost of such borrowing in the future. If the markets expect a downgrade or downgrades by the rating agencies or if such a downgrade has actually taken place, it could increase the cost of borrowing, reduce our potential investor base and adversely affect our business.

Philips operates in approximately 100 countries and its earnings are therefore inevitably exposed to fluctuations in exchange rates of foreign currencies against the euro. Philips' sales are sensitive in particular to movements in the US dollar, Japanese yen and a wide range of other currencies from developed and emerging markets. However, Philips' sourcing and manufacturing spend is concentrated in the Eurozone, United States and China. Therefore the net (revenues less spend) sensitivity of Income from Operations to US dollar and Chinese renminbi is relatively small. Income from Operations is sensitive to movements in currencies from countries where the Group has none or small manufacturing/sourcing activity such as Japan and a range of emerging markets such as Russia, Korea, Indonesia, India and Brazil.

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The credit risk of financial and non-financial counterparties with outstanding payment obligations creates exposures for Philips, particularly in relation to accounts receivable with customers and liquid assets and fair values of derivatives and insurance receivables contracts with financial counterparties. A default by counterparties in such transactions can have a material adverse effect on Philips' financial condition and operating results.

Philips' supply chain is exposed to fluctuations in energy and raw material prices. Commodities such as oil are subject to volatile markets and significant price increases from time to time. If Philips is not able to compensate for, or timely pass on, its increased costs to customers, such price increases could have an adverse impact on its financial condition and operating results.

**Table of Contents**

Risk management 7.6

Philips is exposed to interest rate risk, particularly in relation to its long-term debt position; this risk can take the form of either fair value or cash flow risk. Failure to effectively hedge this risk can impact Philips' financial condition and operating results.

For further analysis, please refer to note 31, Details of treasury / other financial risks.

[Philips is exposed to a number of different fiscal uncertainties which could have a significant impact on local tax results.](#)

Philips is exposed to a number of different tax uncertainties which could result in double taxation, penalties and interest payments. These include transfer pricing uncertainties on internal cross-border deliveries of goods and services, tax uncertainties related to acquisitions and divestments, tax uncertainties related to the use of tax credits and permanent establishments, tax uncertainties due to losses carried forward and tax credits carried forward and potential changes in tax law that could result in higher tax expense and payments. Those uncertainties may have a significant impact on local tax, results which in turn could adversely affect Philips' financial condition and operating results.

The value of the losses carried forward is subject to having sufficient taxable income available within the loss-carry-forward period, but also to having sufficient taxable income within the foreseeable future in the case of losses carried forward with an indefinite carry-forward period. The ultimate realization of the Company's deferred tax assets, including tax losses and credits carried forward, is dependent upon the generation of future taxable income in the countries where the temporary differences, unused tax losses and unused tax credits were incurred and during the periods in which the deferred tax assets become deductible. Additionally, in certain instances, realization of such deferred tax assets is dependent upon the successful execution of tax planning strategies. Accordingly, there can be no absolute assurance that all (net) tax losses and credits carried forward will be realized.

For further details, please refer to the tax risks paragraph in note 8, Income taxes.

[Philips is exposed to uncertainty on the timing and proceeds of a sale of Lumileds.](#)

On January 22, 2016 Philips announced the termination of its agreement with GO Scale Capital to sell a stake of 80.1% in Lumileds due to the inability to mitigate regulatory concerns in the US. Philips is engaging with other parties that have expressed an interest in the Lumileds business. Adverse market conditions during the bidding and sale process and regulatory restrictions may have an adverse effect on the timing of a sale transaction and the potential proceeds from such a transaction. Prolonged adverse conditions could trigger a requirement to no longer classify Lumileds as being held for sale and being reported as discontinued operations. This would have a material impact on the balance sheet and Adjusted IFO as reported by Royal Philips.

[Philips has defined-benefit pension plans and other post-retirement plans in a number of countries. The funded status and the cost of maintaining these plans are influenced by movements in financial market and demographic developments, creating volatility in Philips' financials.](#)

A significant proportion of (former) employees in Europe and North and Latin America is covered by defined-benefit pension plans and other post-retirement plans. The accounting for such plans requires management to make estimates on assumptions such as discount rates, inflation, longevity, expected cost of medical care and expected rates of compensation. Movements (e.g. due to the movements of financial markets) in these assumptions can have a significant impact on the Defined Benefit Obligation and net interest cost. A negative performance of the financial markets could have a material impact on cash funding requirements and net interest cost and also affect the value of certain financial assets and liabilities of the company.

[Philips is exposed to a number of reporting risks.](#)

A risk rating is assigned for each risk identified, based on the likelihood of occurrence and the potential impact of the risk on the financial statements and related disclosures. In determining the probability that a risk will result in a misstatement of a more than inconsequential amount or material nature, the following factors are considered to be critical: complexity of the associated accounting activity or transaction process, history of accounting and reporting errors, likelihood of significant (contingent) liabilities arising from activities, exposure to losses, existence of a related party transaction, volume of activity and homogeneity of the individual transactions processed and changes to the prior period in accounting characteristics compared to the previous period.

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For important critical reporting risk areas identified within Philips we refer to the Use of estimates section in note 1, Significant accounting policies, as the Company assessed that reporting risk is closely related to the use of estimates and application of judgment.

### 7.7 Separation risk

Philips is exposed to risks associated with the separation of its Lighting business.

In September 2014 Philips announced its plan to sharpen its strategic focus by establishing two stand-alone companies focused on HealthTech and Lighting opportunities respectively. This is a complex process which involves certain risks to Philips. Although a stand-alone structure for Philips Lighting was established on February 1, 2016, there are still a number of important

Annual Report 2015 97

## **Table of Contents**

### [Risk management 7.7](#)

milestones to be completed in the separation process. Philips is reviewing all strategic options for Philips Lighting, including public offerings of ownership stakes and a private sale. The completion could take more time than originally planned or anticipated. There is no certainty as to the method or timing of the separation, which may expose Philips to risks regarding the proceeds from a sale of Philips Lighting, additional costs and other adverse consequences.

The separation into Royal Philips and Philips Lighting is unlike divestments or carve out transactions that Philips has implemented in the past, which affected very specific parts of the business of Philips. The separation impacts all businesses and markets as well as all supporting functions and all assets and liabilities of the Group and will continue to require complex and time consuming disentanglement efforts.

The design and execution of the separation requires the devotion of substantial time and attention from management and staff. Although Philips has set-up a dedicated senior project team to work on a successful separation, the separation efforts could distract from and have an adverse effect on the conduct of normal business and our strategy. The separation could increase the likelihood of occurrence and/or potential impact of the risks as described in section 7.2, Risk categories and factors, of this report, such as strategic risks (e.g. insufficient integration of acquisitions), operational risks (e.g. delays in innovation-to-market), compliance risk (e.g. ineffective internal controls) and financial risks (e.g. reporting risks).

The design and execution of the separation will involve and depend on support from external legal, tax, financial and other professional consultants and as a result Philips will incur substantial cost. The separation could take more time than originally anticipated, which may expose Philips to risks of additional cost and other adverse consequences.

The separation of businesses, assets, liabilities, contractual or contingent rights and obligations and legal entities may require Philips to recognize expenses and/or incur financial payments, which otherwise would not have been incurred.

While it is the firm intention to complete the separation, Philips has reserved the right not to proceed with the separation if it determines that it would be in the Company's interest not to do so. If it does proceed with the separation, no assurances can be given that the separation will ultimately lead to the increased benefits contemplated by Philips currently.



## **Table of Contents**

Management 8

### 8 Management

Koninklijke Philips N.V. is managed by an Executive Committee which comprises the members of the Board of Management and certain key officers from functions, businesses and markets.

The Executive Committee operates under the chairmanship of the Chief Executive Officer and shares responsibility for the deployment of Philips' strategy and policies, and the achievement of its objectives and results.

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. Early 2016, a stand-alone structure for Philips Lighting was established, within the Royal Philips Group. Until the right strategic option for its future is identified and executed, the Royal Philips Executive Committee will, under the supervision of the Supervisory Board, continue to oversee the Philips Lighting business.

Under Dutch Law, the Board of Management is accountable for the actions of the Executive Committee and has ultimate responsibility for the management and external reporting of Koninklijke Philips N.V. and is answerable to shareholders at the Annual General Meeting of Shareholders. Pursuant to the two-tier corporate structure, the Board of Management is accountable for its performance to a separate and independent Supervisory Board.

The Rules of Procedure of the Board of Management and Executive Committee are published on the Company's website ([www.philips.com/investor](http://www.philips.com/investor)).

### Corporate governance

A full description of the Company's corporate governance structure is published in chapter 11, Corporate governance, of this report.

### Frans van Houten

Born 1960, Dutch

President/Chief Executive Officer (CEO)

Chairman of the Board of Management since April 2011

Group responsibilities: Chairman of the Executive Committee,

Health Systems, Internal Audit, Information Technology,

Supply Management, Innovation & Strategy, Sustainability, Accelerate! -

Overall transformation, End2End, Quality and Regulatory Compliance

### Abhijit Bhattacharya

[Born 1961, Indian](#)

Executive Vice President &

Chief Financial Officer (CFO)

Member of the Board of Management since December 2015

Group responsibilities: Finance, Capital structure, Mergers & Acquisitions,

Investor Relations, Accelerate! - Operating Model

[Marnix van Ginneken](#)

[Born 1973, Dutch/American](#)

Executive Vice President & Chief Legal Officer

Group responsibilities: Legal and General Secretary

**Table of Contents**

Management 8

Denise Haylor

Born 1964, British/American

Executive Vice President & Chief Human Resources Officer

Group responsibilities: Human Resources, Accelerate! - Culture

Ronald de Jong

Born 1967, Dutch

Executive Vice President &

Chief Market Leader

Group responsibilities: Markets, Countries (all except

Greater China & North America), Government Affairs, Accelerate! - Customer centricity

Pieter Nota

Born 1964, Dutch

Executive Vice President & Chief Executive Officer of Personal Health,

Chief Marketing Officer, Member of the Board of Management since April 2011

Group responsibilities: Sector Consumer Lifestyle, Accelerate! - Resource to

Win, Marketing

Eric Rondolat

Born 1966, Italian/French

Executive Vice President &

Chief Executive Officer Philips Lighting

Group responsibilities: Philips Lighting

100 Annual Report 2015

**Table of Contents**

Supervisory Board 9

9 Supervisory Board

The Supervisory Board supervises the policies of the executive management and the general course of affairs of Koninklijke Philips N.V. and advises the executive management thereon. The Supervisory Board, in the two-tier corporate structure under Dutch law, is a separate and independent corporate body.

The Rules of Procedure of the Supervisory Board are published on the Company's website. For details on the activities of the Supervisory Board, see chapter 10, Supervisory Board report, of this report and section 11.2, Supervisory Board, of this report.

- 1) member of the Audit Committee
- 2) member of the Remuneration Committee
- 3) member of the Corporate Governance and Nomination & Selection Committee
- 4) member of the Quality & Regulatory Committee
- 5) member of the Separation Committee

Jeroen van der Veer

Born 1947, Dutch <sup>2),3),5)</sup>

Chairman

Chairman of the Corporate Governance and Nomination & Selection Committee

Member of the Supervisory Board since 2009; second term expires in 2017

Former Chief Executive and Non-executive Director of Royal Dutch Shell and currently Chairman of the Supervisory Board of ING Group. Member of the Supervisory Board of Concertgebouw N.V. and Royal Boskalis Westminster N.V.

Neelam Dhawan

Born 1959, Indian <sup>1)</sup>

Member of the Supervisory Board since 2012; first term expires in 2016

Currently Managing Director of Hewlett-Packard Enterprise India

Orit Gadiesh

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Born 1951, Israeli/American <sup>1)</sup>

Member of the Supervisory Board since 2014; first term expires in 2018

Currently Chairman of Bain & Company and the International Business Leaders Advisory Council for the Mayor of Shanghai (IBLAC).  
Member of the Foundation Board of the World Economic Forum (WEF). Also serves on the Advisory Board for the British-American Business council

Annual Report 2015 101

## Table of Contents

### Supervisory Board 9

#### Ewald Kist

Born 1944, Dutch <sup>2)</sup>

Member of the Supervisory Board since 2004; third term expires in 2016

Former Chairman of the Executive Board of ING Group and currently member of the Supervisory Boards of the Dutch Central Bank, DSM and Moody's Investor Service

#### Kees van Lede

Born 1942, Dutch <sup>5)</sup>

Chairman of the Separation Committee Member of the Supervisory Board since 2003; fourth term expires in 2017

Former Chairman of the Board of Management of Akzo Nobel. Currently member of the Supervisory Boards of AirFrance/KLM and Senior Advisor JP Morgan Plc.

#### Christine Poon

Born 1952, American <sup>2),3),4)</sup>

Vice-chairman and Secretary

Chairman of the Quality & Regulatory Committee Member of the Supervisory Board since 2009; second term expires in 2017

Former Vice-Chairman of Johnson & Johnson's Board of Directors and Worldwide Chairman of the Pharmaceuticals Group and former dean of Ohio State University's Fisher College of Business. Currently member of the Board of Directors of Prudential and Regeneron

#### Heino von Prondzynski

Born 1949, Swiss/German <sup>2),3),4)</sup>

Chairman of the Remuneration Committee Member of the Supervisory Board since 2007; third term expires in 2019

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Former member of the Corporate Executive Committee of the F. Hoffmann- La Roche Group and former CEO of Roche Diagnostics, currently Chairman of the Supervisory Boards of HTL Strefa and Epigenomics AG. Member of the Supervisory Board of Quotient Ltd.

### David Pyott

Born 1953, British <sup>1),4)</sup>

Member of the Supervisory Board since 2015; first term expires in 2019

Former Chairman and Chief Executive Officer of Allergan, Inc. (since 2001 and 1998, respectively, until 2015). Currently Director of Avery Dennison Corporation and its Lead Independent Director (since 1999 and 2010, respectively). Member of the Board of Directors of Alnylam Pharmaceuticals Inc. and of BioMarin Pharmaceutical Inc. Also member of the Board of Trustees of Chapman University, member of the Governing Board of the London Business School, President of the International Council of Ophthalmology Foundation and member of the Advisory Board of the Foundation of the American Academy of Ophthalmology.

### Jackson Tai

Born 1950, American <sup>1),4),5)</sup>

Chairman of Audit Committee

Member of the Supervisory Board since 2011; second term expires in 2019

Former Vice-Chairman and CEO of DBS Group and DBS Bank Ltd and former Managing Director at J.P. Morgan & Co. Incorporated. Currently a member of the Boards of Directors of The Bank of China Limited, MasterCard Incorporated and Eli Lilly and Company, Also Non-Executive Director of privately-held Russell Reynolds Associates and of Vaporstream



## **Table of Contents**

Supervisory Board report 10

### 10 Supervisory Board report

#### **Introduction**

We as members of the Supervisory Board are fully committed to our role and responsibility in respect of the proper functioning of the corporate governance of Philips. The Supervisory Board supervises and advises the Board of Management and Executive Committee in performing their management tasks and setting the direction of the business of the Philips Group. The Supervisory Board acts, and we as individual members of the Board act, in the interests of Koninklijke Philips N.V., its business and all its stakeholders. This report includes a more specific description of the Supervisory Board's activities during the financial year 2015 and other relevant information on its functioning.

#### **Activities of the Supervisory Board**

The overview below indicates a number of matters that we discussed during meetings throughout 2015:

Establishing Philips Lighting as a stand-alone company, and reviewing the strategic options for its separation. Please also refer to the activities of the Separation Committee, as included below in this Supervisory Board report;

Developing the strategic direction for Philips to capture higher growth in the health technology market opportunities, and for Lighting to transition from conventional lighting to LED applications;

Performance of the Philips Group and its underlying businesses and financial headroom;

Philips' annual management commitment and annual operating plan for 2016;

Capital allocation, including the dividend policy and continuance of the share buyback program;

Quality and regulatory systems and processes, including the interactions with the United States Food and Drug Administration and the remedial efforts in Cleveland and other sites. Please also refer to the description below in this Supervisory Board report of the activities of the Quality & Regulatory Committee that was established in 2015;

Significant mergers, acquisitions and divestments, notably the extensive efforts to obtain regulatory clearance for the sale of the Lumileds and Automotive business to a consortium led by GO Scale Capital which was terminated in January 2016;

Customers and new business models, including the increasing importance of large scale and managed equipment projects in both the HealthTech and Lighting business areas;

Business transformation and the progress being made in the Accelerate! Program;

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Enterprise risk management (which included an annual risk assessment and discussion of the changing nature of the risks faced by Philips and the possible impact of such risks). Such risks included the challenges of an increasingly digital environment, information security, including product security, new business models in the context of changing public policies and the execution risk associated with the separation of the Company;

The Company's program to de-risk its future pension liabilities, and the implications thereof;

Changes in the composition of the Executive Committee and the Board of Management, including the appointment of a new Chief Financial Officer;

Significant civil litigation claims and public investigations against or into the Company; and

A review of the Company's sustainability programs and goals.  
The Supervisory Board conducted "deep dives" on a range of topics including:

The North American Market, which included the recovery of the Diagnostic Imaging business, the scaling of solutions businesses and the importance of unlocking the potential of the Professional Lighting business; and

The strategy for the Lighting business and its translation to an equity story for potential investors.  
The Supervisory Board also reviewed Philips' annual and interim financial statements, including non-financial information, prior to publication thereof.

### **Supervisory Board meetings and attendance**

In 2015, the Supervisory Board convened for seven regular meetings and one extraordinary meeting. Moreover, we collectively and individually interacted with members of the Executive Committee and with senior management outside the formal Supervisory Board meetings. The Chairman of the Supervisory Board and the CEO met regularly for bilateral discussions about the progress of the Company on a variety of matters. The Supervisory Board also held bilateral meetings with several members of the Executive Committee to discuss a range of topics.

The Supervisory Board meetings were well attended in 2015. The attendance percentage at the meetings - including the committee meetings - was again high (in excess of 90%). The Supervisory Board visited the Company's site in Somerset, the United States, and toured its Lighting Application Center, to view demonstrations of its innovations in the Lighting market and meet with employees. The Supervisory Board also visited the Company's site in Best, the Netherlands, where we reviewed, among other things, the quality system of the Image Guided Therapy business group. The Supervisory Board committees also convened regularly (see the separate reports of the committees below) and all of the committees regularly reported back on their activities to the full Supervisory Board. In

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## **Table of Contents**

### [Supervisory Board report 10](#)

In addition to the formal meetings of the Board and its Committees, the Board members also held private meetings. We as members of the Board devoted sufficient time to engage (proactively if the circumstances so required) in our supervisory responsibilities.

### **Composition, diversity and self-evaluation by the Supervisory Board**

The Supervisory Board is a separate corporate body that is independent of the Board of Management (and the Executive Committee). Its independence is also reflected in the requirement that a member of the Supervisory Board cannot be a member of the Board of Management, of the Executive Committee or an employee of Philips. The Supervisory Board furthermore considers all its members to be independent pursuant to the Dutch Corporate Governance Code. We will continue to pay close attention to applicable independence criteria.

The Supervisory Board currently consists of nine members, after the appointment of Mr David Pyott at the 2015 Annual General Meeting.

The agenda for the upcoming 2016 Annual General Meeting of Shareholders will include a proposal to reappoint Mrs Neelam Dhawan to the Supervisory Board for an additional term of four years. The current term of appointment of Mr Ewald Kist will expire at the end of such meeting, after serving three consecutive terms on the Board. We are grateful to Ewald for his years of service, which included him being Chairman of the Audit Committee, for his dedication and the wisdom that he brought to Supervisory Board discussions and decisions.

In 2015, there were also a number of changes to the chairmanships and memberships within the Board. David Pyott was appointed as member of the Supervisory Board and became a member of the Audit Committee. Jackson Tai, Heino von Prondzynski and Kees van Lede were re-appointed as members of the Supervisory Board. Kees van Lede and Heino von Prondzynski stepped down from the Audit Committee. In 2015, we also established two new Supervisory Board Committees: the Separation Committee and the Quality & Regulatory Committee. Please refer to the description of the activities of such committees below in this Supervisory Board report.

The profile of the Supervisory Board aims for an appropriate combination of knowledge and experience among its members, encompassing marketing, manufacturing, technology, financial, economic, social, quality & regulatory and legal aspects of international business, government and public administration in relation to the global and multi-product character of Philips' businesses. The Supervisory Board pays great value to diversity in its composition. More particular it aims for having members with both European and non-European backgrounds (nationality, working experience or otherwise) and one or more members who have held an executive or similar position in business or society.

In addition, we support Philips' policy to appoint a well-balanced mix of women and men to its Board of Management, Executive Committee and Supervisory Board, including the policy of having at least 30% of the seats on the Board of Management and the Supervisory Board held by women and at least 30% of the seats held by men.

Currently, the Supervisory Board's gender diversity is within the statutory criteria. We note that there may be various pragmatic reasons – such as other relevant selection criteria and the availability of suitable candidates within Philips – that could play a role in the achievement of our diversity targets.

In 2015, the members of the Supervisory Board again completed a questionnaire to verify compliance in 2015 with applicable corporate governance rules and its Rules of Procedure. The outcome of this survey was satisfactory.

In addition, we each submitted to the Chairman responses to a questionnaire designed to self-evaluate the functioning of the Supervisory Board. As in previous years, the questionnaire covered topics such as the composition and competence of the Supervisory Board (for example, the Board's size and the education and training requirements of its members), access to information, the frequency and quality of the meetings, quality and timeliness of the meeting materials, the nature of the topics discussed during meetings and the functioning of the Supervisory Board's committees.

The responses to the questionnaire were aggregated into a report, which was discussed by the Supervisory Board in a private meeting. Certain areas were identified that could be improved and it was decided that the Chairman would follow-up with individual members to address specific issues. This resulted in a number of suggestions to improve the quality of the discussion in Board meetings, which will be implemented in 2016. All members of the Supervisory Board had a one-to-one discussion with the Chairman, and the Chairman was evaluated by the Vice-Chairman. The responses provided by the Supervisory Board members indicated that the Board continues to be a well-functioning team and we believe a diversity of experience and skills is represented on the Board. The Board has spent time throughout 2015 considering its composition and it will

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continue to devote attention to this topic during 2016. The functioning of the Supervisory Board committees was considered to be commendable (or better) and specific feedback was addressed by the Chairman of each committee with its members.

The use of an external evaluator to measure the functioning of the Supervisory Board may be considered in the future.

104 Annual Report 2015

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## **Table of Contents**

Supervisory Board report 10

### **Supervisory Board committees**

The Supervisory Board has assigned certain of its tasks to the three long-standing committees, also referred to in the Dutch Corporate Governance Code: the Corporate Governance and Nomination & Selection Committee, the Remuneration Committee and the Audit Committee. The separate reports of these committees are part of this Supervisory Board report and are published below. As explained below, the Supervisory Board additionally established the Separation Committee and the Quality & Regulatory Committee in 2015. The function of all of the Board's committees is to prepare the decision-making of the full Supervisory Board, and the committees currently have no independent or assigned powers. The full Board retains overall responsibility for the activities of its committees.

#### **Separation Committee**

We have established the Separation Committee following the Company's decision to establish two standalone companies focused on the HealthTech and Lighting opportunities respectively. The Separation Committee assists the Supervisory Board in its oversight responsibilities relating to the implementation of this decision. Its members are Jeroen van der Veer and Jackson Tai, chaired by Kees van Lede. The Separation Committee met 5 times in 2015. The Separation Committee reviewed the details of the separation across all Lighting businesses and Markets, and discussed the separation of items including intellectual property (including use of the Philips brand), information technology infrastructure, real estate and legacy liabilities. The allocation of employees between Royal Philips and Philips Lighting was also reviewed. The Separation Committee reported to the full Supervisory Board that it was impressed by the high standard of professionalism and efficiency displayed by the Management throughout the year and commends the Company on a well planned and executed separation.

#### **Quality & Regulatory Committee**

We have established the Quality and Regulatory Committee in view of the continued relevance of the quality of the Company's products, systems, services and software and the development, testing, manufacturing, marketing and servicing thereof, and regulatory requirements relating thereto. The Q&R Committee assists the Supervisory Board in fulfilling its oversight responsibilities in this area, whilst recognizing that the Audit Committee assists the Supervisory Board in the oversight of other areas of regulatory, compliance and legal matters. Its members are Heino von Prondzynski, David Pyott and Jackson Tai, chaired by Christine Poon. The Q&R Committee met 5 times in 2015. In each meeting, the Q&R Committee reviewed material developments, the quality and regulatory dashboards, which display key performance indicators for business groups and markets, the status of ongoing internal and external audits and any remediation actions underway or completed. In addition, the Q&R Committee reviewed the roadmap to simplify the Company's supplier base, the talent and succession planning in the Quality & Regulatory function and the training and education efforts around Quality & Regulatory matters being implemented in the Company. Members of the Q&R Committee visited sites and reviewed quality systems in the United States and the Netherlands.

#### **Supervisory Board remuneration**

The agenda for the upcoming 2016 Annual General Meeting of Shareholders will include a proposal to determine the remuneration of the members of the Quality & Regulatory Committee of the Supervisory Board which will be in line with the remuneration of the members of the Separation Committee as approved at the 2015 Annual General Meeting.

#### **Financial Statements 2015**

The financial statements of the company for 2015, as presented by the Board of Management, have been audited by KPMG Accountants N.V. as independent external auditor appointed by the General Meeting of Shareholders. Its reports have been included in section 13.5, Independent auditor's report, of this report. We have approved these financial statements, and all individual members of the Supervisory Board (together with the members of the Board of Management) have signed these documents.

We recommend to shareholders that they adopt the 2015 financial statements. We likewise recommend to shareholders that they adopt the proposal of the Board of Management to make a distribution of EUR 0.80 per common share (up to EUR 740 million), in cash or in shares at the option of the shareholder, against the net income for 2015 and retained earnings.

Finally, we would like to express our thanks to the members of the Executive Committee and all other employees for their continued contribution during the year.

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February 23, 2016

The Supervisory Board

Jeroen van der Veer

Christine Poon

Neelam Dhawan

Orit Gadiesh

Ewald Kist

Kees van Lede

David Pyott

Heino von Prondzynski

Jackson Tai

### **Further information**

To gain a better understanding of the responsibilities of the Supervisory Board and the internal regulations and procedures governing for its functioning and that of its

Annual Report 2015 105

## **Table of Contents**

Supervisory Board report 10

committees, please refer to chapter 11, Corporate governance, of this report and to the following documents published on the company's website:

Articles of Association

Rules of Procedure Supervisory Board, including the Charters of the Board committees

Rules of Conduct with respect to Inside Information

### **Changes and re-appointments Supervisory Board and committees 2015**

Jackson Tai, Heino von Prondzynski and Kees van Lede were re-appointed as members of the Supervisory Board.

David Pyott was appointed as member of the Supervisory Board and was appointed as a member of the Audit Committee.

The Quality & Regulatory Committee, Chaired by Christine Poon, and the Separation Committee, Chaired by Kees van Lede, were established.

### **Changes and re-appointments Supervisory Board 2016**

It is proposed to re-appoint Neelam Dhawan as a member of the Supervisory Board. The term of appointment of Ewald Kist will expire at the end of the 2016 AGM.

### **Changes Management 2015**

Frans van Houten and Pieter Nota were re-appointed as Chief Executive Officer and member of the Board of Management, respectively.

Abhijit Bhattacharya was appointed as a member of the Board of Management and Chief Financial Officer.

Ron Wirahadiraksa and Jim Andrew left the company, Patrick Kung retired.

### **10.1 Report of the Corporate Governance and Nomination & Selection Committee**

The Corporate Governance and Nomination & Selection Committee is chaired by Jeroen van der Veer and its other members are Christine Poon and Heino von Prondzynski.

The Committee is responsible for the review of selection criteria and appointment procedures for the Board of Management, the Executive Committee, certain other key management positions, as well as the Supervisory Board.

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In 2015, the Committee met five times and devoted time on the appointment or reappointment of candidates to fill current and future vacancies on the Board of Management, Executive Committee and Supervisory Board. In particular, the Committee discussed the outcome of comprehensive third-party reviews of the management of the Royal Philips and Lighting businesses, which included an analysis of competencies and succession planning. The Committee consulted with the CEO and other members of the Board of Management. Following those consultations it prepared decisions and advised the Supervisory Board on the candidates for appointment.

This resulted in Abhijit Bhattacharya succeeding Ron Wirahadiraksa as CFO, including Abhijit's appointment as member of the Board of Management at the Extraordinary General Meeting of Shareholders held on December 18, 2015.

This also resulted in the proposed re-appointment at the upcoming 2016 Annual General Meeting of Shareholders of Neelam Dhawan as a member of the Supervisory Board, as well as the appointment of Christine Poon as Vice-Chairman of the Supervisory Board. As it does each year, the Committee discussed succession planning for Executive Committee members. The Committee furthermore discussed the resignation of Jim Andrew and reviewed candidates for his successor, leading to the appointment of Jean Botti as Philips' new Chief Innovation & Strategy Officer in January 2016, as well as the retirement of Patrick Kung and his succession by Andy Ho.

The Committee spent considerable time, also in consultation with the Separation Committee Chairman, reviewing the implications of the separation of the Company into two companies for governance, succession and talent development.

As indicated in its report above, the Supervisory Board believes it is making good progress in implementing a policy of gender diversity. The Committee strives to continue this trend and give appropriate weight to the diversity policy in the nomination and appointment process on future vacancies, while taking into account the overall profile and selection criteria for appointments of suitable candidates to the Board of Management, Executive Committee and Supervisory Board.

Under its responsibility for the selection criteria and appointment procedures for Philips' senior management, the Committee reviewed the succession plans for top 70 positions and emergency candidates for key roles in the Company. In 2015, there was special



**Table of Contents**

Supervisory Board report 10.1

focus on the management teams of the two operating committees responsible for the day-to-day management of the businesses addressing the HealthTech and Lighting opportunities.

With respect to corporate governance matters, the Committee discussed relevant developments and legislative changes during two meetings. The Committee reviewed the corporate governance of Royal Philips and considered options for governance models for Philips Lighting should it become a company listed at a stock exchange. Given this possibility, the Committee also reviewed potential candidates for a supervisory board of Philips Lighting.

**10.2 Report of the Remuneration Committee****Introduction**

The Remuneration Committee is chaired by Heino von Prondzynski. Its other members are Jeroen van der Veer, Ewald Kist and Christine Poon. The Committee is responsible for preparing decisions of the Supervisory Board on the remuneration of individual members of the Board of Management and the Executive Committee. In performing its duties and responsibilities the Remuneration Committee is assisted by an external consultant and in-house remuneration expert acting on the basis of a protocol which ensures that he acts on the instructions of the Remuneration Committee. Currently, no member of the Remuneration Committee is a member of the management board of another listed company. In line with applicable statutory and other regulations, this report focuses on the terms of engagement and remuneration of the members of the Board of Management. The Committee met six times in 2015.

**10.2.1 Remuneration policy**

The objective of the remuneration policy for members of the Board of Management, as adopted by the general meeting of shareholders, is in line with that for executives throughout the Philips Group. That is, to attract, motivate and retain qualified senior executives of the highest caliber with an international mindset and the background essential for the successful leadership and effective management of a large global company. The Board of Management remuneration policy is benchmarked regularly against companies in the general industry and aims at the median market position.

One of the goals behind the policy is to focus on improving the performance of the company and to enhance the value of the Philips Group. Consequently, the remuneration package includes a variable part in the form of an annual cash incentive and a long-term incentive consisting of performance shares. The policy does not encourage inappropriate risk-taking.

The performance targets for the members of the Board of Management are determined annually at the beginning of the year. The Supervisory Board determines whether performance conditions have been met and can adjust the payout of the annual cash incentive and the long-term incentive grant upward or downward if the predetermined performance criteria were to produce an inappropriate result in extraordinary circumstances. The authority for such adjustments exists on the basis of contractual ultimatum-remedium and claw-back clauses. In addition, pursuant to Dutch legislation effective January 1, 2014, incentives may, under certain circumstances, be amended or clawed back pursuant to statutory powers. For more information please refer to chapter 11, Corporate governance, of this report. Further information on the performance targets is given in the chapters on the Annual Incentive (see sub-section 10.2.6, Annual Incentive, of this report) and the Long-Term Incentive Plan (see sub-section 10.2.7, Long-Term Incentive Plan, of this report) respectively.

**Key features of our Executive Committee Compensation Program**

The list below highlights Philips' approach to remuneration, in particular taking into account Corporate Governance practices in the Netherlands.

**What we do**

We pay for performance

We conduct scenario analyses

We have robust stock ownership guidelines

We have claw-back policies incorporated into our incentive plans

We have a simple and transparent remuneration structure in place

**What we do not do**

We do not pay dividend equivalents on stock options, or restricted share units and performance share units that do not vest

We do not offer executive contracts with longer than 12 months' separation payments

We do not have a remuneration policy in place that encourages our Board of Management to take any inappropriate risks or to act in their own interests

We do not reward failing members of the Board of Management upon termination of contract

We do not grant loans or give guarantees to the Board of Management

**10.2.2 Contracts for the provision of services**

Below, the main elements of the contracts for the provision of services of the members of the Board of Management are included.

**Term of appointment**

The members of the Board of Management are engaged for a period of 4 years, it being understood that this period expires no later than at the end of the following AGM held in the fourth year after the year of appointment.

## **Table of Contents**

### Supervisory Board report 10.2.2

Philips Group

#### **Contract terms for current members**

	end of term
F.A. van Houten	AGM 2019
A. Bhattacharya	AGM 2019
P.A.J. Nota	AGM 2019

#### **Notice period**

Termination of the contract for the provision of services is subject to six months' notice for both parties.

#### **Severance payment**

The severance payment is set at a maximum of one year's base compensation.

#### **Share ownership**

Simultaneously with the introduction of the current Long-Term Incentive Plan (LTI) in 2013, the guideline for members of the Board of Management to hold a certain number of shares in the Company was increased to the level of at least 200% of base pay (300% for the CEO). Until this level has been reached the members of the Board of Management are required to retain all after-tax shares derived from any long-term incentive plan.

Pieter Nota has reached the required share ownership level, the CEO has increased his ownership significantly throughout the year to currently 81% of his target and Abhijit Bhattacharya is at 53% of his target.

#### **10.2.3 Scenario analysis**

The Remuneration Committee conducts a scenario analysis annually. This includes the calculation of remuneration under different scenarios, whereby different Philips performance assumptions and corporate actions are examined. The Supervisory Board concluded that the current policy has proven to function well in terms of a relationship between the strategic objectives and the chosen performance criteria and believes that the Annual and Long-Term Incentive Plans support this relationship.

#### **10.2.4 Remuneration costs**

The table below gives an overview of the costs incurred by the Company in the financial year in relation to the remuneration of the Board of Management. Costs related to performance shares, stock option and restricted share right grants are taken by the Company over a number of years. As a consequence, the costs mentioned below in the performance shares, stock options and restricted share rights columns are the accounting cost of multi-year Long-Term Incentive grants given to members of the Board of Management.

Philips Group

#### **Remuneration Board of Management<sup>1)</sup> in EUR**

2015

	Costs in the year								
	annual base compensation <sup>2)</sup>	base compensation	realized annual incentive	performance shares	stock options	restricted share rights	pension allowances	pension scheme costs	other compensation
F.A. van Houten	1,175,000	1,168,750	768,920	1,273,940	17,713	28,279	529,387	25,241	78,035
A. Bhattacharya	650,000	23,551	11,937	8,968		183	7,315	886	998
P.A.J. Nota	680,000	672,500	383,112	605,749	12,045	21,964	270,529	26,302	104,918
		<b>1,864,801</b>	<b>1,163,969</b>	<b>1,888,657</b>	<b>29,758</b>	<b>50,426</b>	<b>807,231</b>	<b>52,429</b>	<b>183,951</b>

<sup>1)</sup> Reference date for board membership is December 31, 2015

<sup>2)</sup> Base compensation as of April 1, 2015 and for Mr Bhattacharya as of date of appointment as a member of the Board of Management. The performance shares granted in 2013, 2014 and 2015 to Mr R.H. Wirahadiraksa have lapsed per November 30, 2015. The same applies to the premium shares awarded as a result of restricted share right releases in the past.

No more restricted share rights were outstanding on November 30, 2015. Vested stock options may be exercised up to May 30, 2016, and July 29, 2016, respectively. All in accordance with the terms and conditions of the applicable Long-Term Incentive plans.

For further details on the pension allowances and pension costs see sub-section 10.2.8, Pensions, of this report.

### 10.2.5 Annual base compensation

The annual compensation of the members of the Board of Management has been reviewed in April 2015 as part of the regular remuneration review. The annual compensation of Frans van Houten has been increased per April 1, 2015, from EUR 1,150,000 to EUR 1,175,000. The annual compensation of Pieter Nota has been increased from EUR 650,000 to EUR 680,000.

Both increases were made to move base compensation levels closer to market levels. The annual compensation of the CFO, Abhijit Bhattacharya, has been determined per appointment as CFO at EUR 650,000.

### 10.2.6 Annual Incentive

Each year, a variable cash incentive (Annual Incentive) can be earned, based on the achievement of specific and challenging targets. The Annual Incentive criteria are made up for 80% of the financial indicators of the Company and for 20% of the team targets comprising, among others, targets as part of our sustainability program.

The on-target Annual Incentive percentage is set at 80% of the annual base compensation for the CEO and at 60% of the annual base compensation for other members of the Board of Management. The maximum Annual Incentive achievable is 160% of the annual base compensation for the CEO and 120% of the annual base compensation for members of the Board of Management.

**Table of Contents**

Supervisory Board report 10.2.6

To support the performance culture, the Annual Incentive plan is based on (financial) targets at own level and group level results (line-of-sight). The 2015 payouts, shown in the table below, reflect the at or above threshold performance of CSG, Adjusted IFO and Working Capital at the Group level.

Philips Group

**Annual Incentive realization** in EUR

2015 (payout in 2016)

	realized annual incentive	as a % of base compensation (2015)
F.A. van Houten	768,920	65.4%
A. Bhattacharya <sup>1)</sup>	11,937	50.7%
P.A.J. Nota	383,112	56.3%

<sup>1)</sup> Pay-out related to board membership period only

**10.2.7 Long-Term Incentive Plan**

Grants made under the 2015 LTI Plan consist of performance shares only.

**Grant size**

The annual grant size is set by reference to a multiple of base compensation. For the CEO the annual grant size is set at 120% of base compensation and for the other members of the Board of Management at 100% of base compensation. This is broadly at a mid-market level against leading European listed companies. The actual number of performance shares to be awarded is determined by reference to the average of the closing price of the Philips share on the day of publication of the first quarterly results and the four subsequent dealing days.

**Vesting schedule**

Dependent upon the achievement of the performance conditions, cliff-vesting applies three years after the date of grant. During the vesting period, the value of dividends will be added to the performance shares in the form of shares. These dividend-equivalent shares will only be delivered to the extent that the award actually vests.

**Performance conditions**

Vesting of the performance shares is based on two equally weighted performance conditions:

50% Adjusted Earnings per Share growth ( EPS ) and

50% Relative Total Shareholder Return ( TSR )

**EPS**

EPS growth is calculated by applying the simple point-to-point method at year end. Earnings are the income from continued operations attributable to shareholders, as reported in the Annual Report.

The following performance-incentive zone applies for EPS:

Philips Group

**Performance-incentive zone for EPS in %**

	Below threshold	Threshold	Target	Maximum
Payout	0	40	100	200

The EPS targets are set annually by the Supervisory Board. Given that these targets are considered to be company sensitive, disclosure will take place retrospectively at the end of the performance period. EPS targets and the achieved performance are published in the Annual Report after the relevant performance period. For realization of the 2013 grant, see the table on vesting 2013 awards at the end of this section.

**TSR**

The TSR peer group for the LTI Plan consists of the following 21 companies:

Philips Group

**TSR peer group**

ABB	Hitachi	Panasonic
Covidien	Honeywell Int.	Procter & Gamble
Danaher	Johnson Controls	Schneider Electric
Eaton	Johnson & Johnson	Siemens
Electrolux	Legrand	Smiths Group
Emerson Electric	LG Electronics	Toshiba
General Electric	Medtronic	3M

A ranking approach to TSR applies with Philips itself excluded from the peer group to permit interpolation.

On January 26, 2015, Medtronic completed the acquisition of Covidien. To address the delisting of Covidien the Supervisory Board adopted the approach of recognizing Covidien's performance through the delisting date and as a proxy for future performance, assumed reinvestment in an index of the remaining 20 peer companies, therefore, effectively retaining a peer group of 21 companies.

The performance incentive-zone is outlined in the table below:

Philips Group

**Performance-incentive zone for TSR in %**

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	<sup>3</sup> 21								<sup>3</sup> 6
<b>Position</b>	<b>-14</b>	<sup>3</sup> 13	<sup>3</sup> 12	<sup>3</sup> 11	<sup>3</sup> 10	<sup>3</sup> 9	<sup>3</sup> 8	<sup>3</sup> 7	<b>-1</b>
Payout	0	60	60	100	120	140	160	180	200

Under the LTI Plan members of the Board of Management were granted 93,018 performance shares in 2015.

The following tables provide an overview at end December 2015 of stock option grants, restricted share rights grants and performance share grants. The reference date for board membership is December 31, 2015.

**Table of Contents**

[Supervisory Board report 10.2.7](#)

For more details of the LTI Plan see note 28, Share-based compensation.

**Realization of 2013 performance share grant**

The 3-year performance period of the 2013 performance share grant ended on December 31, 2015. The payout results are explained below.

**TSR (50% weighting)**

The TSR achieved by Philips during the performance period was 34.15%. This positioned Philips between the 12th and 13th ranked company in the peer group shown in the table below, resulting in a payout of 60%.

**TSR results Philips LTI Plan 2013 grants Koninklijke Philips:**

**34.15%**

Total Shareholder Return ranking per December 31, 2015

Start date: December 2012

End date: December 2015

Company	total return	rank number
Panasonic	202.52%	1
Covidien	99.10%	2
Medtronic	88.74%	3
Legrand	82.06%	4
3M	81.03%	5
Honeywell International	76.37%	6
Danaher	74.71%	7
Johnson Controls	68.72%	8
Hitachi	65.40%	9
Johnson & Johnson	56.87%	10
Electrolux	53.12%	11
General Electric	52.78%	12
Siemens	29.97%	13
Procter & Gamble	22.03%	14
Eaton	19.13%	15
Schneider Electric	16.17%	16
ABB	12.96%	17
Toshiba	11.35%	18
Emerson Electric	4.24%	19
Smiths Group	3.43%	20
LG Electronics	(30.08)%	21

Philips Group

**Stock options**



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	grant date	number of stock options	value at grant date <sup>1)</sup>	end of lock-up period	value at end of lock-up period <sup>1)</sup>
F.A. van Houten	2012	75,000	212,550	2015	732,368
	2013 <sup>2)</sup>	55,000	242,534	2016	n.a.
A. Bhattacharya	2012	16,500	46,761	2015	161,121
P.A.J. Nota	2012	51,000	144,534	2015	498,010
	2013 <sup>2)</sup>	38,500	169,773	2016	n.a.

<sup>1)</sup> Value based on Black & Scholes value

<sup>2)</sup> Accelerate! Grant

Philips Group

**Restricted share rights**

	grant date	number of restricted share rights originally granted	value at grant date	number of restricted share rights released in 2015	value at release date in 2015
F.A. van Houten	2012	20,001	296,415	6,667	181,209
A. Bhattacharya	2012	4,401	65,223	1,467	39,873
P.A.J. Nota	2012	13,602	201,582	4,534	123,234

**Table of Contents**

Supervisory Board report 10.2.7

**Adjusted EPS growth (50% weighting)**

The EPS payouts and targets set at the beginning of the performance period were as follows:

	below threshold	threshold	target	maximum
EPS				
(euro)	<1.30	1.30	1.50	1.80
Payout	0%	40%	100%	200%

EPS is based on the underlying income from continuing operations attributable to shareholders, as included in the Annual Report, adjusted for changes in accounting principles. Furthermore, the Supervisory Board has also deemed it appropriate to make adjustments relating to certain other items that were not contemplated when the targets were set in 2012. These relate to costs associated with M&A activity, earnings from acquired companies, charges relating to the recent pension de-risking, and impact of foreign exchange variations versus plan. In addition, we have added back in earnings from Lumileds, even though classed as discontinued operations, since planned earnings from this business were included in the original EPS targets.

The resulting EPS achievement was determined by the Supervisory Board as 110%, resulting in a payout of 55%.

In view of the above, the following performance achievement and vesting levels have been determined by the Supervisory Board in respect of the 2013 grant of performance shares:

metric	achievement	weighting	vesting level
TSR	60%	50%	30%
EPS	110%	50%	55%
<b>total</b>			<b>85%</b>

The original grant in 2013 has been downward adjusted by 15% to reflect the performance. The 2013 grant shown in the table headed 'Philips Group -Performance Shares' in this section does not reflect this adjustment.

**10.2.8 Pensions**

Due to legislative changes in the Netherlands, effective January 1, 2015 a new pension arrangement applies to the Board of Management, the other members of the Executive Committee and the Executives working under a Dutch contract.

As of this date pension plans which allow pension accrual based on a pensionable salary exceeding an amount of EUR 100,000 are, for fiscal purposes, considered to be non-qualifying schemes. For this reason the Executive Pension Plan in the Netherlands has been terminated.

The following pension arrangement is in place for the members of the Board of Management with effect from January 1, 2015:

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Flex Pension Plan in the Netherlands, which is a Collective Defined Contribution plan with a fixed contribution of 26.2% up to the maximum pensionable salary of EUR 100,000. The Flex Plan has a target retirement age of 67 and a target accrual rate of 1.85%;

A gross Pension Allowance equal to 25% of the base compensation exceeding EUR 100,000;

A temporary gross Transition Allowance, for a maximum period of 8 years (first 5 years in full; year 6: 75%; year 7: 50%, year 8: 25%) for members of the Board who were participants of the former Executive Pension Plan. The level of the allowance is based on the age and salary of the Board member on December 31, 2014.

The total pension cost of the Company related to this new pension arrangement (including the temporary Transition Allowance for the remaining 7 years) is at a comparable level over a period of time to the pension cost under the former Executive Pension Plan.

### **10.2.9 Additional arrangements**

In addition to the main conditions as stipulated in the contracts for the provision of services, a number of additional arrangements apply to members of the Board of Management. These additional arrangements, such as expense and relocation allowances, medical

Philips Group

**Performance shares<sup>1)</sup>**

	grant date	number of performance shares		end of vesting period	number of performance shares vested	
		originally granted	value at grant date		in 2015	value at vesting date in 2015
F.A. van Houten	2013	62,559	1,320,000	2016	n.a.	n.a.
	2014	59,075	1,380,000	2017	n.a.	n.a.
	2015	54,877	1,410,000	2018	n.a.	n.a.
A. Bhattacharya	2013	11,848	250,000	2016	n.a.	n.a.
	2014	10,702	250,000	2017	n.a.	n.a.
	2015	11,676	300,000	2018	n.a.	n.a.
P.A.J. Nota	2013	29,621	625,000	2016	n.a.	n.a.
	2014	27,825	650,000	2017	n.a.	n.a.
	2015	26,465	680,000	2018	n.a.	n.a.

<sup>1)</sup> Dividend performance shares not included

**Table of Contents**[Supervisory Board report 10.2.9](#)

insurance, accident insurance and company car arrangements, are in line with those for Philips executives in the Netherlands. In the event of disablement, members of the Board of Management are entitled to benefits in line with those for other Philips executives in the Netherlands.

Unless the law provides otherwise, the members of the Board of Management and of the Supervisory Board shall be reimbursed by the Company for various costs and expenses, like reasonable costs of defending claims, as formalized in the Articles of Association. Under certain circumstances, described in the Articles of Association, such as an action or failure to act by a member of the Board of Management or a member of the Supervisory Board that can be characterized as intentional ( opzettelijk ), intentionally reckless ( bewust roekeloos ) or seriously culpable ( ernstig verwijtbaar ), there will be no entitlement to this reimbursement. The Company has also taken out liability insurance (D&O Directors & Officers) for the persons concerned.

**10.2.10 Remuneration of the Supervisory Board**

As the base fee for the members of the Supervisory Board had not changed since 2008, and in view of the increased activities and responsibilities of the Supervisory Board, a revised remuneration structure was proposed and approved by the 2015 General Shareholders Meeting. The table below gives an overview of this new remuneration structure.

Philips Group

**Remuneration Supervisory Board<sup>1)</sup> in EUR**

2015

	Chairman	Vice Chairman	Member
Supervisory Board	135,000	90,000	80,000
Audit Committee	22,500	n.a.	13,000
Remuneration Committee	15,000	n.a.	10,000
Corporate Governance and Nomination & Selection Committee	15,000	n.a.	7,500
Separation Committee	15,000	n.a.	10,000
Attendance fee per inter-European trip	2,500	2,500	2,500
Attendance fee per intercontinental trip	5,000	5,000	5,000
Entitlement to Philips product arrangement	2,000	2,000	2,000

<sup>1)</sup> For more details, see note 29, Information on remuneration

**10.2.11 Year 2016**

2016 will be a momentous year for Philips with the planned separation into two world-class companies focused on HealthTech and Lighting opportunities. As a result of this separation, during 2016 we will review the remuneration and long-term incentive policies that apply to both companies and submit whatever is required by the financial and regulatory authorities and request shareholder approvals, as appropriate.

In respect of the HealthTech business we expect minimal changes in target levels of remuneration that will apply to the Board of Management in 2016.

### 10.3 Report of the Audit Committee

The Audit Committee is chaired by Jackson Tai, and its other members are Neelam Dhawan, Orit Gadiesh and David Pyott. Jeroen van der Veer also regularly participated in Audit Committee meetings. The Committee assists the Supervisory Board in fulfilling its supervisory responsibilities for (inter alia) ensuring the integrity of the Company's financial statements and reviewing the Company's internal controls.

The Audit Committee met five times during 2015, including at the conclusion of each quarter, and reported its findings to the plenary Supervisory Board. The CEO, the CFO, the Chief Legal Officer, the Head of Internal Audit, the Group Controller and the external auditor (KPMG Accountants N.V.) attended all regular meetings.

As decided by the 2015 Annual General Meeting of Shareholders, Ernst & Young Accountants LLP were appointed as the company's new external auditor effective January 1, 2016. To ensure a smooth transition between KPMG Accountants N.V. and Ernst & Young Accountants LLP, the Audit Committee also invited the lead partner from Ernst & Young Accountants LLP to attend Audit Committee meetings during the second half of 2015. KPMG Accountants N.V. and Ernst & Young Accountants LLP each reported that the transition between auditors was proceeding well and the Audit Committee has confidence that Ernst & Young Accountants LLP will assume its auditor duties without interruption.

Furthermore, for each meeting, the Committee met separately with each of the CEO, the CFO, the Chief Legal Officer, the Head of Internal Audit and the external auditor as well as on an ad hoc basis with other company employees, such as the Group Treasurer, the Group Accountant, the Head of Mergers, Acquisitions and Divestments and the Head of Financial Risk and Pensions Management.

The overview below indicates some of the matters that were discussed during meetings throughout 2015:

The Company's 2015 annual and interim financial statements, including non-financial information, prior to publication thereof. The Committee also assessed in its quarterly meetings the adequacy and appropriateness of internal control policies and internal audit programs and their findings.

Matters relating to accounting policies, financial risks and compliance with accounting standards. Compliance with statutory and legal requirements and regulations, particularly in the financial domain, was also reviewed. Important findings, Philips' major

**Table of Contents**

Supervisory Board report 10.3

areas of risk (including the internal auditor's reporting thereon, and the Chief Legal Officer's review of litigation and other claims) and follow-up actions and appropriate measures were examined thoroughly. The Committee again reviewed the Company's pension liabilities and its program to de-risk future pension liabilities and related employee, economic, financial accounting and reporting implications, as well as the implementation of that program. Each quarter, the Committee reviewed the Company's cash flow generation, liquidity and headroom, capital structure throughout the year and the implications for the Company's credit ratings and its ability to undertake its financial commitments, including the Company's share repurchase program and payment of dividends. The Committee also reviewed the goodwill impairment test performed in the second quarter, risk management, tax issues, information security, developments in regulatory investigations as well as legal proceedings including antitrust investigations and related provisions and environmental exposures.

Specific finance topics included the implications to the Company's capital structure following the proposed sale of Lumileds and Automotive (including its classification as discontinued operations), the Volcano acquisition and the accounting therefore, the intended separation of the Lighting business and its potential impact on the 2015 financial statements, as well as taxation, the activities of Philips Capital, the Company's currency hedging practices and the impact of certain potential acquisitions.

With regard to the internal audit, the Committee reviewed, and if required approved, the internal audit charter, audit plan, audit scope and its coverage in relation to the scope of the external audit, as well as the staffing, independence and organizational structure of the internal audit function. The separation of the audit function for Royal Philips and Philips Lighting, including staffing capabilities and its management succession, was also discussed.

With regard to the external audit, the Committee reviewed the proposed audit scope, approach and fees, the independence of the external auditor, non-audit services provided by the external auditor in conformity with the Philips Auditor Policy, as well as any changes to this policy. The Committee also reviewed the independence as well as its professional fitness and good standing of the external auditor and its engagement partners. For information on the fees of KPMG Accountants N.V., please refer to the table 'Fees KPMG' in note 6, Income from operations.

The Company's policy on business controls, the General Business Principles including the deployment thereof and amendments thereto. The Committee was informed on, and it discussed and monitored closely the Company's internal control certification processes, in particular compliance with section 404 of the US Sarbanes-Oxley Act and its requirements regarding assessment, review and monitoring of internal controls. It also discussed on a regular basis the developments in and findings resulting from investigations into alleged violations of the General Business Principles and, if required, any measures taken.

During each Audit Committee meeting, the Committee reviewed the report from the external auditor in which the auditor set forth its findings and attention points during the relevant period. The Committee also assessed the overall performance of the external auditor, as required by the Auditor Policy. The Committee also reviewed its own Charter and concluded that it was satisfactory.

Annual Report 2015 113

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## **Table of Contents**

### [Corporate governance 11](#)

#### [11 Corporate governance](#)

##### **Corporate governance of the Philips Group - Introduction**

Koninklijke Philips N.V., a company organized under Dutch law, is the parent company of the Philips Group. The Company, which started as a limited partnership with the name Philips & Co in Eindhoven, the Netherlands, in 1891, was converted into the company with limited liability N.V. Philips Gloeilampenfabrieken on September 11, 1912. The Company's name was changed to Philips Electronics N.V. on May 6, 1994, to Koninklijke Philips Electronics N.V. on April 1, 1998, and to Koninklijke Philips N.V. on May 15, 2013. Its shares have been listed on the Amsterdam Stock Exchange, Euronext Amsterdam, since 1912. The shares have been traded in the United States since 1962 and have been listed on the New York Stock Exchange since 1987.

Over the last decades the Company has pursued a consistent policy to improve its corporate governance in line with Dutch, US and international (codes of) best practices. The Company has incorporated a fair disclosure practice in its investor relations policy, has strengthened the accountability of its executive management and its independent supervisory directors, and has increased the rights and powers of shareholders and the communication with investors. The Company is required to comply with, inter alia, Dutch corporate governance rules, the US Sarbanes-Oxley Act, other US securities laws and related regulations (including applicable stock exchange rules), insofar as applicable to the Company. A summary of significant differences between the Company's corporate governance practice and the New York Stock Exchange corporate governance standards is published on the Company's website ([www.philips.com/investor](http://www.philips.com/investor)).

In this report, the Company addresses its overall corporate governance structure and states to what extent and how it applies the principles and best practice provisions of the Dutch Corporate Governance Code (as revised on December 10, 2008; the Dutch Corporate Governance Code ). This report also includes the information which the Company is required to disclose pursuant to the Dutch governmental Decree on Article 10 Takeover Directive and the governmental Decree on Corporate Governance. Deviations from aspects of the corporate governance structure of the Company, when deemed necessary in the interests of the Company, will be disclosed in the Annual Report. Substantial changes in the Company's corporate governance structure and in the Company's compliance with the Dutch Corporate Governance Code, if any, will be submitted to the General Meeting of Shareholders for discussion under a separate agenda item. The Supervisory Board and the Board of Management, which are responsible for the corporate governance structure of the Company, are of the opinion that the principles and best practice provisions of the Dutch Corporate Governance Code that are addressed to the Board of Management and the Supervisory Board, interpreted and implemented in line with the best practices followed by the Company, are being applied.

#### **11.1 Board of Management**

##### **Introduction**

The Board of Management is entrusted with the management of the Company. Certain key officers have been appointed to manage the Company together with the Board of Management. The members of the Board of Management and these key officers together constitute the Executive Committee. Under the chairmanship of the President/Chief Executive Officer (CEO), the members of the Executive Committee share responsibility for the deployment of its strategy and policies, and the achievement of its objectives and results. The Executive Committee has, for practical purposes, adopted a division of responsibilities indicating the functional and business areas monitored and reviewed by the individual members. For the purpose of this corporate governance report, where the Executive Committee is mentioned this also includes the Board of Management unless the context requires otherwise.

The Board of Management remains accountable for the actions and decisions of the Executive Committee and has ultimate responsibility for the Company's management and the external reporting and is answerable to shareholders of the Company at the Annual General Meeting of Shareholders.

All resolutions of the Executive Committee are adopted by majority vote comprising the majority of the members of the Board of Management present or represented, such majority comprising the vote of the CEO. The Board of Management retains the authority to, at all times and in all circumstances, adopt resolutions without the participation of the other members of the Executive Committee. In discharging its duties, the Executive Committee shall be guided by the interests of the Company and its affiliated enterprise, taking into consideration the interests of the Company's stakeholders.



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The Executive Committee is supervised by the Supervisory Board and provides the latter with all information the Supervisory Board needs to fulfill its own responsibilities. Major decisions of the Board of Management and Executive Committee require the approval of the Supervisory Board; these include decisions concerning (a) the operational and financial objectives of the Company, (b) the strategy designed to

**Table of Contents**

Corporate governance 11.1

achieve the objectives, (c) if necessary, the parameters to be applied in relation to the strategy and (d) corporate social responsibility issues that are relevant to the Company.

The Executive Committee follows the Rules of Procedure of the Board of Management and Executive Committee, which set forth procedures for meetings, resolutions and minutes. These Rules of Procedure are published on the Company's website.

**(Term of) Appointment and conflicts of interests**

Members of the Board of Management as well as the CEO are appointed by the General Meeting of Shareholders upon a binding recommendation drawn up by the Supervisory Board after consultation with the CEO. This binding recommendation may be overruled by a resolution of the General Meeting of Shareholders adopted by a simple majority of the votes cast and representing at least one-third of the issued share capital. If a simple majority of the votes cast is in favor of the resolution to overrule the binding recommendation, but such majority does not represent at least one-third of the issued share capital, a new meeting may be convened at which the resolution may be passed by a simple majority of the votes cast, regardless of the portion of the issued share capital represented by such majority. In the event a binding recommendation has been overruled, a new binding recommendation shall be submitted to the General Meeting of Shareholders. If such second binding recommendation has been overruled, the General Meeting of Shareholders shall be free to appoint a board member.

Members of the Board of Management and the CEO are appointed for a term of four years, it being understood that this term expires at the end of the General Meeting of Shareholders to be held in the fourth year after the year of their appointment. Reappointment is possible for consecutive terms of four years or, if applicable, until a later retirement date or other contractual termination date in the fourth year, unless the General Meeting of Shareholders resolves otherwise. Members may be suspended by the Supervisory Board and by the General Meeting of Shareholders and dismissed by the latter. Individual data on the members of the Board of Management and Executive Committee are published in chapter 8, Management, of this report.

The other members of the Executive Committee are appointed, suspended and dismissed by the CEO, subject to approval by the Supervisory Board.

The acceptance by a member of the Board of Management of a position as a member of a supervisory board or a position of non-executive director in a one-tier board (Non-Executive Directorship) at another company requires the approval of the Supervisory Board. The Supervisory Board is required to be notified of other important positions (to be) held by a member of the Board of Management. Under the Dutch Corporate Governance Code, no member of the Board of Management shall hold more than two Non-Executive Directorships at listed companies, or is a chairman of a supervisory board or one-tier board, other than of a Group company or participating interest of the Company. Dutch legislation provides for further limitations on the Non-Executive Directorships. No member of the Board of Management shall hold more than two Non-Executive Directorships at large companies (naamloze vennootschappen or besloten vennootschappen) or large foundations (stichtingen) as defined under Dutch law and no member of the Board of Management shall hold the position of chairman of another one-tier board or the position of chairman of another supervisory board. In order for a company or foundation to be regarded as large, it must meet at least two of the following criteria: (i) the value of the assets according to the balance sheet with explanatory notes, considering the acquisition or manufacturing price, exceeds EUR 20 million; (ii) the net turnover exceeds EUR 40 million; or (iii) the average number of employees equals or exceeds 250. During the financial year 2015 all members of the Board of Management complied with the limitations on Non-Executive Directorships described above.

Since 2013, Dutch legislation on board diversity provided that the Company must pursue a policy of having at least 30% of the seats on the Board of Management held by men and at least 30% of the seats held by women. The relevant rule ceased to have effect on January 1, 2016, but a bill aimed at reintroducing the rule was announced in November 2015. For more details on board diversity please be referred to section 10.1, Report of the Corporate Governance and Nomination & Selection Committee, of this report.

Dutch legislation on conflicts of interests provides that a member of the Board of Management may not participate in the adoption of resolutions if he or she has a direct or indirect personal conflict of interest with the Company or related enterprise. If all members of the Board of Management have a conflict, the resolution concerned will be adopted by the Supervisory Board. The Company's corporate governance includes rules to specify situations in which a (potential) conflict may exist, to avoid (potential) conflicts of interests as much as possible, and to deal with such conflicts should they arise. The rules on conflicts of interests apply to the other members of the Executive Committee correspondingly.

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Relevant matters relating to conflicts of interests, if any, shall be mentioned in the Annual Report for the financial year in question. No such matters have occurred during the financial year 2015.

Annual Report 2015 115

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## **Table of Contents**

### Corporate governance 11.1

#### **Amount and composition of the remuneration of the Board of Management**

The remuneration of the individual members of the Board of Management is determined by the Supervisory Board on the proposal of the Remuneration Committee of the Supervisory Board, and must be consistent with the policy thereon as adopted by the General Meeting of Shareholders. The current remuneration policy applicable to the Board of Management was adopted by the 2013 Annual General Meeting of Shareholders, and is published on the Company's website. A full and detailed description of the composition of the remuneration of the individual members of the Board of Management is included in section 10.2, Report of the Remuneration Committee, of this report.

Pursuant to Dutch legislation, the implementation of the remuneration policy during the financial year must be included as a separate agenda item in the convening notice for a General Meeting of Shareholders and must be dealt with before the meeting can proceed to consider and adopt the Annual Accounts.

The remuneration structure of the Company, including severance pay, is such that it promotes the interests of the Company in the medium and long-term, does not encourage members of the Board of Management to act in their own interests and neglect the interests of the Company, and does not reward failing members of the Board of Management upon termination of their employment. The level and structure of remuneration shall be determined in the light of factors such as the results, the share price performance and other developments relevant to the Company. Deviations on elements of the remuneration policy in extraordinary circumstances, when deemed necessary in the interests of the Company, will be disclosed in the Annual Report or, in case of an appointment, in good time prior to the appointment of the person concerned.

All current members of the Board of Management are engaged by means of a services agreement (*overeenkomst van opdracht*), as Dutch legislation prohibits a member of the Board of Management to be employed by means of a contract of employment. In case of the appointment or re-appointment of a member of the Board of Management, the main elements of the services agreement - including the amount of the fixed base compensation, the structure and amount of the variable compensation component, any severance plan, pension arrangements and the general performance criteria - shall be made public no later than at the time of issuance of the notice convening the General Meeting of Shareholders in which a proposal for (re-)appointment of that member of the Board of Management has been placed on the agenda. In compliance with the Dutch Corporate Governance Code, the term of the services agreement of the members of the Board of Management is set at four years and, in case of termination, severance payment is limited to a maximum of one year's base compensation.

From 2003 until 2013, Philips maintained a Long-Term Incentive Plan (LTI Plan) consisting of a mix of restricted shares rights and stock options for members of the Board of Management, Philips executives and other key employees. Since the full revision in 2013 of the LTI Plan applicable to members of the Board of Management, the plan consists of performance shares only, with a three year post-grant performance measurement. For more details please be referred to section 10.2, Report of the Remuneration Committee, of this report.

The so-called ultimatum-remedium clause and claw-back clause of best practice provisions II.2.10 and II.2.11 of the Dutch Corporate Governance Code are applicable to Annual Incentive payments and LTI grants for the year 2009 onwards to all members of the Board of Management. In respect of the LTI grants, the ultimatum-remedium clause can be applied to the performance-related actual number of stock options, restricted share rights and/or performance shares that is granted. In addition, pursuant to Dutch legislation (effective January 1, 2014), the Supervisory Board is authorized to change unpaid bonuses awarded to members of the Board of Management if payment or delivery of the bonus would be unacceptable according to the principles of reasonableness and fairness. The Company, which in this respect may also be represented by the Supervisory Board or a special representative appointed for this purpose by the General Meeting of Shareholders, may also claim repayment of bonuses paid or delivered (after December 31, 2013) insofar as these have been granted on the basis of incorrect information on the fulfillment of the relevant performance criteria or other conditions. Bonuses are broadly defined as non-fixed remuneration, either in cash or in the form of share-based compensation, that is conditional in whole or in part on the achievement of certain targets or the occurrence of certain circumstances. The explanatory notes to the balance sheet shall report on any moderation and/or claim for repayment of board remuneration. No such moderation or claim for repayment has occurred during the financial year 2015.

Dutch legislation also provides for an obligation for the Company to reduce the remuneration of a member of the Board of Management, if and to the extent the value of such member's share-based remuneration would have increased as a result of the announcement of a large transaction (requiring shareholder approval) or a public offer for the Company.

Members of the Board of Management hold shares in the Company for the purpose of long-term investment and are required to refrain from short-term transactions in Philips securities. According to the Philips Rules of Conduct on Inside Information, members of the Board of

Management are only allowed to trade in Philips securities (including the exercise

**Table of Contents**

Corporate governance 11.1

of stock options) during windows of twenty business days following the publication of annual and quarterly results (provided the person involved has no inside information regarding Philips at that time unless an exemption is available). Furthermore, the Rules of Procedure of the Board of Management and Executive Committee contain provisions concerning ownership of and transactions in non-Philips securities by members of the Board of Management. Members of the Board of Management are prohibited from trading, directly or indirectly, in securities of any of the companies belonging to the peer group, during one week preceding the disclosure of Philips annual or quarterly results. The rules referred to above in this paragraph apply to members of the Executive Committee correspondingly. Transactions in shares in the Company carried out by members of the Board of Management or members of the Supervisory Board and other Insiders (if applicable) are notified to the Netherlands Authority for the Financial Markets (AFM) in accordance with Dutch law and, if necessary, to other relevant authorities.

**Indemnification of members of the Board of Management and Supervisory Board**

Unless the law provides otherwise, the members of the Board of Management and of the Supervisory Board shall be reimbursed by the Company for various costs and expenses, such as the reasonable costs of defending claims, as formalized in the Articles of Association. Under certain circumstances, described in the Articles of Association, such as an act or failure to act by a member of the Board of Management or a member of the Supervisory Board that can be characterized as intentional (*opzettelijk*), intentionally reckless (*bewust roekeloos*) or seriously culpable (*ernstig verwijtbaar*), there will be no entitlement to this reimbursement unless the law or the principles of reasonableness and fairness require otherwise. The Company has also taken out liability insurance (D&O-Directors & Officers) for the persons concerned.

In line with regulatory requirements, the Company's policy forbids personal loans to and guarantees on behalf of members of the Board of Management or the Supervisory Board, and no loans and guarantees have been granted and issued, respectively, to such members in 2015, nor are any loans or guarantees outstanding as of December 31, 2015.

The aggregate share ownership of the members of the Board of Management and the Supervisory Board represents less than 1% of the outstanding ordinary shares in the Company.

**Risk management approach**

Within Philips, risk management forms an integral part of business management. The Company has implemented a risk management and internal control system that is designed to provide reasonable assurance that strategic objectives are met by creating focus, by integrating management control over the Company's operations, by ensuring compliance with applicable laws and regulations and by safeguarding the reliability of the financial reporting and its disclosures. The Executive Committee reports on and accounts for internal risk management and control systems to the Supervisory Board and its Audit Committee. The Company has designed its internal control system based on the Internal Control-Integrated Framework (2013) established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

The Company's risk management approach is embedded in the periodic business planning and review cycle and forms an integral part of business management. On the basis of risk assessments, management determines the risks and appropriate risk responses related to the achievement of business objectives and critical business processes. Risk factors and the risk management approach, as well as the sensitivity of the Company's results to external factors and variables, are described in more detail in chapter 7, Risk management, of this report. Significant changes and improvements in the Company's risk management and internal control system have been discussed with the Supervisory Board's Audit Committee and the external auditor and are disclosed in that section as well.

With respect to financial reporting a structured self-assessment and monitoring process is used company-wide to assess, document, review and monitor compliance with internal control over financial reporting. Internal representations received from management, regular management reviews, reviews of the design and effectiveness of internal controls and reviews in group and Business Group, Market and Function Audit & Risk committees are integral parts of the Company's risk management approach. On the basis thereof, the Board of Management confirms that internal controls over financial reporting provide a reasonable level of assurance that the financial reporting does not contain any material inaccuracies, and confirms that these controls have properly functioned in 2015. The financial statements fairly represent the financial condition and result of operations of the Company and provide the required disclosures.

It should be noted that the above does not imply that these systems and procedures provide certainty as to the realization of operational and financial business objectives, nor can they prevent all misstatements, inaccuracies, errors, fraud and non-compliances with rules and regulations.

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In view of the above the Board of Management believes that it is in compliance with the requirements of recommendation II.1.4. of the Dutch Corporate Governance Code. The above statement on internal controls should not be construed as a statement in response to the requirements of section 404 of the US Sarbanes-Oxley Act. The statement as to compliance with section 404 is set forth in section 12.1, Management's report on internal control, of this report.

Annual Report 2015 117

## **Table of Contents**

### **Corporate governance 11.1**

Next to the Philips General Business Principles (GBP), the Company has a Financial Code of Ethics which additionally applies to designated senior executives, including the CEO and the CFO, and employees working in the Finance and Accounting departments. The GBP and the Financial Code of Ethics have been published on the Company's website.

The Company, through the Supervisory Board's Audit Committee, also has appropriate procedures in place for the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls or auditing matters and the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters. The Company's whistleblower mechanisms furthermore allow employees and, since May 2015, external parties to confidentially and anonymously report grievances to the Company, also on other topics than those that relate to questionable accounting or auditing matters. The Company does not tolerate retaliation against (internal) whistleblowers that report a concern in good faith. More information on GBP governance and our whistleblower procedures can be found in chapter 14, Sustainability statements, of this report and chapter 7, Risk management, of this report.

In view of the requirements under the US Securities Exchange Act, procedures are in place to enable the CEO and the CFO to provide certifications with respect to the Annual Report on Form 20-F.

A Disclosure Committee is in place, which advises the various officers and departments involved, including the CEO and the CFO, on the timely review, publication and filing of periodic and current (financial) reports. In addition to the certification by the CEO and the CFO under US law, each individual member of the Board of Management and the Supervisory Board must under Dutch law, sign the Group and Company financial statements being disclosed and submitted to the General Meeting of Shareholders for adoption. If one or more of their signatures is missing, this shall be stated, and the reasons given for this. The members of the Board of Management issue the responsibility statement as referred to in chapter 12, Group financial statements, of this report, as required by applicable Dutch company law and securities law.

### **11.2 Supervisory Board**

#### **Introduction**

The Supervisory Board supervises the policies of the Board of Management and Executive Committee and the general course of affairs of Philips and advises the executive management thereon. The Supervisory Board, in the two-tier corporate structure under Dutch law, is a separate body that is independent of the Board of Management. Its independent character is also reflected in the requirement that members of the Supervisory Board can be neither a member of the Board of Management nor an employee of the Company. The Supervisory Board considers all its members to be independent pursuant to the Dutch Corporate Governance Code and under the applicable US Securities and Exchange Commission standards.

The Supervisory Board, acting in the interests of the Company and the Group and taking into account the relevant interest of the Company's stakeholders, supervises and advises the Board of Management and Executive Committee in performing its management tasks and setting the direction of the Group's business, including (a) the Group's performance, (b) the Group's general strategy and the risks connected to its business activities, (c) the operational and financial objectives, (d) the parameters to be approved in relation to the strategy, (e) corporate social responsibility issues (f) the structure and management of the systems of internal business controls, (g) the financial reporting process, (h) the compliance with applicable laws and regulations, (i) the company-shareholders relationship, and (j) the corporate governance structure of the Company. The Group's strategy and major management decisions are discussed with and approved by the Supervisory Board. For a description of further responsibilities and tasks of the Supervisory Board please refer to the Supervisory Board's Rules of Procedure which are published on the Company's website.

In its report, the Supervisory Board describes the composition and functioning of the Supervisory Board and its committees, the activities of the board and its committees in the financial year 2015, the number of committee meetings and the main items discussed.

#### **Rules of Procedure of the Supervisory Board**

The Supervisory Board's Rules of Procedure set forth its own governance rules (including meetings, items to be discussed, resolutions, appointment and re-election, committees, conflicts of interests, trading in securities, profile of the Supervisory Board). Its composition follows the profile, which aims for an appropriate combination of knowledge and experience among its members encompassing marketing, technological, manufacturing, financial, economic, social and legal aspects of international business and government and public administration



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in relation to the global and multi-product character of the Group's businesses. The Supervisory Board attaches great importance to diversity in its composition. More particularly, it aims at having members with a European and a non-European background (nationality, working experience or otherwise) and one or more members with an executive or similar position in business or society no longer than 5 years ago.

Since 2013, Dutch legislation on board diversity provided that the Company must pursue a policy of having at least 30% of the seats on the Supervisory

**Table of Contents**

Corporate governance 11.2

Board held by men and at least 30% of the seats held by women. The relevant rule ceased to have effect on January 1, 2016, but a bill aimed at reintroducing the rule was announced in November 2015. For more details on board diversity please be referred to section 10.1, Report of the Corporate Governance and Nomination & Selection Committee, of this report.

The Rules of Procedure of the Supervisory Board are published on the Company's website. They include the charters of its committees as mentioned in the Dutch Corporate Governance Code, to which the plenary Supervisory Board, while retaining overall responsibility, has assigned certain tasks: the Corporate Governance and Nomination & Selection Committee, the Audit Committee and the Remuneration Committee. Each committee reports, and submits its minutes for information, to the Supervisory Board.

In 2015, the Supervisory Board additionally established the Separation Committee and the Quality & Regulatory Committee. Please refer to chapter 10, Supervisory Board report, of this report for more information on the composition and activities of these committees.

In line with US and Dutch best practices, the Chairman of the Supervisory Board must be independent pursuant to the Dutch Corporate Governance Code and under the applicable US standards. Furthermore, the Dutch Corporate Governance Code allows a maximum of one member of each Supervisory Board committee not to be independent (as defined by the Code). As mentioned in the introduction of this section 11.2 above, the Supervisory Board considers all its members to be independent.

The Supervisory Board is assisted by the General Secretary of the Company. The General Secretary sees to it that correct procedures are followed and that the Supervisory Board acts in accordance with its statutory obligations and its obligations under the Articles of Association. Furthermore the General Secretary assists the Chairman of the Supervisory Board in the actual organization of the affairs of the Supervisory Board (information, agenda, evaluation, introductory program) and is the contact person for interested parties who want to make concerns known to the Supervisory Board. The General Secretary shall, either on the recommendation of the Supervisory Board or otherwise, be appointed and may be dismissed by the Board of Management, after the approval of the Supervisory Board has been obtained.

**(Term of) Appointment, individual data and conflicts of interests**

The Supervisory Board consists of at least five members (currently nine), including a Chairman, Vice-Chairman and Secretary. The Dutch large company regime does not apply to the Company itself. Members are currently appointed by the General Meeting of Shareholders for fixed terms of four years, upon a binding recommendation from the Supervisory Board.

According to the Company's Articles of Association, this binding recommendation may be overruled by a resolution of the General Meeting of Shareholders adopted by a simple majority of the votes cast and representing at least one-third of the issued share capital. If a simple majority of the votes cast is in favor of the resolution to overrule the binding recommendation, but such majority does not represent at least one-third of the issued share capital, a new meeting may be convened at which the resolution may be passed by a simple majority of the votes cast, regardless of the portion of the issued share capital represented by such majority. In the event a binding recommendation has been overruled, a new binding recommendation shall be submitted to the General Meeting of Shareholders. If such second binding recommendation has been overruled, the General Meeting of Shareholders shall be free to appoint a board member.

There is no age limit applicable, and members are eligible for re-election twice (unless the Supervisory Board resolves to deviate in a specific case). The date of expiration of the terms of Supervisory Board members is published on the Company's website.

Individual data on the members of the Supervisory Board are published in the Annual Report, and updated on the Company's website. Members may be suspended and dismissed by the General Meeting of Shareholders. In the event of inadequate performance, structural incompatibility of interests, and in other instances in which resignation is deemed necessary in the opinion of the Supervisory Board, the Supervisory Board shall submit to the General Meeting of Shareholders a proposal to dismiss the respective member of the Supervisory Board.

After their appointment, all members of the Supervisory Board shall follow an introductory program, which covers general financial and legal affairs, financial reporting by the Company, any specific aspects that are unique to the Company and its business activities, and the responsibilities of a Supervisory Board member.

Any need for further training or education of members will be reviewed annually, also on the basis of an annual evaluation survey.

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Under the Dutch Corporate Governance Code, no member of the Supervisory Board shall hold more than five supervisory board memberships of Dutch listed companies, the chairmanship of a supervisory board counting as two regular memberships. In addition, Dutch legislation provides that no member of the Supervisory Board shall hold more than five Non-Executive Directorships at large companies or foundations as defined under Dutch law (see section

Annual Report 2015 119

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## **Table of Contents**

### **Corporate governance 11.2**

11.1, Board of Management, of this report), with a position as chairman counting for two. During the financial year 2015 all members of the Supervisory Board complied with the limitations on Non-Executive Directorships described above.

Dutch legislation on conflicts of interests provides that a member of the Supervisory Board may not participate in the adoption of resolutions if he or she has a direct or indirect personal conflict of interest with the Company or related enterprise. If all members of the Supervisory Board have a conflict, the resolution concerned will be adopted by the General Meeting of Shareholders. The Company's corporate governance includes rules to specify situations in which a (potential) conflict may exist, to avoid (potential) conflicts of interests as much as possible, and to deal with such conflicts should they arise.

Relevant matters relating to conflicts of interests, if any, shall be mentioned in the Annual Report for the financial year in question. No decisions to enter into material transactions in which there are conflicts of interest with members of the Supervisory Board were taken during the financial year 2015.

### **Meetings of the Supervisory Board**

The Supervisory Board meets at least six times per year, including a meeting on strategy. The Supervisory Board, on the advice of its Audit Committee, also discusses, in any event at least once a year, the main risks of the business, and the result of the assessment of the structure and operation of the internal risk management and control systems, as well as any significant changes thereto. The members of the Executive Committee attend meetings of the Supervisory Board except in matters such as the desired profile, composition and competence of the Supervisory Board and the Executive Committee, as well as the remuneration and performance of individual members of the Executive Committee and the conclusions that must be drawn on the basis thereof. In addition to these items, the Supervisory Board, being responsible for the quality of its own performance, discusses, at least once a year on its own, without the members of the Executive Committee being present, (i) both its own functioning and that of the individual members, and the conclusions that must be drawn on the basis thereof, as well as (ii) both the functioning of the Board of Management and that of the individual members, and the conclusions that must be drawn on the basis thereof. The CEO and other members of the Executive Committee have regular contacts with the Chairman and other members of the Supervisory Board. The Executive Committee is required to keep the Supervisory Board informed of all facts and developments concerning Philips that the Supervisory Board may need in order to function as required and to properly carry out its duties, to consult it on important matters and to submit certain important decisions to it for its prior approval. The Supervisory Board and its individual members each have their own responsibility to request from the Executive Committee and the external auditor all information that the Supervisory Board needs in order to be able to carry out its duties properly as a supervisory body. If the Supervisory Board considers it necessary, it may obtain information from officers and external advisers of the Company. The Company provides the necessary means for this purpose. The Supervisory Board may also require that certain officers and external advisers attend its meetings.

### **The Chairman of the Supervisory Board**

The Supervisory Board's Chairman will see to it that: (a) the members of the Supervisory Board follow their introductory program, (b) the members of the Supervisory Board receive in good time all information which is necessary for the proper performance of their duties, (c) there is sufficient time for consultation and decision-making by the Supervisory Board, (d) the committees of the Supervisory Board function properly, (e) the performance of the Executive Committee members and Supervisory Board members is assessed at least once a year, and (f) the Supervisory Board elects a Vice-Chairman. The Vice-Chairman of the Supervisory Board shall deputize for the Chairman when the occasion arises. The Vice-Chairman shall act as contact of individual members of the Supervisory Board or the Board of Management concerning the functioning of the Chairman of the Supervisory Board.

### **Remuneration of the Supervisory Board and share ownership**

The remuneration of the individual members of the Supervisory Board, as well as the additional remuneration for its Chairman and the members of its committees is determined by the General Meeting of Shareholders. The remuneration of a Supervisory Board member is not dependent on the results of the Company. Further details are published in the Supervisory Board report.

Shares or rights to shares shall not be granted to a Supervisory Board member. In accordance with the Rules of Procedure of the Supervisory Board, any shares in the Company held by a Supervisory Board member are long-term investments. The Supervisory Board has adopted a policy on ownership of and transactions in non-Philips securities by members of the Supervisory Board. This policy is included in the Rules of

Procedure of the Supervisory Board.

**The Corporate Governance and Nomination & Selection Committee**

The Corporate Governance and Nomination & Selection Committee consists of at least the Chairman and Vice- Chairman of the Supervisory Board. The Committee reviews the corporate governance principles applicable to the Company at least once a year, and advises the Supervisory Board on any changes to these principles as it deems appropriate. It also (a) draws up selection criteria and appointment procedures for members of the Supervisory Board, the Board of Management and

120 Annual Report 2015

**Table of Contents**

Corporate governance 11.2

the Executive Committee; (b) periodically assesses the size and composition of the Supervisory Board, the Board of Management and the Executive Committee, and makes the proposals for a composition profile of the Supervisory Board, if appropriate; (c) periodically assesses the functioning of individual members of the Supervisory Board, the Board of Management and the Executive Committee, and reports on this to the Supervisory Board. The Committee also consults with the CEO and the Executive Committee on candidates to fill vacancies on the Supervisory Board, the Board of Management and the Executive Committee, and advises the Supervisory Board on the candidates for appointment. It further supervises the policy of the Executive Committee on the selection criteria and appointment procedures for Philips Executives.

**The Remuneration Committee**

The Remuneration Committee meets at least twice a year and is responsible for preparing decisions of the Supervisory Board on the remuneration of individual members of the Board of Management and the Executive Committee.

The Remuneration Committee prepares an annual remuneration report. The remuneration report contains an account of the manner in which the remuneration policy has been implemented in the past financial year, as well as an overview of the implementation of the remuneration policy planned by the Supervisory Board for the next year(s). The Supervisory Board aims to have appropriate experience available within the Remuneration Committee. No more than one member of the Remuneration Committee shall be an executive board member of another Dutch listed company.

In performing its duties and responsibilities the Remuneration Committee is assisted by an external consultant and an in-house remuneration expert acting on the basis of a protocol ensuring that the expert acts on the instructions of the Remuneration Committee and on an independent basis in which conflicts of interests are avoided.

**The Audit Committee**

The Audit Committee meets at least four times a year, before the publication of the annual, semi-annual and quarterly results. All of the members of the Audit Committee are considered to be independent under the applicable US Securities and Exchange Commission rules and at least one of the members of the Audit Committee, which currently consists of four members of the Supervisory Board, is a financial expert as set out in the Dutch Corporate Governance Code and each member is financially literate. In accordance with this code, a financial expert has relevant knowledge and experience of financial administration and accounting at the company in question. None of the members of the Audit Committee is designated as an Audit Committee financial expert as defined under the regulations of the US Securities and Exchange Commission. The Supervisory Board considers the fact of being compliant with the Dutch Corporate Governance Code, in combination with the expertise and experience available in the Audit Committee as well as the possibility to take advice from internal and external experts and advisors, to be sufficient for the fulfillment of the tasks and responsibilities of the Audit Committee. The Audit Committee may not be chaired by the Chairman of the Supervisory Board or by a (former) member of the Board of Management.

The tasks and functions of the Audit Committee, as described in its charter, which is published on the Company's website as part of the Rules of Procedure of the Supervisory Board, include the duties recommended in the Dutch Corporate Governance Code. More specifically, the Audit Committee assists the Supervisory Board in fulfilling its oversight responsibilities for the integrity of the Company's financial statements, the financial reporting process, the system of internal business controls and risk management, the internal and external audit process, the internal and external auditor's qualifications, its independence and its performance, as well as the Company's process for monitoring compliance with laws and regulations and the General Business Principles (GBP). It reviews the Company's annual and interim financial statements, including non-financial information, prior to publication and advises the Supervisory Board on the adequacy and appropriateness of internal control policies and internal audit programs and their findings.

In reviewing the Company's annual and interim statements, including non-financial information, and advising the Supervisory Board on internal control policies and internal audit programs, the Audit Committee reviews matters relating to accounting policies and compliance with accounting standards, compliance with statutory and legal requirements and regulations, particularly in the financial domain.

Important findings and identified risks are examined thoroughly by the Audit Committee in order to allow appropriate measures to be taken. With regard to the internal audit, the Audit Committee, in cooperation with the external auditor, reviews the internal audit charter, audit plan, audit scope and its coverage in relation to the scope of the external audit, staffing, independence and organizational structure of the internal audit function.

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With regard to the external audit, the Audit Committee reviews the proposed audit scope, approach and fees, the independence of the external auditor, its performance and its (re-)appointment, audit and permitted non-audit services provided by the external auditor in conformity with the Philips Policy on Auditor Independence, as well as any changes to this policy. The Audit Committee also considers the report of the external auditor and its report with respect to the annual financial statements. According to the procedures, the Audit Committee acts as the principal

Annual Report 2015 121

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## **Table of Contents**

### **Corporate governance 11.2**

contact for the external auditor if the auditor discovers irregularities in the content of the financial reports. It also advises on the Supervisory Board's statement to shareholders in the annual accounts. The Audit Committee periodically discusses the Company's policy on business controls, the GBP including the deployment thereof, overviews on tax, IT, litigation and legal proceedings, environmental exposures, financial exposures in the area of treasury, real estate, pensions, and the Group's major areas of risk. The Company's external auditor, in general, attends all Audit Committee meetings and the Audit Committee meets separately at least on a quarterly basis with each of the CEO, the CFO, the internal auditor and the external auditor.

### **11.3 General Meeting of Shareholders**

#### **Introduction**

A General Meeting of Shareholders is held at least once a year to discuss the Annual Report, including the report of the Board of Management, the annual financial statements with explanatory notes thereto and additional information required by law, and the Supervisory Board report, any proposal concerning dividends or other distributions, the appointment of members of the Board of Management and Supervisory Board (if any), important management decisions as required by Dutch law, and any other matters proposed by the Supervisory Board, the Board of Management or shareholders in accordance with the provisions of the Company's Articles of Association. The Annual Report, the financial statements and other regulated information such as defined in the Dutch Act on Financial Supervision (Wet op het Financieel Toezicht), will solely be published in English. As a separate agenda item and in application of Dutch law, the General Meeting of Shareholders discusses the discharge of the members of the Board of Management and the Supervisory Board from responsibility for the performance of their respective duties in the preceding financial year. However, this discharge only covers matters that are known to the Company and the General Meeting of Shareholders when the resolution is adopted. The General Meeting of Shareholders is held in Eindhoven, Amsterdam, Rotterdam, The Hague, Utrecht or Haarlemmermeer (Schiphol Airport) no later than six months after the end of the financial year.

Meetings are convened by public notice, via the Company's website or other electronic means of communication and to registered shareholders by letter or by the use of electronic means of communication, at least 42 days prior to the (Extraordinary) General Meeting of Shareholders. Extraordinary General Meetings of Shareholders may be convened by the Supervisory Board or the Board of Management if deemed necessary and must be held if shareholders jointly representing at least 10% of the outstanding share capital make a written request to that effect to the Supervisory Board and the Board of Management, specifying in detail the business to be dealt with. The agenda of a General Meeting of Shareholders shall contain such business as may be placed thereon by the Board of Management or the Supervisory Board, and agenda items will be explained where necessary in writing. The agenda shall list which items are for discussion and which items are to be voted upon.

Material amendments to the Articles of Association and resolutions for the appointment of members of the Board of Management and Supervisory Board shall be submitted separately to the General Meeting of Shareholders, it being understood that amendments and other proposals that are connected in the context of a proposed (part of the) governance structure may be submitted as one proposal. In accordance with the Articles of Association and Dutch law, requests from shareholders for items to be included on the agenda will generally be honored, subject to the Company's rights to refuse to include the requested agenda item under Dutch law, provided that such requests are made in writing at least 60 days before a General Meeting of Shareholders to the Board of Management and the Supervisory Board by shareholders representing at least 1% of the Company's outstanding capital or, according to the official price list of Euronext Amsterdam, representing a value of at least EUR 50 million. Written requests may be submitted electronically and shall comply with the procedure stipulated by the Board of Management, which procedure is posted on the Company's website.

Pursuant to Dutch legislation, shareholders requesting an item to be included on the agenda, have an obligation to disclose their full economic interest (i.e. long position and short position) to the Company. The Company has the obligation to publish such disclosures on its website.

#### **Main powers of the General Meeting of Shareholders**

All outstanding shares carry voting rights. The main powers of the General Meeting of Shareholders are to appoint, suspend and dismiss members of the Board of Management and of the Supervisory Board, to adopt the annual accounts, declare dividends and to discharge the Board of Management and the Supervisory Board from responsibility for the performance of their respective duties for the previous financial year, to appoint the external auditor as required by Dutch law, to adopt amendments to the Articles of Association and proposals to dissolve or liquidate the Company, to issue shares or rights to shares, to restrict or exclude pre-emptive rights of shareholders and to repurchase or cancel outstanding shares. Following common corporate practice in the Netherlands, the Company each year requests limited authorization to issue (rights to)



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shares, to restrict or exclude pre-emptive rights and to repurchase shares. In compliance with Dutch law, decisions of the Board of Management that are so far-reaching that they would greatly change the identity or nature of the Company or the business require the approval of the General Meeting of Shareholders. This includes resolutions to

122 Annual Report 2015

**Table of Contents**

Corporate governance 11.3

(a) transfer the business of the Company, or almost the entire business of the Company, to a third-party (b) enter into or discontinue long-term cooperation by the Company or a subsidiary with another legal entity or company or as a fully liable partner in a limited partnership or ordinary partnership, if this cooperation or its discontinuation is of material significance to the Company or (c) acquire or dispose of a participating interest in the capital of a company to the value of at least one-third of the amount of the assets according to the balance sheet and notes thereto or, if the Company prepares a consolidated balance sheet, according to the consolidated balance sheet and notes thereto as published in the last adopted annual accounts of the Company, by the Company or one of its subsidiaries. Thus the Company applies principle IV.1 of the Dutch Corporate Governance Code within the framework of the Articles of Association and Dutch law and in the manner as described in this corporate governance report.

The Board of Management and Supervisory Board are also accountable, at the Annual General Meeting of Shareholders, for the policy on the additions to reserves and dividends (the level and purpose of the additions to reserves, the amount of the dividend and the type of dividend). This subject is dealt with and explained as a separate agenda item at the Annual General Meeting of Shareholders. A resolution to pay a dividend is dealt with as a separate agenda item at the General Meeting of Shareholders.

The Board of Management and the Supervisory Board are required to provide the General Meeting of Shareholders with all requested information, unless this would be prejudicial to an overriding interest of the Company. If the Board of Management and the Supervisory Board invoke an overriding interest in refusing to provide information, reasons must be given. If a serious private bid is made for a business unit or a participating interest and the value of the bid exceeds a certain threshold (currently one-third of the amount of the assets according to the balance sheet and notes thereto or, if the Company prepares a consolidated balance sheet, according to the consolidated balance sheet and notes thereto as published in the last adopted annual accounts of the Company), and such bid is made public, the Board of Management shall, at its earliest convenience, make public its position on the bid and the reasons for this position.

A resolution to dissolve the Company or change its Articles of Association can be adopted at a General Meeting of Shareholders by at least three-fourths of the votes cast, at which meeting more than half of the issued share capital is represented. If the requisite share capital is not represented, a further meeting shall be convened, to be held within eight weeks of the first meeting, to which no quorum requirement applies. Furthermore, the resolution requires the approval of the Supervisory Board. If the resolution is proposed by the Board of Management, the adoption needs an absolute majority of votes and no quorum requirement applies to the meeting.

**Repurchase and issue of (rights to) shares**

At the 2015 Annual General Meeting of Shareholders it was resolved to authorize the Board of Management, subject to the approval of the Supervisory Board, to acquire shares in the Company within the limits of the Articles of Association and within a certain price range up to and including November 6, 2016. The maximum number of shares the company may hold, will not exceed 10% of the issued share capital as of May 7, 2015, which number may be increased by 10% of the issued capital as of that same date in connection with the execution of share repurchase programs for capital reduction programs.

In addition, at the 2015 Annual General Meeting of Shareholders it was resolved to authorize the Board of Management, subject to the approval of the Supervisory Board, to issue shares or grant rights to acquire shares in the Company as well as to restrict or exclude the pre-emption right accruing to shareholders up to and including November 6, 2016. This authorization is limited to a maximum of 10% of the number of shares issued as of May 7, 2015 plus 10% of the issued capital in connection with or on the occasion of mergers, acquisitions and/or strategic alliances.

**11.4 Meeting logistics and other information****Introduction**

Pursuant to Dutch law, the record date for the exercise of the voting rights and the rights relating to General Meetings of Shareholders is set at the 28th day prior to the day of the meeting. Shareholders registered at such date are entitled to attend the meeting and to exercise the other shareholder rights (in the meeting in question) notwithstanding subsequent sale of their shares thereafter. This date will be published in advance of every General Meeting of Shareholders.

Information which is required to be published or deposited pursuant to the provisions of company law and securities law applicable to the Company and which is relevant to the shareholders, is placed and updated on the Company's website, or hyperlinks are established. The Board of

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Management and Supervisory Board shall ensure that the General Meeting of Shareholders is informed of facts and circumstances relevant to proposed resolutions in explanatory notes to the agenda and, if deemed appropriate, by means of a shareholders circular published on the Company's website.

Resolutions adopted at a General Meeting of Shareholders shall be recorded by a civil law notary and co-signed by the chairman of the meeting; such

Annual Report 2015 123

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## **Table of Contents**

### **Corporate governance 11.4**

resolutions shall also be published on the Company's website within 15 days after the meeting. A draft summary of the discussions during the General Meeting of Shareholders, in the language of the meeting, is made available to shareholders, on request, no later than three months after the meeting. Shareholders shall have the opportunity to respond to this summary for three months, after which a final summary is adopted by the chairman of the meeting in question. Such final summary shall be made available on the Company's website.

### **Registration, attending meetings and proxy voting**

Holders of common shares who wish to exercise the rights attached to their shares in respect of a General Meeting of Shareholders, are required to register for such meeting. Shareholders may attend a General Meeting of Shareholders in person, or may grant a power of attorney to a third-party to attend the meeting and to vote on their behalf. Holders of common shares in bearer form will also be able to give voting instructions via Internet (assuming the agenda for such meeting includes voting items). In addition, the Company will distribute a voting instruction form for a General Meeting of Shareholders. By giving voting instructions via Internet or by returning the form, shareholders grant power to an independent proxy holder who will vote according to the instructions expressly given on the voting instruction form. Also other persons entitled to vote shall be given the possibility to give voting proxies or instructions to an independent third-party prior to the meeting. Details on the registration for meetings, attending and proxy voting will be included in the notice convening a General Meeting of Shareholders.

### **Preference shares and the Stichting Preferente Aandelen Philips**

As a means to protect the Company and its stakeholders against an unsolicited attempt to obtain (de facto) control of the Company, the General Meeting of Shareholders in 1989 adopted amendments to the Company's Articles of Association that allow the Board of Management and the Supervisory Board to issue (rights to) preference shares to a third-party. As a result, the Stichting Preferente Aandelen Philips (the Foundation) was created, which was granted the right to acquire preference shares in the Company. The mere notification that the Foundation wishes to exercise its rights, should a third-party ever seem likely in the judgment of the Foundation to obtain (de facto) control of the Company, will result in the preference shares being effectively issued. The Foundation may exercise this right for as many preference shares as there are ordinary shares in the Company outstanding at that time. No preference shares have been issued as of December 31, 2015. In addition, the Foundation has the right to file a petition with the Enterprise Chamber of the Amsterdam Court of Appeal to commence an inquiry procedure within the meaning of section 2:344 Dutch Civil Code.

The object of the Foundation is to represent the interests of the Company, the enterprises maintained by the Company and its affiliated companies within the Group, in such a way that the interests of Philips, those enterprises and all parties involved with them are safeguarded as effectively as possible, and that they are afforded maximum protection against influences which, in conflict with those interests, may undermine the autonomy and identity of Philips and those enterprises, and also to do anything related to the above ends or conducive to them. In the event of (an attempt at) a hostile takeover or other attempt to obtain (de facto) control of the Company this arrangement will allow the Company and its Board of Management and Supervisory Board to determine its position in relation to the third-party and its plans, seek alternatives and defend Philips' interests and those of its stakeholders from a position of strength. The members of the self-electing Board of the Foundation are Messrs P.A.F.W. Elverding, M.W. den Boogert and F.J.G.M. Cremers. No Philips board members or officers are represented on the board of the Foundation.

The Company does not have any other anti-takeover measures in the sense of other measures which exclusively or almost exclusively have the purpose of frustrating future public bids for the shares in the capital of the Company in case no agreement is reached with the Board of Management on such public bid.

Furthermore, the Company does not have measures which specifically have the purpose of preventing a bidder who has acquired 75% of the shares in the capital of the Company from appointing or dismissing members of the Board of Management and subsequently amending the Articles of Association of the Company. It should be noted that also in the event of (an attempt at) a hostile takeover or other attempt to obtain (de facto) control of the Company, the Board of Management and the Supervisory Board are authorized to exercise in the interests of Philips all powers vested in them.

### **Annual financial statements**

The annual financial statements are prepared by the Board of Management and reviewed by the Supervisory Board upon the advice of its Audit Committee and taking into account the report of the external auditor. Upon approval by the Supervisory Board, the accounts are signed by all

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members of both the Board of Management and the Supervisory Board and are published together with the opinion of the external auditor. The Board of Management is responsible, under the supervision of the Supervisory Board, for the quality and completeness of such publicly disclosed financial reports. The annual financial statements are presented for discussion and adoption at the Annual General Meeting of Shareholders, to be convened subsequently. The Company, under US securities regulations, separately

124 Annual Report 2015

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**Table of Contents**

Corporate governance 11.4

files its Annual Report on Form 20-F, incorporating major parts of the Annual Report as prepared under the requirements of Dutch law.

**Internal controls and disclosure policies**

Comprehensive internal procedures, compliance with which is supervised by the Supervisory Board, are in place for the preparation and publication of the Annual Report, the annual accounts, the quarterly figures and ad hoc financial information. As from 2003, the internal assurance process for business risk assessment has been strengthened and the review frequency has been upgraded to a quarterly review cycle, in line with best practices in this area.

As part of these procedures, a Disclosure Committee has been appointed by the Board of Management to oversee the Company's disclosure activities and to assist the Executive Committee in fulfilling its responsibilities in this respect. The Committee's purpose is to ensure that the Company implements and maintains internal procedures for the timely collection, evaluation and disclosure, as appropriate, of information potentially subject to public disclosure under the legal, regulatory and stock exchange requirements to which the Company is subject. Such procedures are designed to capture information that is relevant to an assessment of the need to disclose developments and risks that pertain to the Company's various businesses, and their effectiveness for this purpose will be reviewed periodically.

**Auditor information**

In accordance with the procedures laid down in the Philips Auditor Policy and as mandatorily required by Dutch law, the external auditor of the Company is appointed by the General Meeting of Shareholders on the proposal of the Supervisory Board, after the latter has been advised by the Audit Committee and the Board of Management. Under this Auditor Policy, as updated in 2013, the Supervisory Board and the Audit Committee assess the functioning of the external auditor. The main conclusions of this assessment shall be communicated to the General Meeting of Shareholders for the purposes of assessing the nomination for the appointment of the external auditor.

The current auditor of the Company, KPMG Accountants N.V., was appointed by the 1995 General Meeting of Shareholders. In 2002, when the Auditor Policy was adopted, the appointment of KPMG Accountants N.V. was confirmed by the Supervisory Board for an additional three years. The 2008, 2011 and 2014 General Meetings of Shareholders resolved to re-appoint KPMG Accountants N.V. as auditor, at the latest meeting up to and including the financial year 2015. Mr E.H.W. Weusten is the current partner of KPMG Accountants N.V. in charge of the audit duties for Philips.

The 2015 Annual General Meeting of Shareholders appointed Ernst & Young Accountants LLP as the Company's new auditor as of January 1, 2016. Mr C.B. Boogaart is the current partner of Ernst & Young Accountants LLP N.V. in charge of the audit duties for Philips.

The external auditor attends, in principle, all meetings of the Audit Committee. The findings of the external auditor, the audit approach and the risk analysis are also discussed at these meetings. The external auditor attends the meeting of the Supervisory Board at which the report of the external auditor with respect to the audit of the annual accounts is discussed, and at which the annual accounts are approved. In its audit report on the annual accounts to the Board of Management and the Supervisory Board, the external auditor refers to the financial reporting risks and issues that were identified during the audit, internal control matters, and any other matters, as appropriate, requiring communication under the auditing and other standards generally accepted in the Netherlands and the US.

The external auditor shall attend the Annual General Meeting of Shareholders. Questions may be put to him at the meeting about his report. The Board of Management and the Audit Committee of the Supervisory Board shall report on their dealings with the external auditor to the Supervisory Board on an annual basis, particularly with regard to the auditor's independence. The Supervisory Board shall take this into account when deciding upon its nomination for the appointment of an external auditor.

**Auditor policy**

Dutch law requires the separation of audit and non-audit services, meaning the Company's external auditor is no longer allowed to provide non-audit services. In light of this legislation, the Auditor Policy was updated in 2013. The policy is published on the Company's website. The policy is also in line with US Securities and Exchange Commission rules under which the appointed external auditor must be independent of the Company both in fact and appearance.

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The Auditor Policy includes rules for the pre-approval by the Audit Committee of all services to be provided by the external auditor. Proposed services may be pre-approved at the beginning of the year by the Audit Committee (annual pre-approval) or may be pre-approved during the year by the Audit Committee in respect of a particular engagement (specific pre-approval). The annual pre-approval is based on a detailed, itemized list of services to be provided, designed to ensure that there is no management discretion in determining whether a service has been approved and to ensure the Audit Committee is informed of each services it is pre-approving. Unless pre-approval with respect to a specific service has been given at the beginning of the year, each proposed service requires specific pre-approval during the year. Any annually pre-approved services where the fee for

Annual Report 2015 125

## **Table of Contents**

### [Corporate governance 11.4](#)

the engagement is expected to exceed pre-approved cost levels or budgeted amounts will also require specific pre-approval. The term of any annual pre-approval is 12 months from the date of the pre-approval unless the Audit Committee states otherwise. During 2015, there were no services provided to the Company by the external auditor which were not pre-approved by the Audit Committee.

### **11.5 Investor Relations**

#### **Introduction**

The Company is continually striving to improve relations with its shareholders. In addition to communication with its shareholders at the Annual General Meeting of Shareholders, Philips elaborates its financial results during (public) conference calls, which are broadly accessible. It publishes informative annual, semi-annual and quarterly reports and press releases, and informs investors via its extensive website. The Company is strict in its compliance with applicable rules and regulations on fair and non-selective disclosure and equal treatment of shareholders.

From time to time the Company communicates with investors via road shows, broker conferences and a Capital Markets Day, announced in advance on the Company's website. Shareholders can follow in real time, by means of webcasting or telephone lines, the meetings and presentations organized by the Company. Thus the Company applies recommendation IV.3.1 of the Dutch Corporate Governance Code, which in its perception and in view of market practice does not extend to less important analyst meetings and presentations. It is Philips' policy to post presentations to analysts and shareholders on the Company's website. These meetings and presentations will not take place shortly before the publication of annual, semi-annual and quarterly financial information.

Furthermore, the Company engages in bilateral communications with investors. These take place either at the initiative of the Company or at the initiative of investors. The Company is generally represented by its Investor Relations department during these interactions, however, on a limited number of occasions the Investor Relations department is accompanied by one or more members of the senior management. The subject matter of the bilateral communications ranges from individual queries from investors to more elaborate discussions following disclosures that the Company has made, such as its annual and quarterly reports. Also here, the Company is strict in its compliance with applicable rules and regulations on fair and non-selective disclosure and equal treatment of shareholders.

The Company shall not, in advance, assess, comment upon or correct, other than factually, any analyst's reports and valuations. No fee(s) will be paid by the Company to parties for the carrying-out of research for analysts' reports or for the production or publication of analysts' reports, with the exception of credit-rating agencies.

#### **Major shareholders and other information for shareholders**

The Dutch Act on Financial Supervision imposes an obligation on persons holding certain interests to disclose (inter alia) percentage holdings in the capital and/or voting rights in the Company when such holdings reach, exceed or fall below 3, 5, 10, 15, 20, 25, 30, 40, 50, 60, 75 and 95 percent (as a result of an acquisition or disposal by a person, or as a result of a change in the company's total number of voting rights or capital issued). Certain cash settled derivatives are also taken into account when calculating the capital interest. The statutory obligation to disclose capital interest does not only relate to gross long positions, but also to gross short positions. Required disclosures must be made to the Netherlands Authority for the Financial Markets (AFM) without delay. The AFM then notifies such disclosures to the Company and includes them in a register which is published on the AFM's website. Furthermore, an obligation to disclose (net) short positions is set out in the EU Regulation on Short Selling.

On June 23, 2015 the Company received notification from the AFM that it had received disclosure under the Dutch Act on Financial Supervision of 4.97% of the voting rights by Dodge & Cox. On July 24, 2015 the Company received notification from the AFM that it had received disclosure under such Act of a substantial holding of 4.06%, and of 5% of the voting rights by Blackrock, Inc. On January 7, 2016 the Company received notification from the AFM that it had received disclosure under such Act of a substantial holding (and voting rights) of 4.99% by Harris Associates L.P. As per December 31, 2015, approximately 91% of the common shares were held in bearer form and approximately 9% of the common shares were represented by registered shares of New York Registry issued in the name of approximately 1,124 holders of record, including Cede & Co. Cede & Co acts as nominee for the Depository Trust Company holding the shares (indirectly) for individual investors as beneficiaries. Citibank, N.A., 388 Greenwich Street, New York, New York 10013 is the transfer agent and registrar.



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Only bearer shares are traded on the stock market of Euronext Amsterdam. Only shares of New York Registry are traded on the New York Stock Exchange. Bearer shares and registered shares may be exchanged for each other. Since certain shares are held by brokers and other nominees, these numbers may not be representative of the actual number of United States beneficial holders or the number of Shares of New York Registry beneficially held by US residents.

The provisions applicable to all corporate bonds that have been issued by the Company in March 2008 and 2012 contain a Change of Control Triggering Event . This

126 Annual Report 2015

## **Table of Contents**

Corporate governance 11.5

means that if the Company experienced such an event with respect to a series of corporate bonds the Company might be required to offer to purchase the bonds of that series at a purchase price equal to 101% of their principal amount, plus accrued and unpaid interest, if any.

### **Corporate seat and head office**

The statutory seat of the Company is Eindhoven, the Netherlands, and the statutory list of all subsidiaries and affiliated companies, prepared in accordance with the relevant legal requirements (Dutch Civil Code, Book 2, Sections 379 and 414), forms part of the notes to the consolidated financial statements and is deposited at the office of the Commercial Register in Eindhoven, the Netherlands (file no. 17001910).

The executive offices of the Company are located at the Philips Center, Amstelplein 2, 1096 BC Amsterdam, the Netherlands, telephone 0031 (0)20 59 77 777.

### **Compliance with the Dutch Corporate Governance Code**

In accordance with the governmental Decree of December 10, 2009, the Company fully complies with the Dutch Corporate Governance Code and applies all its principles and best practice provisions that are addressed to the Board of Management or the Supervisory Board. The full text of the Dutch Corporate Governance Code can be found at the website of the Monitoring Commission Corporate Governance Code ([www.commissiecorporategovernance.nl](http://www.commissiecorporategovernance.nl)).

February 23, 2016

## **11.6 Additional information**

Set forth below is a summary of certain provisions of the Articles of Association of the Company, applicable Dutch law and related Company policies. This summary does not constitute legal advice regarding those matters and should not be regarded as such.

### **Articles of association**

#### **Object and purpose**

The objects of the Company are to establish, participate in, administer and finance legal entities, companies and other legal forms for the purpose of the manufacture and trading of electrical, electronic, mechanical or chemical products, the development and exploitation of technical and other expertise, including software, or for the purpose of other activities, and to do everything pertaining thereto or connected therewith, including the provision of security in particular for commitments of business undertakings which belong to its group, all this in the widest sense, as may also be conducive to the proper continuity of the collectivity of business undertakings, in the Netherlands and abroad, which are carried on by the Company and the companies in which it directly or indirectly participates.

#### **Share Capital**

As of December 31, 2015, the issued share capital consists only of common shares; no preference shares have been issued.

#### **Voting rights**

Each common share and each preference share is entitled to one vote. All common shares vote together on all voting matters presented at a General Meeting of Shareholders. Major shareholders do not have different voting rights than other shareholders.

#### **Dividends**

A dividend will first be declared on preference shares out of net income. The Board of Management has the power to determine what portion of the net income shall be retained by way of reserve, subject to the approval of the Supervisory Board. The remainder of the net income, after

reservations made, shall be available for distribution to holders of common shares subject to shareholder approval after year-end.

#### **Liquidation rights**

In the event of the dissolution and liquidation of the Company, the assets remaining after payment of all debts and liquidation expenses are to be distributed in the following order of priority: to the holders of preference shares, the amount paid thereon; and the remainder to the holders of the common shares.

#### **Preemptive rights**

Shareholders have a pro rata preferential right of subscription to any common share issuance unless the right is restricted or excluded. If designated by the General Meeting of Shareholders, the Board of Management has the power to restrict or exclude the preferential subscription rights. A designation of the Board of Management will be effective for a specified period of up to five years and may be renewed. Currently, the Board of Management has been granted the power to restrict or exclude the preferential right of subscription up to and including November 6, 2016. If the Board of Management has not been designated, the General Meeting of Shareholders has the power to restrict or exclude such rights, upon the proposal of the Board of Management, which proposal must be approved by the Supervisory Board. Resolutions by the General Meeting of Shareholders referred to in this paragraph require approval of at least two-thirds of the votes cast if less than half of the issued share capital is represented at the meeting.

The foregoing provisions also apply to the issuance of rights to subscribe for shares.

#### **General Meeting of Shareholders**

The Annual General Meeting of Shareholders shall be held each year not later than the thirtieth day of June and, at the Board of Management's option, in Eindhoven, Amsterdam, The Hague, Rotterdam,

## **Table of Contents**

### **Corporate governance 11.6**

Utrecht or Haarlemmermeer (including Schiphol airport); the notice convening the meeting shall inform the shareholders accordingly.

Without prejudice to applicable laws and regulations, the Board of Management may resolve to give notice to holders of bearer shares via the Company's website and/or by other electronic means representing a public announcement, which announcement remains directly and permanently accessible until the General Meeting of shareholders. Holders of registered shares shall be notified by letter, unless the Board of Management resolves to give notice to holders of registered shares by electronic means of communication by sending a legible and reproducible message to the address indicated by the shareholder to the Company for such purpose provided the relevant shareholder has agreed hereto.

In principle all shareholders are entitled to attend the General Meeting of Shareholders, to address the meeting and to vote, except for shares held in treasury by the Company. They may exercise the aforementioned rights at a meeting only for the common shares which on the record date are registered in their name. The record date is published in the above announcement. Holders of registered shares must advise the Company in writing of their intention to attend the General Meeting of Shareholders. Holders of bearer shares who either in person or by proxy wish to attend the General Meeting of Shareholders, should notify ABN AMRO Bank N.V. acting as agent for the Company. They must submit a confirmation by a participating institution, in which administration they are registered as holders of the shares, that such shares are registered and will remain registered in its administration up to and including the record date, whereupon the holder will receive an admission ticket for the General Meeting of Shareholders. Holders of shares who wish to attend by proxy have to submit the proxy at the same time. A participating institution is a bank or broker which according to the Dutch Securities Depository Act (Wet giraal effectenverkeer) is a participating institution (aangesloten instelling) of Nederlands Centraal Instituut voor Giraal Effectenverkeer B.V. (Euroclear Nederland).

In connection with the General Meeting of Shareholders, the Company doesn't solicit proxies within the United States.

The Articles of Association of the Company provide that there are no quorum requirements to hold a General Meeting of Shareholders and, unless specified otherwise in the articles of association of the Company, resolutions of the General Meeting of Shareholders shall be adopted by a simple majority of votes. Certain shareholder actions and certain resolutions may require a quorum.

### **Limitations on right to hold or vote Common Shares**

There are no limitations imposed by Dutch law or by the Articles of Association on the right of non-resident owners to hold or vote the Common Shares.

### **Exchange controls**

Cash dividends payable in Euros on Netherlands registered shares and bearer shares may be officially transferred from the Netherlands and converted into any other currency without Dutch legal restrictions, except that for statistical purposes such payments and transactions must be reported to the Dutch Central Bank, and furthermore, no payments, including dividend payments, may be made to jurisdictions subject to sanctions adopted by the government of the Netherlands and implementing resolutions of the Security Council of the United Nations.

The Articles of Association of the Company provide that cash distributions on Shares of New York Registry shall be paid in US dollars, converted at the rate of exchange on the stock market of Euronext Amsterdam at the close of business on the day fixed and announced for that purpose by the Board of Management.

### **General**

The corporate governance rules introduced by the New York Stock Exchange (NYSE) allow foreign private issuers, like the Company, to follow home country practices on most corporate governance matters instead of those that apply to US domestic issuers, provided that they disclose any significant ways in which their corporate governance practices differ from those applying to listed domestic US companies under the NYSE listing standards. A summary of significant differences between certain Dutch practices on corporate governance matters and the corporate governance provisions applicable to US companies under the NYSE listing standards appears below.

### **Dutch corporate governance provisions**

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The Company is a company organized under Dutch law, with its Common Shares listed on Euronext Amsterdam, and is subject to the Dutch Corporate Governance Code of December 10, 2008 (the Dutch Corporate Governance Code ). Philip s New York Registry Shares, representing Common Shares of the Company, are listed on the NYSE.

### **Board structure**

The NYSE listing standards prescribe regularly scheduled executive sessions of non-executive directors. The Company has a two-tier corporate structure consisting of a Board of Management consisting of executive directors under the supervision of a Supervisory Board consisting exclusively of non-executive directors. Members of the Board of Management and other officers and employees cannot simultaneously act as member of the Supervisory Board. The Supervisory Board must approve specified decisions of the Board of Management.

128 Annual Report 2015

**Table of Contents**

Corporate governance 11.6

**Independence of members of our Supervisory Board**

Under the Dutch Corporate Governance Code all members of the Supervisory Board with the exception of not more than one person, must be independent. The present members of our Supervisory Board are all independent within the meaning of the Dutch Corporate Governance Code. The definitions of independence under the Dutch Corporate Governance Code, however, differ in their details from the definitions of independence under the NYSE listing standards. In some cases the Dutch requirements are stricter than the NYSE listing standards and in other cases the NYSE listing standards are the stricter of the two.

**Committees of our Supervisory Board**

The Company has established an Audit Committee, a Remuneration Committee and a Corporate Governance and Nomination & Selection Committee, consisting of members of the Supervisory Board only. The roles, responsibilities and composition of these committees reflect the requirements of the Dutch Corporate Governance Code, the company's Articles of Association and Dutch law, which differ from the NYSE listing standards in these respects. In 2015, the Supervisory Board additionally established the Separation Committee and Quality & Regulatory Committee. The role of each committee is to advise the Supervisory Board and to prepare the decision-making of the Supervisory Board. In principle, the entire Supervisory Board remains responsible for its decisions even if they were prepared by one of the Supervisory Board's committees.

The NYSE requires that, when an audit committee member of a US domestic listed company serves on four or more audit committees of public companies, the listed company should disclose (either on its website or in its Annual Report on Form 10-K) that the board of directors has determined that this simultaneous service would not impair the director's service to the listed company. Dutch law does not require the Company to make such a determination.

In accordance with the procedures laid down in the Philips Auditor Policy and as mandatorily required by Dutch law, the external auditor of the Company is appointed by the General Meeting of Shareholders on the proposal of the Supervisory Board, after the latter has been advised by the Audit Committee and the Board of Management.

**Major shareholders as filed with SEC**

On January 30, 2013, BlackRock Inc. filed a Schedule 13G with the SEC indicating that it beneficially owned 5.09% (48,728,999 shares) of the Company's common shares. On February 13, 2013, Dodge & Cox filed a Schedule 13G with the SEC indicating that it beneficially owned 6.7% (63,848,817 shares) of the Company's common shares. On February 14, 2013, Southeastern Asset Management Inc. filed a Schedule 13G with the SEC indicating that it beneficially owned 6.5% (62,001,965 shares) of the Company's common shares. On March 11, 2013, BlackRock Inc. filed a Schedule 13G with the SEC indicating that it beneficially owned 4.73% (45,264,486 shares) of the Company's common shares. On August 9, 2013, Southeastern Asset Management Inc. filed a Schedule 13G with the SEC indicating that it beneficially owned 4.93% (48,050,071 shares) of the Company's common shares. On February 13, 2014, Dodge & Cox filed a Schedule 13G with the SEC indicating that it beneficially owned 5.7% (53,107,793 shares) of the Company's common shares. On February 13, 2015, Southeastern Asset Management Inc. filed a Schedule 13G with the SEC indicating that it beneficially owned 5.4% (50,880,362 shares) of the Company's common shares. On February 13, 2015, Dodge & Cox filed a Schedule 13G with the SEC indicating that it beneficially owned 6.3% (59,366,413 shares) of the Company's common shares. On July 10, 2015, Southeastern Asset Management Inc. filed a Schedule 13G with the SEC indicating that it beneficially owned 4.6% (44,012,103 shares) of the Company's common shares. On January 22, 2016, BlackRock Inc. filed a Schedule 13G with the SEC indicating that it beneficially owned 6.0% (55,645,648 shares) of the Company's common shares. On February 12, 2016, Dodge & Cox filed a Schedule 13G with the SEC indicating that it beneficially owned 3.4% (31,421,723 shares) of the Company's common shares. Please also refer to Major shareholders and other information for shareholders in section 11.5, Investor Relations, of this report.

**Equity compensation plans**

The Company complies with Dutch legal requirements regarding shareholder approval of equity compensation plans. Dutch law does not require shareholder approval of certain equity compensation plans for which the NYSE listing standards would require such approval. The Company is subject to a requirement to seek shareholder approval for equity compensation-plans for its members of the Board of Management.

**Code of business conduct**

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The listing standards of the NYSE prescribe certain parameters for listed company codes of business conduct and ethics. The Company has implemented the Philips General Business Principles applicable to all employees and a Financial Code of Ethics applicable to all employees performing an accounting or financial function. Waivers granted to Senior (Financial) Officers (as defined in our Financial Code of Ethics) will be disclosed. In 2015 the Company did not grant any waivers of the Financial Code of Ethics.

### **KPMG**

From June 2014 to October 2015, KPMG Accountants N.V. (KPMG), the Company's independent registered public accounting firm, had a Chief Executive Officer who was the Chief Financial Officer of Philips in the period 1997-2005. The former KPMG CEO receives a monthly pension payment, which is immaterial to his net worth, from the Philips Pension Fund. The Philips

Annual Report 2015 129

## **Table of Contents**

### Corporate governance 11.6

Pension Fund is a separate and financially independent entity with an independent Board of Trustees who are legally responsible to safeguard the retirement benefits of the participants of the Philips Pension Fund. Royal Philips is not liable for any financial deficits of the Philips Pension Fund and Royal Philips has no discretion over the level and payments of benefits to participants. The Philips Pension Fund is considered an affiliate of Philips under SEC independence rules, which are applicable to KPMG audit of Philips, and accordingly, the financial relationship violates the US Securities and Exchange Commission's regulations. KPMG is not the independent auditor of the Philips Pension Fund. KPMG has put in place a process whereby the KPMG CEO is not in the chain of command with respect to the Philips' audit or the ratings or compensation of partners who work on the Philips' audit. KPMG has advised Philips' management and its audit committee that this situation, considering the actions taken by the firm, does not impact the firm's ability to apply objective and impartial judgment on all matters encompassed within their annual audits of Philips. Philips' audit committee concurs that this financial relationship does not impact the firm's ability to apply objective and impartial judgment on all matters encompassed within the annual audits of Philips.

### Change in Registrant's Certifying Accountant

The 2015 Annual General Meeting of Shareholders appointed Ernst & Young Accountants LLP (EY) as the Company's new auditor as of January 1, 2016. Under Dutch legislation on mandatory auditor rotation (in effect at the time of the 2015 AGM), the Company was required to engage a new audit firm for its statutory audit for the financial year starting January 1, 2016. The Audit Committee, jointly with management, conducted a comprehensive tender and selection process for a new external auditor (incorporating an interim period of one year with the current external auditor) and resolved to recommend to the Supervisory Board the appointment of a new auditor. This resulted in the Supervisory Board proposing and recommending the appointment of EY as the company's new auditor at the 2015 Annual General Meeting of Shareholders, which was held on May 7, 2015.

KPMG Accountants N.V. (KPMG) was previously the Company's auditor and, following the Dutch legislation on mandatory auditor rotation, declined to stand for re-election. During the years ended 31 December 2014 and 2013 (1) KPMG has not issued any reports on the financial statements of the Company or on the effectiveness of internal control over financial reporting that contained an adverse opinion or a disclaimer of opinion, nor were the auditors' reports of KPMG qualified or modified as to uncertainty, audit scope, or accounting principles, and (2) there has not been any disagreement over any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreement if not resolved to KPMG's satisfaction would have caused it to make reference to the subject matter of the disagreement in connection with its auditors' reports, or any reportable event as described in Item 16F(a)(1)(v) of Form 20-F.

The Company has provided KPMG with a copy of the foregoing disclosure and has requested that KPMG furnish the Company with a letter addressed to the SEC stating whether it agrees with such disclosure and, if not, stating the respects in which it does not agree. A copy of the letter, dated 23 February 2016, in which KPMG states that they agree with such disclosure, is filed herewith as Exhibit 15 (b).



## **Table of Contents**

[Group financial statements 12](#)

### [12 Group financial statements](#)

#### **Introduction**

This section of the Annual Report contains the audited consolidated financial statements including the notes thereon that have been prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed by the European Union (EU) and with the statutory provisions of Part 9, Book 2 of the Dutch Civil Code. All standards and interpretations issued by the International Accounting Standards Board (IASB) and the IFRS Interpretations Committee effective year-end 2015 have been endorsed by the EU, except that the EU did not adopt some 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 fully with IFRS as issued by the IASB.

Together with the section Company financial statements, this section contains the statutory financial statements of the Company.

The following sections and chapters:

chapter 4, Our strategic focus, of this report

chapter 5, Group performance, of this report

chapter 6, Sector performance, of this report

chapter 7, Risk management, of this report

chapter 10, Supervisory Board report, of this report

section 10.1, Report of the Corporate Governance and Nomination & Selection Committee, of this report

section 10.2, Report of the Remuneration Committee, of this report

chapter 11, Corporate governance, of this report

Forward-looking statements, of this report  
form the Management report within the meaning of section 2:391 of the Dutch Civil Code (and related Decrees).

The sections Group performance and Sector performance provide an extensive analysis of the developments during the financial year 2015 and the results. The term EBIT has the same meaning as Income from operations (IFO), and is used to evaluate the performance of the business. These sections also provide information on the business outlook, investments, financing, personnel and research and development activities.

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The Statement of income included in the section Company financial statements has been prepared in accordance with section 2:402 of the Dutch Civil Code, which allows a simplified Statement of income in the Company financial statements in the event that a comprehensive Statement of income is included in the consolidated Group financial statements.

For Additional information within the meaning of section 2:392 of the Dutch Civil Code, please refer to section 13.5, Independent auditor's report, of this report, section 5.4, Proposed distribution to shareholders, of this report, and note 32, Subsequent events.

Please refer to Forward-looking statements, of this report for more information about forward-looking statements, third-party market share data, fair value information, and revisions and reclassifications.

The Board of Management of the Company hereby declares that, to the best of our knowledge, the Group financial statements and Company financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole and that the management report referred to above gives a true and fair view concerning the position as per the balance sheet date, the development and performance of the business during the financial year of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks that they face.

### *Board of Management*

Frans van Houten

Abhijit Bhattacharya

Pieter Nota

February 23, 2016

Annual Report 2015 131

## **Table of Contents**

[Group financial statements 12.1](#)

### **12.1 Management's report on internal control**

#### **Management's report on internal control over financial reporting pursuant to section 404 of the US Sarbanes-Oxley Act**

The Board of Management of Koninklijke Philips N.V. (the Company) is responsible for establishing and maintaining an adequate system of internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the US Securities Exchange Act). Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of our financial reporting for external purposes in accordance with IFRS as issued by the IASB.

Internal control over financial reporting includes maintaining records that, in reasonable detail, accurately and fairly reflect our transactions; providing reasonable assurance that transactions are recorded as necessary for preparation of our financial statements; providing reasonable assurance that receipts and expenditures of company assets are made in accordance with management authorization; and providing reasonable assurance that unauthorized acquisition, use or disposition of company assets that could have a material effect on our financial statements would be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our financial statements would be prevented or detected. Also, projections of any evaluation of the effectiveness of internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Board of Management conducted an assessment of the Company's internal control over financial reporting based on the *Internal Control-Integrated Framework (2013)* established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on that assessment, the Board of Management concluded that, as of December 31, 2015, the Company's internal control over Group financial reporting is considered effective.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2015, as included in this section Group financial statements, has been audited by KPMG Accountants N.V., an independent registered public accounting firm, as stated in their report which follows hereafter.

#### *Board of Management*

Frans van Houten

Abhijit Bhattacharya

Pieter Nota

February 23, 2016

#### **12.1.1 Disclosure controls and procedures**

The Company's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by the Annual Report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective as of December 31, 2015.

#### **12.1.2 Changes in internal control over financial reporting**

During the year ended December 31, 2015, there have been no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### **12.2 Report of the independent auditor**

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Management's report on internal control over financial reporting is set out in section 12.1, Management's report on internal control, of this report. The report set out in sub-section 12.3.2, Independent auditors' report on internal control over financial reporting, of this report, is provided in compliance with standards of the Public Company Accounting Oversight Board in the US and includes an opinion on the effectiveness of internal control over financial reporting as at December 31, 2015.

KPMG Accountants N.V. has also issued a report on the consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board in the US, which is set out in sub-section 12.3.1, Independent auditors' report on the consolidated financial statements, of this report.

KPMG Accountants N.V. has also issued a report on the consolidated financial statements and the Company financial statements, in accordance with Dutch law, including the Dutch standards on auditing, of Koninklijke Philips N.V., which is set out in section 13.5, Independent auditor's report, of this report.

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**Table of Contents**

[Group financial statements 12.3](#)

**[12.3 Independent auditors reports on the consolidated financial statements and on internal control over financial reporting](#)**

**[12.3.1 Independent auditors report on the consolidated financial statements](#)**

**[Report of Independent Registered Public Accounting Firm](#)**

To: The Supervisory Board and Shareholders of Koninklijke Philips N.V.

We have audited the accompanying consolidated balance sheets of Koninklijke Philips N.V. and subsidiaries as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, cash flows, and changes in equity for each of the years in the three-year period ended December 31, 2015. These consolidated financial statements are the responsibility of the Koninklijke Philips N.V.'s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Koninklijke Philips N.V. and subsidiaries as of December 31, 2015 and 2014, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2015, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Koninklijke Philips N.V.'s internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 23, 2016, expressed an unqualified opinion on the effectiveness of the Koninklijke Philips N.V.'s internal control over financial reporting.

Amsterdam, The Netherlands

February 23, 2016

/s/ KPMG Accountants N.V.

Note that the report set out above is included for the purpose of Koninklijke Philips N.V.'s Annual Report on Form 20-F for 2015 only and does not form part of Koninklijke Philips N.V.'s Annual Report for 2015.

Annual Report 2015 133

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**Table of Contents**

[Group financial statements 12.3.2](#)

**12.3.2 Independent auditors' report on internal control over financial reporting**

**Report of Independent Registered Public Accounting Firm**

To: The Supervisory Board and Shareholders of Koninklijke Philips N.V.

We have audited Koninklijke Philips N.V.'s internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Koninklijke Philips N.V.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying section 12.1, *Management's report on internal control*, of this Form 20-F. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Koninklijke Philips N.V. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Koninklijke Philips N.V. and subsidiaries as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, cash flows, and changes in equity for each of the years in the three-year period ended December 31, 2015, and our report dated February 23, 2016, expressed an unqualified opinion on those consolidated financial statements.

Amsterdam, The Netherlands

February 23, 2016

/s/ KPMG Accountants N.V.



**Table of Contents**

Group financial statements 12.4

**12.4 Consolidated statements of income**

Philips Group

**Consolidated statements of income** in millions of EUR unless otherwise stated

For the years ended December 31

	2013	2014	2015
Sales	21,990	21,391	24,244
Cost of sales	(12,653)	(13,185)	(14,388)
<b>Gross margin</b>	<b>9,337</b>	<b>8,206</b>	<b>9,856</b>
Selling expenses	(5,057)	(5,124)	(5,815)
Research and development expenses	(1,659)	(1,635)	(1,927)
General and administrative expenses	(825)	(747)	(1,209)
Impairment of goodwill	(28)	(3)	
Other business income	122	63	137
Other business expenses	(35)	(274)	(50)
<b>Income from operations</b>	<b>1,855</b>	<b>486</b>	<b>992</b>
Financial income	70	114	98
Financial expenses	(400)	(415)	(467)
<b>Income before taxes</b>	<b>1,525</b>	<b>185</b>	<b>623</b>
Income tax expense	(466)	(26)	(239)
<b>Income after taxes</b>	<b>1,059</b>	<b>159</b>	<b>384</b>
Results relating to investments in associates:			
Company's participation in income	5	30	10
Other results	(30)	32	20
<b>Income from continuing operations</b>	<b>1,034</b>	<b>221</b>	<b>414</b>
Discontinued operations - net of income tax	138	190	245
<b>Net income</b>	<b>1,172</b>	<b>411</b>	<b>659</b>
<b>Attribution of net income (loss)</b>			
Net income attributable to Koninklijke Philips N.V. shareholders	1,169	415	645
Net income attributable to non-controlling interests	3	(4)	14



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Philips Group

**Earnings per common share attributable to shareholders<sup>1)</sup>** in EUR unless otherwise stated

For the years ended December 31

	2013	2014	2015
<b>Basic earnings per common share in EUR</b>			
Income from continuing operations attributable to shareholders	1.13	0.25	0.44
Net income attributable to shareholders	1.28	0.45	0.70
<b>Diluted earnings per common share in EUR</b>			
Income from continuing operations attributable to shareholders	1.12	0.24	0.43
Net income attributable to shareholders	1.27	0.45	0.70

The accompanying notes are an integral part of these consolidated financial statements.

<sup>1)</sup> Shareholders in this table refer to shareholders of Koninklijke Philips N.V.

Annual Report 2015 135

**Table of Contents**

Group financial statements 12.5

**12.5 Consolidated statements of comprehensive income**

Philips Group

**Consolidated statements of comprehensive income** in millions of EUR unless otherwise stated

For the years ended December 31

	2013	2014	2015
<b>Net income for the period</b>	<b>1,172</b>	<b>411</b>	<b>659</b>
Pensions and other post-employment plans:			
Remeasurements	139	(972)	(101)
Income tax effect on remeasurements	(77)	289	9
Revaluation reserve:			
Release revaluation reserve	(31)	(10)	(9)
Reclassification directly into retained earnings	31	10	9
Total of items that will not be reclassified to profit or loss	62	(683)	(92)
Currency translation differences:			
Net current period change, before tax	(427)	600	643
Income tax effect	(35)	203	187
Reclassification adjustment for gain realized	(14)	(5)	(1)
Available-for-sale financial assets:			
Net current period change, before tax	(5)	30	33
Income tax effect		(4)	
Reclassification adjustment for loss (gain) realized	6	(54)	(4)
Cash flow hedges:			
Net current period change, before tax	68	(40)	(38)
Income tax effect	(2)	10	
Reclassification adjustment for loss (gain) realized	(62)	(7)	63
Total of items that are or may be reclassified to profit or loss	(471)	733	883
<b>Other comprehensive (loss) income for period</b>	<b>(409)</b>	<b>50</b>	<b>791</b>
<b>Total comprehensive income for the period</b>	<b>763</b>	<b>461</b>	<b>1,450</b>
Total comprehensive income attributable to:			
Shareholders of Koninklijke Philips N.V.	760	465	1,436
Non-controlling interests	3	(4)	14

The accompanying notes are an integral part of these consolidated financial statements.



**Table of Contents**

Group financial statements 12.6

**12.6 Consolidated balance sheets**

Philips Group  
**Consolidated balance sheets** in millions of EUR unless otherwise stated

As of December 31

	2014	2015
<b>Non-current assets</b>		
Property, plant and equipment:		
- At cost	6,844	7,217
- Less accumulated depreciation	(4,749)	(4,895)
	2,095	2,322
Goodwill	7,158	8,523
Intangible assets excluding goodwill:		
- At cost	8,020	9,251
- Less accumulated amortization	(4,652)	(5,558)
	3,368	3,693
Non-current receivables	177	191
Investments in associates	157	181
Other non-current financial assets	462	489
Non-current derivative financial assets	15	58
Deferred tax assets	2,460	2,758
Other non-current assets	69	68
<b>Total non-current assets</b>	<b>15,961</b>	<b>18,283</b>
<b>Current assets</b>		
Inventories	3,314	3,463
Current financial assets	125	12
Other current assets	411	444
Current derivative financial assets	192	103
Income tax receivable	140	114
Receivables:		
- Accounts receivable	4,476	4,727
- Accounts receivable from related parties	14	16
- Other current receivables	233	239
	4,723	4,982
Assets classified as held for sale	1,613	1,809
Cash and cash equivalents	1,873	1,766
<b>Total current assets</b>	<b>12,391</b>	<b>12,693</b>
<b>Total assets</b>	<b>28,352</b>	<b>30,976</b>



**Table of Contents**

## Group financial statements 12.6

	2014	2015
<b>Equity</b>		
Shareholders' equity:		
Preference shares, par value EUR 0.20 per share:		
- Authorized: 2,000,000,000 shares (2014: 2,000,000,000 shares), issued none		
Common shares, par value EUR 0.20 per share:		
- Authorized: 2,000,000,000 shares (2014: 2,000,000,000 shares)		
- Issued and fully paid: 931,130,387 shares (2014: 934,819,413 shares)	187	186
Capital in excess of par value	2,181	2,669
Retained earnings	8,790	8,040
Revaluation reserve	13	4
Currency translation differences	229	1,058
Available-for-sale financial assets	27	56
Cash flow hedges	(13)	12
Treasury shares, at cost 14,026,801 shares (2014: 20,430,544 shares)	(547)	(363)
	10,867	11,662
Non-controlling interests	101	118
<b>Group equity</b>	<b>10,968</b>	<b>11,780</b>
<b>Non-current liabilities</b>		
Long-term debt	3,712	4,095
Non-current derivative financial liabilities	551	695
Long-term provisions	2,500	2,392
Deferred tax liabilities	107	164
Other non-current liabilities	1,838	1,782
<b>Total non-current liabilities</b>	<b>8,708</b>	<b>9,128</b>
<b>Current liabilities</b>		
Short-term debt	392	1,665
Derivative financial liabilities	306	238
Income tax payable	102	116
Accounts and notes payable:		
- Trade creditors	2,495	2,669
- Accounts payable to related parties	4	4
	2,499	2,673
Accrued liabilities	2,692	2,863
Short-term provisions	945	833
Liabilities directly associated with assets held for sale	349	407
Other current liabilities	1,391	1,273
<b>Total current liabilities</b>	<b>8,676</b>	<b>10,068</b>
<b>Total liabilities and group equity</b>	<b>28,352</b>	<b>30,976</b>

The accompanying notes are an integral part of these consolidated financial statements.

**Table of Contents**

Group financial statements 12.7

**12.7 Consolidated statements of cash flows**

Philips Group

**Consolidated statements of cash flows** in millions of EUR unless otherwise stated

For the years ended December 31

	2013	2014	2015
<b>Cash flows from operating activities</b>			
Net income	1,172	411	659
Result of discontinued operations - net of income tax	(138)	(190)	(245)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation, amortization, and impairments of fixed assets	1,177	1,187	1,281
Impairment of goodwill and other non-current financial assets	38	21	48
Net gain on sale of assets	(54)	(83)	(110)
Interest income	(54)	(39)	(48)
Interest expense on debt, borrowings and other liabilities	258	231	278
Income taxes	466	26	239
Results from investments in associates	25	(62)	(10)
Decrease (Increase) in working capital	(1,167)	312	67
<i>Decrease (Increase) in receivables and other current assets</i>	(486)	(75)	161
<i>Decrease (Increase) in inventories</i>	(165)	(77)	22
<i>(Decrease) increase in accounts payable, accrued and other current liabilities</i>	(516)	464	(116)
Increase in non-current receivables, other assets and other liabilities	(264)	(412)	(135)
(Decrease) increase in provisions	(194)	640	(278)
Other items	299	(242)	(99)
Interest paid	(267)	(232)	(265)
Interest received	52	38	48
Dividends received from investments in associates	6	41	17
Dividends paid to non-controlling interests	(7)		
Income taxes paid	(436)	(344)	(280)
<b>Net cash provided by operating activities</b>	<b>912</b>	<b>1,303</b>	<b>1,167</b>
<b>Cash flows from investing activities</b>			
Net capital expenditures	(830)	(806)	(842)
<i>Purchase of intangible assets</i>	(49)	(114)	(121)
<i>Expenditures on development assets</i>	(326)	(295)	(314)
<i>Capital expenditures on property, plant and equipment</i>	(482)	(437)	(522)
<i>Proceeds from sales of property, plant and equipment</i>	27	40	115
Cash used for derivatives and current financial assets	(101)	(7)	(72)
Purchase of other non-current financial assets	(13)	(81)	(21)
Proceeds from other non-current financial assets	14	107	53
Purchase of businesses, net of cash acquired	(11)	(177)	(1,116)
Proceeds from sale of interests in businesses, net of cash disposed of	79	(20)	57
<b>Net cash used for investing activities</b>	<b>(862)</b>	<b>(984)</b>	<b>(1,941)</b>
<b>Cash flows from financing activities</b>			



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Proceeds from issuance (payments) of short-term debt	(285)	(37)	1,241
Principal payments on long-term debt	(186)	(333)	(104)
Proceeds from issuance of long-term debt	64	69	94
Re-issuance of treasury shares	107	117	81
Purchase of treasury shares	(669)	(713)	(506)
Dividends paid	(272)	(292)	(298)
<b>Net cash provided by (used for) financing activities</b>	<b>(1,241)</b>	<b>(1,189)</b>	<b>508</b>
<b>Net cash used for continuing operations</b>	<b>(1,191)</b>	<b>(870)</b>	<b>(266)</b>
<b>Cash flows from discontinued operations</b>			
Net cash provided by (used for) operating activities	(68)	105	79
Net cash provided by (used for) investing activities	(47)	88	
<b>Net cash (used for) provided by discontinued operations</b>	<b>(115)</b>	<b>193</b>	<b>79</b>
<b>Net cash used for continuing and discontinued operations</b>	<b>(1,306)</b>	<b>(677)</b>	<b>(187)</b>
Effect of changes in exchange rates on cash and cash equivalents	(63)	85	80
Cash and cash equivalents at the beginning of the year	3,834	2,465	1,873
<b>Cash and cash equivalents at the end of the year</b>	<b>2,465</b>	<b>1,873</b>	<b>1,766</b>

The accompanying notes are an integral part of these consolidated financial statements. For a number of reasons, principally the effects of translation differences and consolidation changes, certain items in the statements of cash flows do not correspond to the differences between the balance sheet amounts for the respective items.

**Table of Contents**

Group financial statements 12.8

**12.8 Consolidated statements of changes in equity**

Philips Group

**Consolidated statements of changes in equity** in millions of EUR unless otherwise stated

For the year ended December 31

	common shares	capital in excess of par value	retained earnings	revaluation reserve	currency translation differences	available- for-sale financial assets	cash flow hedges	treasury shares at cost	total sharehold- ers' equity	non-controlling interests	Group equity
<b>Balance as of Jan. 1, 2013</b>	<b>191</b>	<b>1,304</b>	<b>10,724</b>	<b>54</b>	<b>(93)</b>	<b>54</b>	<b>20</b>	<b>(1,103)</b>	<b>11,151</b>	<b>34</b>	<b>11,185</b>
Total comprehensive income (loss)			1,262	(31)	(476)	1	4		760	3	763
Dividend distributed	4	402	(678)						(272)		(272)
Movement in non-controlling interests										(24)	(24)
Cancellation of treasury shares	(7)		(780)					787			
Purchase of treasury shares			(38)					(631)	(669)		(669)
Re-issuance of treasury shares		(36)	(75)					229	118		118
Share-based compensation plans		105							105		105
Income tax share-based compensation plans		21							21		21
<b>Balance as of Dec. 31, 2013</b>	<b>188</b>	<b>1,796</b>	<b>10,415</b>	<b>23</b>	<b>(569)</b>	<b>55</b>	<b>24</b>	<b>(718)</b>	<b>11,214</b>	<b>13</b>	<b>11,227</b>
Total comprehensive income (loss)			(258)	(10)	798	(28)	(37)		465	(4)	461
Dividend distributed	3	433	(729)						(293)		(293)
Movement in non-controlling interests										92	92
Cancellation of treasury shares	(4)		(529)					533			
Purchase of treasury shares			(26)					(688)	(714)		(714)
Re-issuance of treasury shares		(127)	(83)					326	116		116
Share-based compensation plans		88							88		88
Income tax share-based compensation plans		(9)							(9)		(9)
<b>Balance as of Dec. 31, 2014</b>	<b>187</b>	<b>2,181</b>	<b>8,790</b>	<b>13</b>	<b>229</b>	<b>27</b>	<b>(13)</b>	<b>(547)</b>	<b>10,867</b>	<b>101</b>	<b>10,968</b>
Total comprehensive income (loss)			562	(9)	829	29	25		1,436	14	1,450
Dividend distributed	3	429	(730)						(298)		(298)
Movement in non-controlling interests										3	3
Cancellation of treasury shares	(4)		(513)					517			
Purchase of treasury shares			(12)					(495)	(507)		(507)
Re-issuance of treasury shares		(23)	(57)					162	82		82
Share-based compensation plans		101							101		101

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Income tax share-based compensation plans		(19)						(19)		(19)	
<b>Balance as of Dec. 31, 2015</b>	<b>186</b>	<b>2,669</b>	<b>8,040</b>	<b>4</b>	<b>1,058</b>	<b>56</b>	<b>12</b>	<b>(363)</b>	<b>11,662</b>	<b>118</b>	<b>11,780</b>

The accompanying notes are an integral part of these consolidated financial statements.

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**Table of Contents**

Group financial statements 12.9

**12.9 Notes**

**Notes to the Consolidated financial statements of the Philips Group**

**Significant accounting policies**

The Consolidated financial statements in the Group financial statements section have been prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed by the European Union (EU) and with the statutory provisions of Part 9, Book 2 of the Dutch Civil Code. All standards and interpretations issued by the International Accounting Standards Board (IASB) and the IFRS Interpretations Committee effective year-end 2015 have been endorsed by the EU, except that the EU did not adopt some of the paragraphs of IAS 39 applicable to certain hedge transactions. Koninklijke Philips N.V. (hereafter: the Company or 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. These accounting policies have been applied by group entities.

The Consolidated financial statements have been prepared under the historical cost convention, unless otherwise indicated. The Consolidated financial statements are presented in euro, which is the presentation currency.

On February 23, 2016, the Board of Management authorized the Consolidated financial statements for issue. The Consolidated financial statements as presented in this report are subject to adoption by the Annual General Meeting of Shareholders, to be held on May 12, 2016.

**Use of estimates**

The preparation of the Consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. These estimates inherently contain a degree of uncertainty. Actual results may differ from these estimates under different assumptions or conditions.

These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities at the date of the Consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. The Company evaluates these estimates and judgments on an ongoing basis and base our estimates on historical experience, current and expected future outcomes, third-party evaluations and various other assumptions that we believe are reasonable under the circumstances. The results of these estimates form the basis for making judgments about the carrying values of assets and liabilities as well as identifying and assessing the accounting treatment with respect to commitments and contingencies. The Company revises material estimates if changes occur in the circumstances or there is new information or experience on which an estimate was or can be based.

The areas where the most significant judgments and estimates are made are goodwill, deferred tax asset recoverability, impairments, financial instruments, the accounting for an arrangement containing a lease, revenue recognition (multiple element arrangements), assets and liabilities from employee benefit plans, other provisions, uncertain tax positions and other contingencies, classification of assets and liabilities held for sale and the presentation of items of profit and loss and cash flows as continued or discontinued, as well as when determining the fair values of acquired identifiable intangible assets based on an assessment of future cash flows.

Further judgment is applied when analyzing impairments of goodwill and intangible assets not yet ready for use that are performed annually and whenever a triggering event has occurred to determine whether the carrying value exceeds the recoverable amount. These analyses generally are based on estimates of future cash flows. Furthermore, the Company applies judgment when actuarial assumptions are established to anticipate future events and are used in calculating post-employment benefit expenses and liabilities. These factors include assumptions with respect to interest rates, rates of increase in healthcare costs, rates of future compensation increases, turnover rates and life expectancy.

**Changes in accounting policies**

The accounting policies set out in this section have been applied consistently for all periods presented in these Consolidated financial statements.

**Prior-year information**

The presentation of certain prior-year disclosures have been adjusted to align with the current year disclosures.

### **Specific choices within IFRS**

Sometimes IFRS allows alternative accounting treatments for measurement and/or disclosure. The most important of these alternative treatments are mentioned below.

#### **Tangible and intangible fixed assets**

Under IFRS, an entity shall choose either the cost model or the revaluation model as its accounting for tangible and intangible fixed assets. In this respect, items of property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. The useful lives and residual values are evaluated annually. Furthermore, the Company chose to apply the cost model meaning that costs relating to product development,

## **Table of Contents**

### [Group financial statements 12.9](#)

the development and purchase of software for internal use and other intangible assets are capitalized and subsequently amortized over the estimated useful life.

### **Employee benefit accounting**

IFRS does not specify how an entity should present its service costs related to pensions and net interest on the net defined benefit liability (asset) in the Statement of income. With regards to these elements, the Company presents service costs in Income from operations and the net interest expenses related to defined benefit plans in Financial expense.

### **Cash flow statements**

Under IFRS, an entity shall report cash flows from operating activities using either the direct method (whereby major classes of gross cash receipts and gross cash payments are disclosed) or the indirect method (whereby profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows). In this respect, the Company chose to prepare the cash flow statements using the indirect method.

Furthermore, interest cash flows are presented in cash flows from operating activities rather than financing or investing cash flows, because they enter into the determination of profit or loss. The Company chose to present dividends paid to shareholders of Koninklijke Philips N.V. as a component of cash flows from financing activities, rather than to present such dividends as operating cash flows which is an allowed alternative under IFRS.

### [Policies that are more critical in nature](#)

#### **Revenue recognition**

Revenue from the sale of goods in the course of the ordinary activities is measured at the fair value of the consideration received or receivable, net of returns, trade discounts and volume rebates. Revenue for sale of goods is recognized when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of the goods can be estimated reliably, there is no continuing involvement with goods, and the amount of revenue can be measured reliably. If it is probable that discounts will be granted and the amount can be measured reliably, then the discount is recognized as a reduction of revenue as the sales are recognized.

Transfer of risks and rewards varies depending on the individual terms of the contract of sale. For consumer-type products in the sectors Lighting and Consumer Lifestyle these criteria are met at the time the product is shipped and delivered to the customer and title and risk have passed to the customer (depending on the delivery conditions) and acceptance of the product has been obtained. Examples of delivery conditions are Free on Board point of delivery and Costs, Insurance Paid point of delivery, where the point of delivery may be the shipping warehouse or any other point of destination as agreed in the contract with the customer and where title and risk for the goods pass to the customer.

Revenues of transactions that have separately identifiable components are recognized based on their relative fair values. These transactions mainly occur in the Healthcare sector and include arrangements that require subsequent installation and training activities in order to become operable for the customer. However, since payment for the equipment is contingent upon the completion of the installation process, revenue recognition is generally deferred until the installation has been completed and the product is ready to be used by the customer in the way contractually agreed.

Revenues are recorded net of sales taxes, customer discounts, rebates and similar charges. For products for which a right of return exists during a defined period, revenue recognition is determined based on the historical pattern of actual returns, or in cases where such information is not available, revenue recognition is postponed until the return period has lapsed. Return policies are typically based on customary return arrangements in local markets.

In case of loss under a sales agreement, the loss is recognized immediately.

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Shipping and handling billed to customers is recognized as revenues. Expenses incurred for shipping and handling of internal movements of goods are recorded as cost of sales. Shipping and handling related to sales to third parties are recorded as selling expenses. When shipping and handling is part of a project and billed to the customer, then the related expenses are recorded as cost of sales. Service revenue related to repair and maintenance activities for goods sold is recognized ratably over the service period or as services are rendered.

A provision for product warranty is made at the time of revenue recognition and reflects the estimated costs of replacement and free-of-charge services that will be incurred by the Company with respect to the products. For certain products, the customer has the option to purchase an extension of the warranty, which is subsequently billed to the customer. Revenue recognition occurs on a straight-line basis over the extended warranty contract period.

Revenue from services is recognized when the Company can reliably measure the amount of revenue and the associated cost related to the stage of completion of a contract or transaction, and the recovery of the consideration is considered probable. Royalty income, which is generally earned based upon

**Table of Contents**

Group financial statements 12.9

a percentage of sales or a fixed amount per product sold, is recognized on an accrual basis based on actual or reliably estimated sales made by the licensees.

Grants from the government are recognized at their fair value where there is a reasonable assurance that the grant will be received and the Company will comply with all attached conditions. Government grants relating to costs are deferred and recognized in the Statement of income over the period necessary to match them with the costs that they are intended to compensate.

**Income tax**

Income tax comprises current and deferred tax. Income tax is recognized in the Statement of income except to the extent that it relates to items recognized directly within equity or in other comprehensive income. Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially-enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax assets and liabilities are recognized, using the balance sheet method, for the expected tax consequences of temporary differences between the carrying amounts of assets and liabilities and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantially-enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally-enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income in the countries where the deferred tax assets originated and during the periods when the deferred tax assets become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment.

Deferred tax liabilities for withholding taxes are recognized for subsidiaries in situations where the income is to be paid out as dividend in the foreseeable future and for undistributed earnings of unconsolidated companies to the extent that these withholding taxes are not expected to be refundable or deductible. Changes in tax rates are reflected in the period when the change has been enacted or substantially-enacted by the reporting date.

**Provisions**

Provisions are recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax discount rate that reflects current market assessments of the time value of money. The increase in the provision due to passage of time is recognized as interest expense. The accounting and presentation for some of the Company's provisions is as follows:

**Product warranty** A provision for warranties is recognized when the underlying products or services are sold. The provision is based on historical warranty data and a weighing of possible outcomes against their associated probabilities.

**Environmental provisions** Measurement of liabilities associated with environmental obligations, is based on current legal and constructive requirements. Liabilities and expected insurance recoveries, if any, are recorded separately. The carrying amount of environmental liabilities is regularly reviewed and adjusted for new facts and changes in law.



**Restructuring-related provisions** The provision for restructuring relates to the estimated costs of initiated restructurings, the most significant of which have been approved by the Executive Committee, and which generally involve the realignment of certain parts of the industrial and commercial organization. When such restructurings require discontinuance and/or closure of lines of activities, the anticipated costs of closure or discontinuance are included in restructuring provisions. A liability is recognized for those costs only when the Company has a detailed formal plan for the restructuring and has raised a valid expectation with those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it. Before a provision is established, the Company recognizes any impairment loss on the assets associated with the restructuring.

**Litigation provisions** In relation to legal claim provisions and settlements, the relevant balances are transferred to Other liabilities at the point the amount and timing of cash outflows are no longer uncertain.

## **Table of Contents**

### [Group financial statements 12.9](#)

Settlements which are agreed for amounts in excess of existing provisions are reflected as increases of Other liabilities.

#### **Goodwill**

The measurement of goodwill at initial recognition is described under Basis of consolidation below. Goodwill is subsequently measured at cost less accumulated impairment losses. In respect of investments in associates, the carrying amount of goodwill is included in the carrying amount of investment, and an impairment loss on such investment is allocated to the investment as a whole.

#### **Intangible assets other than goodwill**

Acquired finite-lived intangible assets are amortized using the straight-line method over their estimated useful life. The useful lives are evaluated annually. Patents and trademarks with a finite useful life acquired from third parties either separately or as part of a business combination are capitalized at cost and amortized over their remaining useful lives. Intangible assets acquired as part of a business combination are capitalized at their acquisition-date fair value.

The Company expenses all research costs as incurred. Expenditure on development activities, whereby research findings are applied to a plan or design for the production of new or substantially improved products and processes, is capitalized as an intangible asset if the product or process is technically and commercially feasible and the Company has sufficient resources and the intention to complete development.

The development expenditure capitalized comprises of all directly attributable costs (including the cost of materials and direct labor). Other development expenditures and expenditures on research activities are recognized in the Statement of income. Capitalized development expenditure is stated at cost less accumulated amortization and impairment losses. Amortization of capitalized development expenditure is charged to the Statement of income on a straight-line basis over the estimated useful lives of the intangible assets.

#### **Discontinued operations and non-current assets held for sale**

Non-current assets (disposal groups comprising assets and liabilities) that are expected to be recovered primarily through sale rather than through continuing use are classified as held for sale.

A discontinued operation is a component of an entity that either has been disposed of, or that is classified as held for sale, and (a) represents a separate major line of business or geographical area of operations; and (b) is a part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations; or (c) is a subsidiary acquired exclusively with a view to sell.

Non-current assets held for sale and discontinued operations are carried at the lower of carrying amount or fair value less cost to sell. Any gain or loss from disposal, together with the results of these operations until the date of disposal, is reported separately as discontinued operations. The financial information of discontinued operations is excluded from the respective captions in the Consolidated financial statements and related notes for all periods presented. Comparatives in the balance sheet are not re-presented when a non-current asset or disposal group is classified as held for sale. Comparatives are re-presented for presentation of discontinued operations in the Statement of cash flow and Statement of income.

Adjustments in the current period to amounts previously presented in discontinued operations that are directly related to the disposal of a discontinued operation in a prior period are classified separately in discontinued operations. Circumstances to which these adjustments may relate include resolution of uncertainties that arise from the terms of the disposal transaction, such as the resolution of purchase price adjustments and indemnifications, resolution of uncertainties that arise from and are directly related to the operations of the component before its disposal, such as environmental and product warranty obligations retained by the Company, or the settlement of employee benefit plan obligations provided that the settlement is directly related to the disposal transaction.

#### **Impairment**

### [Impairment of goodwill and intangible assets not yet ready for use](#)

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Goodwill and intangible assets not yet ready for use are not amortized but tested for impairment annually and whenever impairment indicators require. In most cases the Company identified its cash generating units for goodwill at one level below that of an operating segment. Cash flows at this level are substantially independent from other cash flows and this is the lowest level at which goodwill is monitored by the Executive Committee. The Company performed and completed annual impairment tests in the same quarter of all years presented in the Statements of income. An impairment loss is recognized in the Statement of income whenever and to the extent that the carrying amount of a cash-generating unit exceeds the unit's recoverable amount, which is the greater of its value in use and fair value less cost to sell. Value in use is measured as the present value of future cash flows expected to be generated by the asset.

### [Impairment of non-financial assets other than goodwill, intangible assets not yet ready for use, inventories and deferred tax assets](#)

Non-financial assets other than goodwill, intangible assets not yet ready for use, inventories and deferred tax assets are reviewed for impairment whenever events or changes in circumstances indicate that the

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**Table of Contents**[Group financial statements 12.9](#)

carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is recognized and measured by a comparison of the carrying amount of an asset with the greater of its value in use and fair value less cost to sell. Value in use is measured as the present value of future cash flows expected to be generated by the asset. If the carrying amount of an asset is deemed not recoverable, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the recoverable amount. The review for impairment is carried out at the level where cash flows occur that are independent of other cash flows.

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if and to the extent there has been a change in the estimates used to determine the recoverable amount. The loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized. Reversals of impairment are recognized in the Statement of income.

**Impairment of financial assets**

A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset. In case of available-for-sale financial assets, a significant or prolonged decline in the fair value of the financial assets below its cost is considered an indicator that the financial assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the Statement of income - is reclassified from the fair value reserve in equity (through Other comprehensive income) to the Statement of income.

If objective evidence indicates that financial assets that are carried at cost need to be tested for impairment, calculations are based on information derived from business plans and other information available for estimating their fair value, which is based on estimated future cash flows discounted at the asset's original effective interest rate. Any impairment loss is charged to the Statement of income.

An impairment loss related to financial assets is reversed if in a subsequent period, the fair value increases and the increase can be related objectively to an event occurring after the impairment loss was recognized. The loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined if no impairment loss had been recognized. Reversals of impairment are recognized in the Statement of income except for reversals of impairment of available-for-sale equity securities, which are recognized in Other comprehensive income.

**Other policies****Basis of consolidation**

The Consolidated financial statements comprise the financial statements of Koninklijke Philips N.V. and all subsidiaries that the Company controls, i.e. when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The existence and effect of potential voting rights are considered when assessing whether the Company controls another entity. Subsidiaries are fully consolidated from the date that control commences until the date that control ceases. All intercompany balances and transactions have been eliminated in the Consolidated financial statements. Unrealized losses are eliminated in the same way as unrealized gains, but only to the extent that there is no evidence of impairment.

**Business combinations**

Business combinations are accounted for using the acquisition method. Under the acquisition method, the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree are recognized at the acquisition date, which is the date on which control is transferred to the Company.

The Company measures goodwill at the acquisition date as:

the fair value of the consideration transferred; plus

the recognized amount of any non-controlling interest in the acquiree; plus

if the business combination is achieved in stages, the fair value of the existing equity interest in the acquiree; less

the net recognized amount (generally fair value) of the identifiable assets acquired and liabilities assumed.

Costs related to the acquisition, other than those associated with the issue of debt or equity securities, that the Company incurs are expensed as incurred.

Any contingent consideration payable is recognized at fair value at the acquisition date and initially is presented as Long-term provisions. When the timing and amount of the consideration become more certain, it is reclassified to Accrued liabilities. If the contingent consideration that meets the definition of a financial instrument is classified as equity, it is not remeasured and settlement is accounted for within equity. Otherwise, subsequent changes to the fair value of the contingent consideration are recognized in the Statement of income.

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**Table of Contents**[Group financial statements 12.9](#)

Non-controlling interests are measured at their proportionate share of the acquiree's identifiable net assets at the date of acquisition.

[Acquisitions of and adjustments to non-controlling interests](#)

Acquisitions of non-controlling interests are accounted for as transactions with owners in their capacity as owners and therefore no goodwill is recognized. Adjustments to non-controlling interests arising from transactions that do not involve the loss of control are based on a proportionate amount of the net assets of the subsidiary.

[Loss of control](#)

Upon the loss of control, the Company derecognizes the assets and liabilities of the subsidiary, any non-controlling interests and the other components of equity related to the subsidiary. Any surplus or deficit arising on the loss of control is recognized in the Statement of income. If the Company retains any interest in the previous subsidiary, then such interest is measured at fair value at the date the control is lost. Subsequently it is accounted for as either an equity-accounted investee (associate) or as an available-for-sale financial asset, depending on the level of influence retained.

[Investments in associates \(equity-accounted investees\)](#)

Associates are all entities over which the Company has significant influence, but does not control. Significant influence is presumed with a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognized at cost. The Company's investments in associates includes goodwill identified on acquisition, net of any accumulated impairment loss.

The Company's share of the net income of these companies is included in Results relating to investments in associates in the Statement of income, after adjustments to align the accounting policies with those of the Company, from the date that significant influence commences until the date that significant influence ceases. Dilution gains and losses arising from investments in associates are recognized in the Statement of income as part of Other results relating to investments in associates. When the Company's share of losses exceeds its interest in an associate, the carrying amount of that interest (including any long-term loans) is reduced to zero and recognition of further losses is discontinued except to the extent that the Company has incurred legal or constructive obligations or made payments on behalf of the associate. Unrealized gains on transactions between the Company and its associates are eliminated to the extent of the Company's interest in the associates. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Remeasurement differences of an equity stake resulting from gaining control over the investee previously recorded as associate are recorded under Results relating to investments in associates.

**Foreign currencies**[Foreign currency transactions](#)

The financial statements of all group entities are measured using the currency of the primary economic environment in which the entity operates (functional currency). The euro (EUR) is the functional currency of the Company and presentation currency of the Group financial statements. Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are remeasured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the Statement of income, except when deferred in Other comprehensive income as qualifying cash flow hedges and qualifying net investment hedges.

Foreign currency differences arising from translation are recognized in the Statement of income, except for available-for-sale equity investments which are recognized in Other comprehensive income, unless regarding an impairment in which case foreign currency differences that have been recognized in Other comprehensive income are reclassified to the Statement of income.

All exchange difference items are presented as part of Cost of sales, with the exception of tax items and financial income and expense, which are recognized in the same line item as they relate in the Statement of income.

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Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency using the exchange rate at the date the fair value was determined. Non-monetary items in a foreign currency that are measured based on historical cost are translated using the exchange rate at the transaction date.

### Foreign operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated to euro at exchange rates at the reporting date. The income and expenses of foreign operations are translated to euro at exchange rates at the dates of the transactions.

Foreign currency differences arising on translation of foreign operations into euro are recognized in Other comprehensive income, and presented as part of Currency translation differences in Equity. However, if

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**Table of Contents**[Group financial statements 12.9](#)

the operation is a non-wholly owned subsidiary, then the relevant proportionate share of the translation difference is allocated to Non-controlling interests.

When a foreign operation is disposed of such that control, significant influence or joint control is lost, the cumulative amount in the Currency translation differences related to the foreign operation is reclassified to the Statement of income as part of the gain or loss on disposal. When the Company disposes of only part of its interest in a subsidiary that includes a foreign operation while retaining control, the respective proportion of the cumulative amount is reattributed to Non-controlling interests. When the Company disposes of only part of its investment in an associate or joint venture that includes a foreign operation while retaining significant influence or joint control, the relevant proportion of the cumulative amount is reclassified to the Statement of income.

**Financial instruments**[Non-derivative financial instruments](#)

Non-derivative financial instruments are recognized initially at fair value when the Company becomes a party to the contractual provisions of the instrument.

Regular way purchases and sales of financial assets are accounted for at the trade date. Dividend and interest income are recognized when earned. Gains or losses, if any, are recorded in Financial income and expense.

Non-derivative financial instruments comprise cash and cash equivalents, receivables, other non-current financial assets, debt and other financial liabilities that are not designated as hedges.

[Cash and cash equivalents](#)

Cash and cash equivalents include all cash balances and short-term highly liquid investments with an original maturity of three months or less that are readily convertible into known amounts of cash.

[Receivables](#)

Receivables are carried at the lower of amortized cost or the present value of estimated future cash flows, taking into account discounts given or agreed. The present value of estimated future cash flows is determined through the use of value adjustments for uncollectible amounts. As soon as individual trade accounts receivable can no longer be collected in the normal way and are expected to result in a loss, they are designated as doubtful trade accounts receivable and valued at the expected collectible amounts. They are written off when they are deemed to be uncollectible because of bankruptcy or other forms of receivership of the debtors. The allowance for the risk of non-collection of trade accounts receivable takes into account credit-risk concentration, collective debt risk based on average historical losses, and specific circumstances such as serious adverse economic conditions in a specific country or region.

[Other non-current financial assets](#)

Other non-current financial assets include held-to-maturity investments, loans receivable and available-for-sale financial assets and financial assets at fair value through profit or loss.

Held-to-maturity investments are those debt securities which the Company has the ability and intent to hold until maturity. Held-to-maturity debt investments are recorded at amortized cost, adjusted for the amortization or accretion of premiums or discounts using the effective interest method.

Loans receivable are stated at amortized cost, less impairment.

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale and that are not classified in any of the other categories of financial assets. Subsequent to initial recognition, they are measured at fair value and changes therein, other than



impairment losses and foreign currency differences on available for sale-debt instruments are recognized in Other comprehensive income and presented in the fair value reserve in equity. When an investment is derecognized, the gain or loss accumulated in equity is reclassified to the Statement of income.

Available-for-sale financial assets including investments in privately-held companies that are not associates, and do not have a quoted market price in an active market and whose fair value could not be reliably determined, are carried at cost.

A financial asset is classified as fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated as fair value through profit or loss if the Company manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Company's documented risk management or investment strategy. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognized in the Statement of income. Attributable transaction costs are recognized in the Statement of income as incurred.

## Equity

Common shares are classified as equity. Incremental costs directly attributable to the issuance of shares are recognized as a deduction from equity. Where the Company purchases the Company's equity share capital (treasury shares), the consideration paid, including any directly attributable incremental transaction costs (net of income taxes), is deducted from equity attributable to the Company's equity holders until the shares are cancelled or reissued. Where such ordinary shares are subsequently reissued, any consideration received, net of any directly

## **Table of Contents**

### [Group financial statements 12.9](#)

attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Company's equity holders.

Dividends are recognized as a liability in the period in which they are declared. The income tax consequences of dividends are recognized when a liability to pay the dividend is recognized.

### [Debt and other liabilities](#)

Debt and liabilities other than provisions are stated at amortized cost.

### [Derivative financial instruments, including hedge accounting](#)

The Company uses derivative financial instruments principally to manage its foreign currency risks and, to a more limited extent, for managing interest rate and commodity price risks. All derivative financial instruments are accounted for at the trade date and classified as current or non-current assets or liabilities based on the maturity date or the earlier termination date. Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related. The Company measures all derivative financial instruments at fair value derived from market prices of the instruments, or calculated as the present value of the estimated future cash flows based on observable interest yield curves, basis spread, credit spreads and foreign exchange rates, or from option pricing models, as appropriate. Gains or losses arising from changes in fair value of derivatives are recognized in the Statement of income, except for derivatives that are highly effective and qualify for cash flow or net investment hedge accounting.

Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a cash flow hedge, are recorded in Other comprehensive income, until the Statement of income is affected by the variability in cash flows of the designated hedged item. To the extent that the hedge is ineffective, changes in the fair value are recognized in the Statement of income.

The Company formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. When it is established that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Company discontinues hedge accounting prospectively. When hedge accounting is discontinued because it is expected that a forecasted transaction will not occur, the Company continues to carry the derivative on the Balance sheet at its fair value, and gains and losses that were accumulated in equity are recognized immediately in the Statement of income.

Foreign currency differences arising on the retranslation of financial instruments designated as a hedge of a net investment in a foreign operation are recognized directly as a separate component of equity through Other comprehensive income, to the extent that the hedge is effective. To the extent that the hedge is ineffective, such differences are recognized in the Statement of income.

### [Offsetting and master netting agreements](#)

The Company presents financial assets and financial liabilities on a gross basis as separate line items in the Consolidated balance sheet.

Master netting agreements may be entered into when the Company undertakes a number of financial instrument transactions with a single counterparty. Such an agreement provides for a net settlement of all financial instruments covered by the agreement in the event of default or certain termination events on any of the transactions. A master netting agreement may create a right of offset that becomes enforceable and affects the realization or settlement of individual financial assets and financial liabilities only following a specified termination event. However, if this contractual right is subject to certain limitations then it does not necessarily provide a basis for offsetting unless both of the offsetting criteria are met, i.e. there is a legally enforceable right and an intention to settle net or simultaneously.

### **Property, plant and equipment**

The costs of Property, plant and equipment comprises of all directly attributable costs (including the cost of material and direct labor). Government grants for assets are deducted from the cost of the related asset.

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Depreciation is generally calculated using the straight-line method over the useful life of the asset. Gains and losses on the sale of property, plant and equipment are included in Other business income. Costs related to repair and maintenance activities are expensed in the period in which they are incurred unless leading to an extension of the original lifetime or capacity.

Plant and equipment under finance leases and leasehold improvements are amortized using the straight-line method over the shorter of the lease term or the estimated useful life of the asset. The gain realized on sale and operating leaseback transactions that are concluded based upon market conditions is recognized at the time of the sale.

### **Leased assets**

Leases in which the Company is the lessee and has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the commencement of the lease at the lower of the fair value of the leased assets and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges. The interest element of the finance

**Table of Contents**[Group financial statements 12.9](#)

cost is charged to the Statement of income over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The corresponding rental obligations, net of finance charges, are included in other short-term and other non-current liabilities. The property, plant and equipment acquired under finance leases is depreciated over the shorter of the useful life of the assets and the lease term.

Leases in which the Company is the lessee and in which substantially all risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are recognized in the Statement of income on a straight-line basis over the term of the lease.

**Inventories**

Inventories are stated at the lower of cost or net realizable value. The cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. The costs of conversion of inventories include direct labor and fixed and variable production overheads, taking into account the stage of completion and the normal capacity of production facilities. Costs of idle facility and abnormal waste are expensed. The cost of inventories is determined using the first-in, first-out (FIFO) method. Inventory is reduced for the estimated losses due to obsolescence. This reduction is determined for groups of products based on purchases in the recent past and/or expected future demand.

**Employee benefit accounting**

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognized as an employee benefit expense in the Statement of income in the periods during which services are rendered by employees.

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. Plans for which the Company has no legal or constructive obligation to pay further amounts, however for which contributions paid by the Company are not fixed, are also treated as defined benefit plan. The net pension asset or liability recognized in the Consolidated balance sheets in respect of defined benefit post-employment plans is the fair value of plan assets less the present value of the projected defined benefit obligation (DBO) at the balance sheet date. The projected defined benefit obligation is calculated annually by qualified actuaries using the projected unit credit method. Recognized assets are limited to the present value of any reductions in future contributions or any future refunds.

For the Company's major plans, a full discount rate curve of high-quality corporate bonds is used to determine the defined benefit obligation. The curves are based on Towers Watson's RATE:Link methodology which uses data of corporate bonds rated AA or equivalent. For the other plans a single point discount rate is used based on corporate bonds for which there is a deep market and the plan's maturity. Plans in countries without a deep corporate bond market use a discount rate based on the local sovereign curve and the plan's maturity.

Pension costs in respect of defined benefit post-employment plans primarily represent the increase of the actuarial present value of the obligation for post-employment benefits based on employee service during the year and the interest on the net recognized asset or liability in respect of employee service in previous years.

Remeasurements of the net defined benefit liability comprise actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (excluding interest). The Company recognizes all remeasurements in Other comprehensive income.

The Company recognizes gains and losses on the settlement of a defined benefit plan when the settlement occurs. The gain or loss on settlement is the difference between the present value of the defined benefit obligation being settled, as determined on the date of settlement, and the settlement price, including any plan assets transferred and any payments made directly by the Company in connection with the settlement. In this respect, the amount of the plan assets transferred is adjusted for the effect of the asset ceiling. Past service costs following from the introduction of a change to the benefit payable under a plan or a significant reduction of the number of employees covered by a plan (curtailment), are recognized in full in the Statement of income.

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. The Company recognizes a liability and an expense for bonuses and incentives based on a formula that takes into consideration the profit attributable

to the Company's shareholders after certain adjustments.

The Company's net obligation in respect of long-term employee benefits is the amount of future benefit that employees have earned in return for their service in the current and prior periods, such as jubilee entitlements. That benefit is discounted to determine its present value. Remeasurements are recognized in the Statement of income in the period in which they arise.

**Share-based payment**

The grant-date fair value of equity-settled share-based payment awards granted to employees is recognized as personnel expense, with a

## **Table of Contents**

### **Group financial statements 12.9**

corresponding increase in equity, over the vesting period of the award. The Company uses the Black-Scholes option-pricing model and Monte Carlo sampling to determine the fair value of the awards, depending on the type of instruments granted and certain vesting conditions.

### **Financial income and expenses**

Financial income comprises interest income on funds invested (including available-for-sale financial assets), dividend income, net gains on the disposal of available-for-sale financial assets, net fair value gains on financial assets at fair value through profit or loss, net gains on the remeasurement to fair value of any preexisting available-for-sale interest in an acquiree, and net gains on foreign exchange impacts that are recognized in the Statement of income.

Interest income is recognized on accrual basis in the Statement of income, using the effective interest method. Dividend income is recognized in the Statement of income on the date that the Company's right to receive payment is established, which in the case of quoted securities is normally the ex-dividend date.

Financial expenses comprise interest expenses on borrowings, unwinding of the discount on provisions and contingent consideration, losses on disposal of available-for-sale financial assets, net fair value losses on financial assets at fair value through profit or loss, impairment losses recognized on financial assets (other than trade receivables), net interest expenses related to defined benefit plans and net losses on foreign exchange impacts that are recognized in the Statement of income.

### **Financial guarantees**

The Company recognizes a liability at the fair value of the obligation at the inception of a financial guarantee contract. The guarantee is subsequently measured at the higher of the best estimate of the obligation or the amount initially recognized.

### **Cash flow statements**

Cash flows arising from transactions in a foreign currency are translated in the Company's functional currency using the exchange rate at the date of the cash flow. Cash flows from derivative instruments that are accounted for as cash flow hedges are classified in the same category as the cash flows from the hedged items. Cash flows from other derivative instruments are classified as investing cash flow.

### **Segment information**

Operating segments are components of the Company's business activities about which separate financial information is available that is evaluated regularly by the chief operating decision maker (the Executive Committee of the Company). The Executive Committee decides how to allocate resources and assesses performance. Reportable segments comprise the operating sectors Healthcare, Consumer Lifestyle and Lighting. Innovation, Group & Services (IG&S) is a sector but not a separate reportable segment and holds, among others, headquarters, overhead and regional/ country organization expenses. Segment accounting policies are the same as the accounting policies applied by the Company.

### **Earnings per Share**

The Company presents basic and diluted earnings per share (EPS) data for its common shares. Basic EPS is calculated by dividing the Net income (loss) attributable to shareholders by the weighted average number of common shares outstanding during the period, adjusted for own shares held. Diluted EPS is determined by adjusting the Net income (loss) attributable to shareholders and the weighted average number of common shares outstanding during the period, adjusted for own shares held, for the effects of all dilutive potential common shares, which comprises of restricted shares, performance shares and share options granted to employees.

### **New standards and interpretations**

#### **IFRS accounting standards adopted as from 2015**

The Company has adopted the following amended standard as of January 1, 2015:

[Defined Benefit Plans: Employee Contributions \(Amendments to IAS 19\)](#)

The amendment introduces a relief regarding the accounting for contributions from employees related to defined benefit plans that involve such contributions. The relief is that when certain conditions are met, a company is permitted (but not required) to recognize the employee contributions as a reduction of the service cost in the period in which the related service is rendered. The amendments apply retrospectively for annual periods beginning on or after July 1, 2014.

Philips traditionally deducted employee contributions from service cost as per the above, that became formal guidance with the issuance of this amendment. As such, there was no retrospective impact of the implementation of this amendment.

Changes to other policies, following from amendments to standards, interpretations and the annual improvement cycles, did not have a material impact on the Group financial statements. In case of the absence of explicit transition requirements for new accounting pronouncements, the Company accounts for any change in accounting policies retrospectively.

**IFRS accounting standards to be adopted as from 2016 and onwards**

A number of new standards and amendments to existing standards have been published and are mandatory for the Company beginning on or after January 1, 2016 or later periods, and the Company has not early adopted them. Those which may be the most

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## **Table of Contents**

[Group financial statements 12.9](#)

relevant to the Company are set out below. Changes to other standards, following from amendments and the annual improvement cycles, are not expected to have a material impact on the Company's financial statements.

### [IFRS 9 Financial Instruments](#)

IFRS 9 Financial Instruments brings together the classification and measurement, impairment and hedge accounting phases of the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement.

IFRS 9 adds a new expected loss impairment model and amendments to classification and measurement for financial assets. The impairment model is based on the concept of providing for expected losses at inception of a contract, except in the case of purchased or originated credit-impaired financial assets, where expected credit losses are incorporated into the effective interest rate.

The standard supersedes all previous versions of IFRS 9 and is effective for periods beginning on or after January 1, 2018. It is not yet endorsed by the EU. The Company is currently in the process of assessing the impact of the new Standard.

### [IFRS 15 Revenue from Contracts with Customers](#)

IFRS 15 specifies how and when revenue is recognized as well as describes more informative and relevant disclosures. The standard supersedes IAS 18 Revenue, IAS 11 Construction Contracts and a number of revenue-related interpretations.

The new standard provides a single, principles based five-step model to be applied to all contracts with customers. Furthermore, it provides new guidance on whether revenue should be recognized at a point in time or over time. The standard also introduces new guidance on costs of fulfilling and obtaining a contract, specifying the circumstances in which such costs should be capitalized. Costs that do not meet the criteria must be expensed when incurred.

IFRS 15 must be applied for periods beginning on or after January 1, 2018. It is not yet endorsed by the EU. The Company is currently assessing the impact of the new standard.

### [IFRS 16 Leases](#)

For lessees, IFRS 16 (issued on January 13, 2016) requires most leases to be recognized on-balance (under a single model), eliminating the distinction between operating and finance leases. Lessor accounting however remains largely unchanged and the distinction between operating and finance leases is retained. IFRS 16 supersedes IAS 17 Leases and related interpretations.

Under IFRS 16 a lessee recognizes a right-of-use asset and a lease liability. The right-of-use asset is treated similarly to other non-financial assets and is depreciated accordingly. The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease if that can be readily determined, and the liability accrues interest. As with current IAS 17, under IFRS 16 lessors classify leases as operating or finance in nature.

IFRS 16 must be applied for periods beginning on or after January 1, 2019, with earlier adoption permitted if abovementioned IFRS 15 has also been applied. IFRS 16 is not yet endorsed by the EU. The Company is currently assessing the impact of the new standard.

Annual Report 2015 151



**Table of Contents**

Group financial statements 12.9

**Information by sector and main country**

Philips Group

**Information on income statement and cash flow by sector** in millions of EUR unless otherwise stated

2013 - 2015

	sales	sales including intercompany	research and development expenses	income from operations	income from operations as a % of sales	cash flow before financing activities
<b>2015</b>						
Healthcare	10,912	10,933	(1,073)	819	7.5%	81
Consumer Lifestyle	5,347	5,360	(301)	621	11.6%	589
Lighting	7,411	7,454	(315)	486	6.6%	642
Innovation, Group & Services	574	777	(238)	(934)		(2,086)
Inter-sector eliminations		(280)				
<b>Philips Group</b>	<b>24,244</b>	<b>24,244</b>	<b>(1,927)</b>	<b>992</b>	<b>4.1%</b>	<b>(774)</b>
<b>2014</b>						
Healthcare	9,186	9,209	(822)	456	5.0%	910
Consumer Lifestyle	4,731	4,739	(263)	520	11.0%	553
Lighting	6,869	6,927	(330)	185	2.7%	442
Innovation, Group & Services	605	934	(220)	(675)		(1,586)
Inter-sector eliminations		(418)				
<b>Philips Group</b>	<b>21,391</b>	<b>21,391</b>	<b>(1,635)</b>	<b>486</b>	<b>2.3%</b>	<b>319</b>
<b>2013</b>						
Healthcare	9,575	9,600	(810)	1,315	13.7%	1,292
Consumer Lifestyle	4,605	4,622	(268)	429	9.3%	480
Lighting	7,145	7,211	(313)	413	5.8%	418
Innovation, Group & Services	665	977	(268)	(302)		(2,140)
Inter-sector eliminations		(420)				
<b>Philips Group</b>	<b>21,990</b>	<b>21,990</b>	<b>(1,659)</b>	<b>1,855</b>	<b>8.4%</b>	<b>50</b>

In 2015, our sectors were organized based on the nature of the products and services. The four sectors comprised Healthcare, Consumer Lifestyle, Lighting and Innovation, Group & Services. A short description of these sectors is as follows:

Healthcare consisted of the following businesses - Imaging Systems, Healthcare Informatics, Services & Solutions, Patient Care & Monitoring Solutions, and Customer Services.

Consumer Lifestyle consisted of the following businesses - Personal Care, Domestic Appliances, and Health & Wellness.

Lighting consisted of the following businesses - Light Sources & Electronics, Professional Lighting Solutions, and Consumer Luminaires.

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Innovation, Group & Services consisted of group headquarters, as well as the overhead expenses of regional and country organizations. Also included are the net results of group innovation, intellectual property & services, the global service units and Philips pension and other postretirement benefit costs not directly allocated to the other sectors.

Transactions between the sectors mainly related to services provided by the sector Innovation, Group & Services to the other sectors. The pricing of such transactions was determined on an arm's length basis.

From an external financial reporting perspective, it should be noted that Royal Philips will introduce new segment reporting, from Q1 2016 onwards. The new reporting structure will be based on different segments than the sectors currently presented and discussed in this Annual Report. Philips health technology activities will be reported in three segments (Personal Health, Diagnosis & Treatment, Connected Care & Health Informatics), the Philips Lighting businesses within one segment, and the remaining unallocated corporate items will contain certain legacy items and separation costs. For more details on the new segment reporting in 2016 and onwards, please refer to the introduction of chapter 6, Sector performance, of this report.

**Table of Contents**

Group financial statements 12.9

Philips Group

**Information on balance sheet and capital expenditure** in millions of EUR

2013 - 2015

	total assets	net operating capital	total liabilities excl. debt	current accounts receivable, net	tangible and intangible assets	depreciation and amortization <sup>1)</sup>	capital expenditures
<b>2015</b>							
Healthcare	13,363	9,212	4,095	2,343	8,587	(618)	154
Consumer Lifestyle	3,080	1,453	1,627	853	1,658	(205)	107
Lighting	5,875	3,813	2,043	1,442	3,303	(281)	88
Innovation, Group & Services	6,849	(3,382)	5,264	89	990	(177)	173
<b>Sector totals</b>	<b>29,167</b>	<b>11,096</b>	<b>13,029</b>	<b>4,727</b>	<b>14,538</b>	<b>(1,281)</b>	<b>522</b>
Assets classified as held for sale	1,809		407				
<b>Total assets/liabilities (excl. debt)</b>	<b>30,976</b>		<b>13,436</b>				
<b>2014</b>							
Healthcare	11,274	7,565	3,629	2,112	6,934	(480)	127
Consumer Lifestyle	3,049	1,353	1,696	791	1,647	(198)	109
Lighting	5,739	3,638	2,081	1,438	3,167	(351)	84
Innovation, Group & Services	6,677	(3,718)	5,525	135	873	(158)	117
<b>Sector totals</b>	<b>26,739</b>	<b>8,838</b>	<b>12,931</b>	<b>4,476</b>	<b>12,621</b>	<b>(1,187)</b>	<b>437</b>
Assets classified as held for sale	1,613		349				
<b>Total assets/liabilities (excl. debt)</b>	<b>28,352</b>		<b>13,280</b>				
<b>2013</b>							
Healthcare	10,465	7,437	2,943	1,978	6,467	(517)	132
Consumer Lifestyle	2,832	1,261	1,571	743	1,574	(199)	135
Lighting	6,711	4,462	2,229	1,567	3,857	(333)	117
Innovation, Group & Services	6,044	(2,922)	4,340	132	648	(128)	98
<b>Sector totals</b>	<b>26,052</b>	<b>10,238</b>	<b>11,083</b>	<b>4,420</b>	<b>12,546</b>	<b>(1,177)</b>	<b>482</b>
Assets classified as held for sale	507		348				
<b>Total assets/liabilities (excl. debt)</b>	<b>26,559</b>		<b>11,431</b>				

<sup>1)</sup> Includes impairments of tangible and intangible assets excluding goodwill  
Philips Group

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Goodwill assigned to sectors in millions of EUR

2014 - 2015

	carrying value							
	at January 1	reclassification	acquisitions	purchase price allocation adjustment	impairments	divestments and transfers to assets classified as held for sale	translation differences	carrying value at December 31
<b>2015</b>								
Healthcare	4,779		636				514	5,929
Consumer Lifestyle	686						47	733
Lighting	1,676			8		(1)	161	1,844
Innovation, Group & Services	17					1	(1)	17
<b>Philips Group</b>	<b>7,158</b>		<b>636</b>	<b>8</b>			<b>721</b>	<b>8,523</b>
<b>2014</b>								
Healthcare	4,275		1	8		(2)	497	4,779
Consumer Lifestyle	632						54	686
Lighting	1,586		58			(155)	187	1,676
Innovation, Group & Services	11		9			(3)		17
<b>Philips Group</b>	<b>6,504</b>		<b>68</b>	<b>8</b>		<b>(160)</b>	<b>738</b>	<b>7,158</b>

Annual Report 2015 153

**Table of Contents**

Group financial statements 12.9

Philips Group

**Main countries** in millions of EUR

2013 - 2015

	sales <sup>1)</sup>	tangible and intangible assets
<b>2015</b>		
Netherlands	639	970
United States	7,522	9,291
China	2,774	1,194
Germany	1,357	170
Japan	992	455
India	845	134
France	806	48
Other countries	9,309	2,276
<b>Total main countries</b>	<b>24,244</b>	<b>14,538</b>
Assets classified as held for sale		1,159
<b>Total tangible and intangible assets</b>		<b>15,697</b>
<b>2014</b>		
Netherlands	594	937
United States	6,160	7,649
China	2,362	1,135
Germany	1,351	153
Japan	908	379
France	839	52
United Kingdom	722	594
Other countries	8,455	1,722
<b>Total main countries</b>	<b>21,391</b>	<b>12,621</b>
Assets classified as held for sale		989
<b>Total tangible and intangible assets</b>		<b>13,610</b>
<b>2013</b>		
Netherlands	649	915
United States	6,325	7,384
China	2,616	1,057
Germany	1,316	288
Japan	943	401
France	890	80
United Kingdom	677	573
Other countries	8,574	1,848
<b>Total main countries</b>	<b>21,990</b>	<b>12,546</b>
Assets classified as held for sale		62

**Total tangible and intangible assets****12,608**

<sup>1)</sup> The sales are reported based on country of destination.

**Discontinued operations and other assets classified as held for sale**

Discontinued operations included in the Consolidated statements of income and the Consolidated statements of cash flows consist of the combined Lumileds and Automotive businesses and certain other divestments reported as discontinued operations.

**Discontinued operations: Combined Lumileds and Automotive businesses**

The combined businesses of Lumileds and Automotive were reported as discontinued operations in the Consolidated statements of income and Consolidated statements of cash flows with the related assets and liabilities as per the end of November 2014 included as

Assets classified as held for sale and Liabilities directly associated with assets held for sale in the Consolidated balance sheet.

As announced on January 22, 2016, Philips and GO Scale Capital have withdrawn their filing with the Committee on Foreign Investment in the United States (CFIUS) and terminated the agreement pursuant to which the consortium led by GO Scale Capital would have acquired an 80.1% interest in the combined businesses of Lumileds and Automotive. Despite the parties' extensive efforts to mitigate CFIUS' concern, regulatory clearance has not been granted for this particular transaction. Philips is actively engaging with other parties that have expressed an interest in the businesses.

**Table of Contents**

Group financial statements 12.9

The following table summarizes the results of the combined businesses of Lumileds and Automotive included in the Consolidated statements of income as discontinued operations.

Philips Group

**Results of combined Lumileds and Automotive Lighting businesses** in millions of EUR

2013 - 2015

	2013	2014	2015
Sales	1,268	1,416	1,619
Costs and expenses	(1,134)	(1,202)	(1,320)
<b>Income before taxes</b>	<b>134</b>	<b>214</b>	<b>299</b>
Income tax expense	(1)	(73)	(53)
<b>Results from discontinued operations</b>	<b>133</b>	<b>141</b>	<b>246</b>

Upon disposal, the associated currency translation differences, part of Shareholders' equity, will be recognized in the Consolidated statement of income. At December 31, 2015, the estimated release amounts to a EUR 76 million gain.

The following table presents the assets and liabilities of the combined Lumileds and Automotive business, as Assets classified as held for sale and Liabilities directly associated with assets classified as held for sale in the Consolidated balance sheet as from 2014.

Philips Group

**Assets and liabilities of combined Lumileds and Automotive Lighting businesses** in millions of EUR

2014 - 2015

	2014	2015
Property, plant and equipment	666	762
Intangible assets including goodwill	295	379
Inventories	248	285
Accounts receivable	278	314
Other assets	14	34
<b>Assets classified as held for sale</b>	<b>1501</b>	<b>1,774</b>
Accounts payable	(134)	(192)
Provisions	(34)	(39)
Other liabilities	(149)	(170)

<b>Liabilities directly associated with assets held for sale</b>	<b>(317)</b>	<b>(401)</b>
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**Discontinued operations: Other**

Certain results of other divestments, including the Audio, Video, Multimedia & Accessories business and the Television business, reported as discontinued operations are included, with a net loss of EUR 1 million in 2015 (2014: a net gain of EUR 49 million; 2013: a net gain of EUR 5 million).

**Other assets classified as held for sale**

Assets and liabilities directly associated with assets held for sale relate to property, plant and equipment for an amount of EUR 1 million (December 31, 2014: EUR 23 million) and businesses net assets classified as held for sale amounted to EUR 28 million at December 31, 2015 (December 31, 2014 EUR 19 million).

In 2015, property, plant and equipment divested assets classified as held for sale amounted to EUR 43 million with proceeds of EUR 88 million. Other non-current financial assets divested classified as held for sale amounted to EUR 20 million with proceeds of EUR 20 million. Businesses divested net assets classified as held for sale amounted to EUR 9 million. The businesses divested had proceeds of EUR 59 million.

In 2014, property, plant and equipment divested assets classified as held for sale amounted to EUR 17 million with proceeds of EUR 19 million. Other non-current financial assets divested classified as held for sale amounted to EUR 76 million with proceeds of EUR 76 million. Businesses divested net assets classified as held for sale amounted to EUR 46 million. The businesses divested had proceeds of EUR 45 million.



**Acquisitions and divestments**

**2015**

**Acquisitions**

Philips completed four acquisitions in 2015. These acquisitions involved an aggregated net cash outflow of EUR 1,116 million, with Volcano Corporation (Volcano) being the most notable acquisition.

On February 17, 2015, Philips completed the acquisition of Volcano for a total cash consideration of EUR 1,250 million. This amount involved the purchase price of shares (EUR 822 million), the payoff of certain debt (EUR 405 million) and the settlement of outstanding stock options (EUR 23 million). The overall cash position of Volcano on the transaction date was EUR 158 million, resulting in a net cash outflow related to this acquisition of EUR 1,092 million.

Volcano is a US-based global leader in catheter-based imaging and measurement solutions for cardiovascular applications and is very complementary to the Philips vision, strategy, and portfolio in image-guided therapy.

**Table of Contents**

## Group financial statements

Transaction-related costs that were recognized in General and administrative expenses amounted to EUR 15 million. As of February 17, 2015, Volcano is 100% consolidated as part of the Healthcare sector. The condensed balance sheet of Volcano, immediately before and after the acquisition was as follows:

Volcano

**Balance sheet** in millions of EUR

2015

	before acquisition date	after acquisition date
Goodwill	133	627
Other intangible assets	87	320
Property, plant and equipment	105	105
Other assets	80	50
Other liabilities	(41)	(142)
Working Capital	112	156
Cash	158	158
<b>Total assets and liabilities</b>	<b>634</b>	<b>1,274</b>
Group Equity	(219)	(1,250)
Loans	(415)	(24)
<b>Financed by</b>	<b>(634)</b>	<b>(1,274)</b>

The goodwill is primarily related to synergies expected to be achieved from integrating Volcano within the Healthcare sector. The goodwill is not tax-deductible. Other intangible assets are comprised of the following:

Volcano

**Other intangible assets** in millions of EUR

2015

	amount	amortization period in years
Installed base	62	6
Developed technology - Systems	155	15

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Developed technology - Disposables	58	15
Developed technology - Peripheral Therapeutics	26	15
IPR&D	6	n/a
Trade names	13	10
<b>Total other intangible assets</b>	<b>320</b>	

For the period from February 17, 2015, Volcano contributed sales of EUR 286 million and a loss from operations of EUR 113 million, which includes acquisition related costs of EUR 103 million.

### Divestments

Philips completed seven divestments during 2015, with the sale of the 20% interest in Assembléon Holding B.V. and the sale of the Remote Control activities being the most notable divestments. The seven divestments involved an aggregated cash consideration of EUR 59 million.

### 2014

#### Acquisitions

Philips completed three acquisitions in 2014. These acquisitions involved an aggregated purchase price of EUR 171 million.

One of the acquisitions in 2014, was General Lighting Company (GLC), domiciled in the Kingdom of Saudi Arabia (KSA). This acquisition enables Philips to grow its business in KSA, the largest economy in the Middle East by GDP, particularly in LED lighting.

On September 2, 2014, the Company acquired 51% of GLC from a consortium of shareholders for a total amount of EUR 146 million (on a cash-free, debt-free basis). Taking into account closing conditions, Philips paid an amount of EUR 148 million.

#### Divestments

Apart from the divestment of the Audio, Video, Multimedia & Accessories business, Philips completed two other divestments of business activities during 2014, which related to Healthcare and Lighting activities. The two transactions involved an aggregate consideration of EUR 43 million.

#### Interests in entities

In this section we discuss the nature of, and risks associated with, the Company's interests in its consolidated entities and associates, and the effects of those interests on the Company's financial position and financial performance. Interests in entities relates to:

Interests in subsidiaries

Investments in associates

#### Interests in subsidiaries

##### Wholly owned subsidiaries

The Group financial statements comprise the assets and liabilities of approximately 450 legal entities. Set out below is a list of material subsidiaries representing greater than 5% of either the consolidated group sales, income from operations or net income (before any intra-group eliminations). All of the entities are 100% owned and have been for the last 3 years.

**Table of Contents**

Group financial statements 12.9

Philips Group

**Interests in materially wholly owned subsidiaries** in alphabetical order

2015

Legal entity name	Principal country of business
Invivo Corporation	United States
Lumileds Malaysia Sdn. Bhd.	Malaysia
Philips (China) Investment Company, Ltd.	China
Philips Consumer Lifestyle B.V.	Netherlands
Philips Electronics North America Corporation	United States
Philips Electronics Singapore Pte Ltd	Singapore
Philips GmbH	Germany
Philips Innovative Applications	Belgium
Philips Lighting B.V.	Netherlands
Philips Medizin Systeme Böblingen GmbH	Germany
Philips Nederland B.V.	Netherlands
Philips Oral Healthcare, LLC	United States
Philips Respironics GK	Japan
Philips Ultrasound, Inc.	United States
RI Finance, Inc.	United States
RIC Investments, LLC	United States

**Not wholly owned subsidiaries**

In total, 19 consolidated subsidiaries are not wholly owned by the Company. Among the consolidated legal entities is Saudi Lighting Company Limited created after the acquisition of General Lighting Company (GLC) where the Company owns 51% of the voting power. The Company controls this entity. The sales, income from operations and net income of this entity is 3% of the consolidated financial data. The non-controlling interest of 49% represents an amount of EUR 102 million as per December 31, 2015.

Also among the consolidated legal entities is Philips India Limited where the Company owns 96% of the voting power. The non-controlling interest of 4% represents an amount of EUR 10 million as per December 31, 2015.

The sales, income from operations and net income of the remaining not wholly owned subsidiaries (before any intra-group eliminations) are less than 2% of the consolidated financial data of the Company and are therefore not considered material.

**Investments in associates**

Philips has investments in a number of associates, none of them are regarded as individually material.

The changes during 2015 are as follows:

Philips Group

**Investments in associates** in millions of EUR

2015

Total investments

<b>Balance as of January 1, 2015</b>	<b>157</b>
Changes:	
Acquisitions/additions	1
Reclassifications	18
Share in income	10
Share in other comprehensive income	1
Impairments	(2)
Dividends declared	(17)
Translation and exchange rate differences	13
<b>Balance as of December 31, 2015</b>	<b>181</b>

Included in the line reclassifications is an investment of EUR 18 million that was reclassified from available-for-sale financial assets. The Company owns less than 20% in the capital of the underlying company but is able to exercise significant influence and is therefore accounted for as an Investment in associate.

The Company owns one equity interest which represents more than 20% in the capital of the underlying company. With respect to this equity interest, the Company cannot exercise significant influence based on governance agreements concluded among shareholders. This equity interests is accounted for as Other non-current financial assets. In 2015, the Company's share in the net income of this entity was insignificant.

### Income from operations

For information related to Sales and tangible and intangible assets on a geographical and sector basis, see note 2, Information by sector and main country.

Philips Group

**Sales and costs by nature** in millions of EUR

2013 - 2015

	2013	2014	2015
Sales	21,990	21,391	24,244
Costs of materials used	(7,494)	(7,296)	(8,446)
Employee benefit expenses	(5,814)	(6,080)	(7,107)
Depreciation and amortization	(1,177)	(1,187)	(1,281)
Shipping and handling	(762)	(741)	(806)
Advertising and promotion	(869)	(913)	(1,000)
Lease expense <sup>1)</sup>	(344)	(318)	(324)
Other operational costs <sup>2)</sup>	(3,734)	(4,156)	(4,375)
Impairment of goodwill	(28)	(3)	
Other business income (expenses)	87	(211)	87
<b>Income from operations</b>	<b>1,855</b>	<b>486</b>	<b>992</b>

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- 1) Lease expense includes EUR 35 million (2014: EUR 35 million, 2013: EUR 42 million) of other costs, such as fuel and electricity, and taxes to be paid and reimbursed to the lessor
- 2) Other operational costs contain items which are dissimilar in nature and individually insignificant in amount to disclose separately. These costs contain among others expenses for outsourcing services, mainly in IT and HR, 3rd party workers, consultants, warranty, patents and costs for travelling and external legal services.

Annual Report 2015 157

**Table of Contents**

Group financial statements 12.9

**Sales composition**

Philips Group

**Sales composition** in millions of EUR

2013 - 2015

	2013	2014	2015
Goods	18,398	17,972	20,659
Services	3,130	2,948	3,080
Royalties	462	471	505
<b>Sales</b>	<b>21,990</b>	<b>21,391</b>	<b>24,244</b>

Philips has no single external customer that represents 10% or more of sales.

**Costs of materials used**

Cost of materials used represents the inventory recognized in cost of sales.

**Employee benefit expenses**

Philips Group

**Employee benefit expenses** in millions of EUR

2013 - 2015

	2013	2014	2015
Salaries and wages	4,722	5,018	5,533
Post-employment benefits costs	354	326	780
Other social security and similar charges:			
- Required by law	621	623	664
- Voluntary	117	113	130
<b>Employee benefit expenses</b>	<b>5,814</b>	<b>6,080</b>	<b>7,107</b>

The employee benefit expense relate to employees who are working on the payroll of Philips, both with permanent and temporary contracts.

For further information on post-employment benefit costs, see note 20, Post-employment benefits.

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For details on the remuneration of the members of the Board of Management and the Supervisory Board, see note 29, Information on remuneration.

### Employees

The average number of employees by category is summarized as follows:

Philips Group

#### Employees in FTEs

2013 - 2015

	2013	2014	2015
Production	50,628	48,110	46,869
Research and development	11,757	11,714	11,462
Other	31,673	32,684	34,011
<b>Employees</b>	<b>94,058</b>	<b>92,508</b>	<b>92,342</b>
3rd party workers	12,194	12,562	13,314
<b>Continuing operations</b>	<b>106,252</b>	<b>105,070</b>	<b>105,656</b>
<b>Discontinued operations</b>	<b>10,792</b>	<b>9,222</b>	<b>8,556</b>

Employees consist of those persons working on the payroll of Philips and whose costs are reflected in the Employee benefit expenses table. 3<sup>rd</sup> party workers consist of personnel hired on a per-period basis, via external companies.



**Depreciation and amortization**

Depreciation of property, plant and equipment and amortization of intangible assets, including impairments, are as follows:

Philips Group

**Depreciation and amortization<sup>1)</sup>** in millions of EUR

2013 - 2015

	2013	2014	2015
Depreciation of property, plant and equipment	521	592	582
Amortization of software	39	32	48
Amortization of other intangible assets	393	332	380
Amortization of development costs	224	231	271
<b>Depreciation and amortization</b>	<b>1,177</b>	<b>1,187</b>	<b>1,281</b>

<sup>1)</sup> Includes impairments

Depreciation of property, plant and equipment is primarily included in cost of sales. Amortization of the categories of other intangible assets are reported in selling expenses for brand names and customer relationships and are reported in cost of sales for technology based and other intangible assets. Amortization of development cost is included in research and development expenses.

**Shipping and handling**

Shipping and handling costs are included in cost of sales and selling expenses.

**Advertising and promotion**

Advertising and promotion costs are included in selling expenses.

**Audit fees**

Philips Group

**Fees KPMG** in millions of EUR

2013 - 2015

	2013	2014	2015
Audit fees	15.6	14.9	15.3
- consolidated financial statements	10.1	9.6	9.8
- statutory financial statements	5.5	5.3	5.5
Audit-related fees <sup>1)</sup>	2.2	3.9	4.9
- acquisitions and divestments	0.4	2.4	3.6
- sustainability assurance	0.7	0.6	0.6

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- other	1.1	0.9	0.7
Tax fees <sup>2)</sup>	0.8	0.2	1.1
- tax compliance services	0.8	0.2	1.1
Other fees	1.3	0.0	0.0
- other	1.3	0.0	0.0
<b>Fees KPMG</b>	<b>19.9</b>	<b>19.0</b>	<b>21.3</b>

<sup>1)</sup> The percentage of audit-related fees in 2015 is 23.0% of the total fees

<sup>2)</sup> The percentage of tax fees in 2015 is 5.2% of the total fees

This table Fees KPMG forms an integral part of the Company Financial Statements, please refer to note B, Audit fees.

### Impairment of goodwill

In 2014, goodwill impairment charges amount to EUR 3 million consisting of impairments on divested businesses in Healthcare and Lighting. In 2013, goodwill

**Table of Contents**

Group financial statements 12.9

impairment charges amounted to EUR 28 million, including EUR 26 million as result of reduced growth expectations in Consumer Luminaires, see note 11, Goodwill.

**Other business income (expenses)**

Other business income (expenses) consists of the following:

Philips Group

**Other business income (expenses)** in millions of EUR

**2013 - 2015**

	2013	2014	2015
Result on disposal of businesses:			
- income	50	7	4
- expense	(1)	(2)	(5)
Result on disposal of fixed assets:			
- income	18	18	79
- expense	(13)	(1)	(9)
Result on other remaining businesses:			
- income	54	38	54
- expense	(21)	(271)	(36)
<b>Other business income (expenses)</b>	<b>87</b>	<b>(211)</b>	<b>87</b>
Total other business income	122	63	137
Total other business expense	(35)	(274)	(50)

In 2015, result on disposal of businesses was mainly due to divestment of non-strategic businesses. For further information, see note 4, Acquisitions and divestments.

In 2015, result on disposal of fixed assets was mainly due to sale of real estate assets.

In 2015, result on other remaining businesses mainly relates to non-core revenue and various legal matters.

In 2014 remaining business expense mainly relates to certain parts of the Cathode Ray Tube antitrust litigation as mentioned in note 26, Contingent assets and liabilities for which the Company concluded it was able to make a reliable estimate of the cash outflow or was able to reach a settlement with the relevant plaintiffs. For more details reference is made to note 19, Provisions - litigation provisions and note 26, Contingent assets and liabilities - legal proceedings.

**Financial income and expenses**

Philips Group

**Financial income and expenses** in millions of EUR

2013 - 2015

	2013	2014	2015
Interest income	54	39	48
Interest income from loans and receivables	32	22	21
Interest income from cash and cash equivalents	22	17	27
Dividend income from available for sale financial assets	5	4	6
Net gains from disposal of financial assets		60	20
Net change in fair value of financial assets at fair value through profit or loss			4
Other financial income	11	11	20
<b>Financial income</b>	<b>70</b>	<b>114</b>	<b>98</b>
Interest expense	(323)	(290)	(350)
Interest on debt and borrowings	(245)	(224)	(271)
Finance charges under finance lease contract	(7)	(7)	(7)
Interest expenses - pensions	(71)	(59)	(72)
Provision-related accretion and interest	(25)	(80)	(35)
Net foreign exchange losses	(6)	(1)	(11)
Impairment loss of financial assets	(10)	(17)	(46)
Net change in fair value of financial assets at fair value through profit or loss	(9)	(6)	
Net change in fair value of financial liabilities at fair value through profit or loss	(3)	(2)	
Other financial expenses	(24)	(19)	(25)
<b>Financial expense</b>	<b>(400)</b>	<b>(415)</b>	<b>(467)</b>
<b>Financial income and expenses</b>	<b>(330)</b>	<b>(301)</b>	<b>(369)</b>

Net financial income and expense showed a EUR 369 million expenses in 2015, which was 68 million higher than in 2014. Interest expense in 2015 was EUR 60 million higher than in 2014, mainly due to weaker EUR against USD in relation to interest expenses on USD bonds. The gain from disposal of financial assets in 2015 amounted to EUR 20 million, mainly from Assembléon, Silicon & Software Systems and other equity interest. The impairment charges in 2015 amounted to EUR 46 million mainly due to valuation allowances on Other current receivables. Provision-related accretion and interest in 2015 primarily consisted of interest expense related to the jury verdict in the Masimo litigation, and accretion expense associated with other discounted provisions and uncertain tax positions.

Interest expense in 2014 was EUR 33 million lower than in 2013, mainly as a result of lower average outstanding debt and lower interest related to pensions in 2014. The gain from disposal on financial assets in 2014 amounted to EUR 60 million, mainly from Neusoft, Chimei Innolux, Gilde III and Sapiens. In 2014 impairment charges amounted to EUR 17 million. Provision-related accretion and interest in 2014 primarily consisted of interest expense related to the jury verdict in the

**Table of Contents**[Group financial statements 12.9](#)

Masimo litigation, and accretion expense associated with other discounted provisions and uncertain tax positions.

Net financial income and expense showed a EUR 330 million expense in 2013. Total financial income of EUR 70 million included a EUR 54 million interest income.

**Income taxes**

The income tax expense of continuing operations amounted to EUR 239 million (2014: EUR 26 million, 2013: EUR 466 million).

The components of income before taxes and income tax expense are as follows:

Philips Group

**Income tax expense** in millions of EUR

2013 - 2015

	2013	2014	2015
Netherlands	281	665	229
Foreign	1,244	(480)	394
<b>Income before taxes of continuing operations</b>	<b>1,525</b>	<b>185</b>	<b>623</b>
Netherlands:			
Current tax (expense) benefit	5	(12)	8
Deferred tax expense	(107)	(29)	
<b>Total tax (expense) benefit of continuing operations (Netherlands)</b>	<b>(102)</b>	<b>(41)</b>	<b>8</b>
Foreign:			
Current tax expense	(274)	(250)	(242)
Deferred tax (expense) benefit	(90)	265	(5)
<b>Total tax (expense) benefit of continuing operations (foreign)</b>	<b>(364)</b>	<b>15</b>	<b>(247)</b>
<b>Income tax expense of continuing operations</b>	<b>(466)</b>	<b>(26)</b>	<b>(239)</b>

Income tax expense of continuing operations excludes the tax expense of the discontinued operations of EUR 54 million (2014: EUR 11 million, 2013: EUR 11 million).

The components of income tax expense of continuing operations are as follows:

Philips Group

**Current income tax expense** in millions of EUR

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2013 - 2015

	2013	2014	2015
Current year tax expense	(262)	(241)	(244)
Prior year tax (expense) benefit	(7)	(21)	10
<b>Current tax expense</b>	<b>(269)</b>	<b>(262)</b>	<b>(234)</b>

Philips Group

**Deferred income tax expense** in millions of EUR

2013 - 2015

	2013	2014	2015
Tax loss carryforwards previously unrecognized	20	18	7
Current year tax loss carryforwards unrecognized	(29)	(65)	(86)
Tax assets relating to temporary differences unrecognized	(3)	(47)	(31)
Prior year tax (expense) benefit	15	34	(7)
Tax rate changes		12	(19)
Deferred tax (expense) benefit recognized for the current year	(200)	284	131
<b>Deferred tax (expense) benefit</b>	<b>(197)</b>	<b>236</b>	<b>(5)</b>

Philips operations are subject to income taxes in various foreign jurisdictions. The statutory income tax rates vary from 10.0% to 39.0%, which results in a difference between the weighted average statutory income tax rate and the Netherlands statutory income tax rate of 25.0% (2014: 25.0%; 2013: 25.0%).

A reconciliation of the weighted average statutory income tax rate to the effective income tax rate of continuing operations is as follows:

Philips Group

**Effective tax rate** in %

2013 - 2015

	2013	2014	2015
Weighted average statutory income tax rate in %	29.2	7.9	29.8
Increase (Decrease) in tax rate resulting from:			
- recognition of previously unrecognized tax loss carryforwards	(1.3)	(9.6)	(1.2)
- current year tax loss carryforwards unrecognized	1.9	34.9	13.7
- current year temporary differences unrecognized	0.2	25.5	4.9
Non-deductible impairment charges	0.7	1.8	0.1
Non-taxable income	(8.9)	(100.1)	(30.7)
Non-deductible expense	8.1	51.6	20.5

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Withholding and other taxes	0.9	13.4	4.9
Tax rate changes		(6.3)	3.0
Prior year tax expense	(0.2)	(30.8)	(0.4)
Tax expense (benefit) due to other liabilities	0.3	5.6	(5.9)
Tax incentives	(0.7)	(7.4)	(0.7)
Others, net	0.4	27.6	0.4
<b>Effective tax rate</b>	<b>30.6</b>	<b>14.1</b>	<b>38.4</b>

The weighted average statutory income tax rate increased in 2015 compared to 2014, as a consequence of a significant change in the geographical mix of actual profits.

The effective income tax rate is higher than the weighted average statutory income tax rate in 2015, mainly due to the non-deductible expenses, new loss carryforwards and temporary differences not expected to be realized which are partly offset by non-taxable income. Non-taxable income is partly attributable to favorable tax regulations relating to R&D investments.

**Table of Contents**

Group financial statements 12.9

**Deferred tax assets and liabilities**

Net deferred tax assets relate to the following balance sheet captions and tax loss carryforwards (including tax credit carryforwards), of which the movements during the years 2015 and 2014 respectively are presented in the tables below.

Deferred tax assets are recognized for temporary differences, unused tax losses, and unused tax credits to the extent that realization of the related tax benefits is probable. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income in the countries where the deferred tax assets originated and during the periods when the deferred tax assets become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment.

The net deferred tax assets of EUR 2,594 million (2014: EUR 2,353 million) consist of deferred tax assets of EUR 2,758 million (2014: EUR 2,460 million) in countries with a net deferred tax asset position and deferred tax liabilities of EUR 164 million (2014: EUR 107 million) in countries with a net deferred tax liability position. Of the

Philips Group

**Deferred tax assets and liabilities** in millions of EUR

2015

	Balance as of January 1, 2015	recognized in income statement	other <sup>1)</sup>	Balance as of December 31, 2015	Assets	Liabilities
Intangible assets	(980)	131	(240)	(1,089)	195	(1,284)
Property, plant and equipment	73	(50)	(4)	19	63	(44)
Inventories	311	10	33	354	360	(6)
Prepaid pensions	98	(142)	41	(3)		(3)
Other receivables	49		2	51	57	(6)
Other assets	24	13	(20)	17	31	(14)
Provisions:						
- pensions	562	(23)	30	569	569	
- guarantees	4	(1)		3	3	
- termination benefits	109	(40)	1	70	71	(1)
- other postretirement benefits	71	1	(2)	70	70	
- other provisions	783	(3)	5	785	805	(20)
Other liabilities	209	(33)	19	195	216	(21)
Deferred tax assets on tax loss carryforwards (including tax credit carryforwards)	1,040	132	381	1,553	1,553	
Set-off deferred tax positions					(1,235)	1,235
<b>Net deferred tax assets</b>	<b>2,353</b>	<b>(5)</b>	<b>246</b>	<b>2,594</b>	<b>2,758</b>	<b>(164)</b>

1)



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Other includes the movements of assets and liabilities recognized in OCI, which includes foreign currency translation differences, and acquisitions and divestments.

Philips Group

### Deferred tax assets and liabilities in millions of EUR

2014

	Balance as of January 1, 2014	recognized in income statement	other <sup>1)</sup>	Balance as of December 31, 2014	Assets	Liabilities
Intangible assets	(871)	59	(168)	(980)	114	(1,094)
Property, plant and equipment	58	9	6	73	120	(47)
Inventories	264	24	23	311	317	(6)
Prepaid pension	(1)	(40)	139	98	99	(1)
Other receivables	50	6	(7)	49	58	(9)
Other assets	32	(8)		24	45	(21)
<b>Provisions:</b>						
- pensions	426	(49)	185	562	562	
- guarantees	29	(25)		4	4	
- termination benefits	97	23	(11)	109	109	
- other postretirement benefits	57	2	12	71	71	
- other provisions	567	126	90	783	791	(8)
Other liabilities	192	(1)	18	209	226	(17)
Deferred tax assets on tax loss carryforwards (including tax credit carryforwards)	699	110	231	1,040	1,040	
Set-off deferred tax positions					(1,096)	1,096
<b>Net deferred tax assets</b>	<b>1,599</b>	<b>236</b>	<b>518</b>	<b>2,353</b>	<b>2,460</b>	<b>(107)</b>

<sup>1)</sup> Other includes the movements of assets and liabilities recognized in OCI, which includes foreign currency translation differences, and acquisitions and divestments.

Annual Report 2015 161

**Table of Contents**[Group financial statements 12.9](#)

total deferred tax assets of EUR 2,758 million at December 31, 2015, (2014: EUR 2,460 million), EUR 2,119 million (2014: EUR 1,352 million) is recognized in respect of fiscal entities in various countries where there have been fiscal losses in the current or preceding period. Management's projections support the assumption that it is probable that the results of future operations will generate sufficient taxable income to utilize these deferred tax assets.

At December 31, 2015 and 2014, there were no recognized deferred tax liabilities for taxes that would be payable on the unremitted earnings of certain foreign subsidiaries of Philips Holding USA since it has been determined that undistributed profits of such subsidiaries will not be distributed in the foreseeable future. The temporary differences associated with the investments in subsidiaries of Philips Holding USA, for which a deferred tax liability has not been recognized, aggregate to EUR 78 million (2014: EUR 47 million).

At December 31, 2015, net operating loss carryforwards expire as follows:

Philips Group

**Expiry years of net operating loss carryforwards** in millions of EUR

Total	2016	2017	2018	2019	2020	2021/ 2025	later	unlimited
7,566		2	9	176	207	2,459	1,456	3,257

The Company also has tax credit carryforwards of EUR 217 million, which are available to offset future tax, if any, and which expire as follows:

Philips Group

**Expiry years of tax credit carryforwards** in millions of EUR

Total	2016	2017	2018	2019	2020	2021/ 2025	later	unlimited
217		4	5	4	2	39	146	17

At December 31, 2015, net operating loss and tax credit carryforwards for which no deferred tax assets have been recognized in the balance sheet, expire as follows:

Philips Group

**Net operating loss and tax credit carryforwards for which no deferred tax asset has been recognized** in millions of EUR

Total	2016	2017	2018	2019	2020	2021/ 2025	later	unlimited
2,507		4	5	84	103	335	550	1,426

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At December 31, 2015, the amount of deductible temporary differences for which no deferred tax asset has been recognized in the balance sheet is EUR 139 million (2014: EUR 190 million).

Classification of the income tax payable and receivable is as follows:

Philips Group

**Income tax payables and receivables** in millions of EUR

2014 - 2015

	2014	2015
Income tax receivables	140	114
Income tax receivables - under non-current receivables		
Income tax payables	(102)	(116)
Income tax payables - under non-current liabilities	(1)	

### Tax risks

Philips is exposed to tax uncertainties. These uncertainties include, among others, the following:

### **Transfer pricing uncertainties**

Philips has issued transfer pricing directives, which are in accordance with international guidelines such as those of the Organization of Economic Co-operation and Development. As transfer pricing has a cross-border effect, potential adjustments by local tax authorities on implemented transfer pricing procedures in a country may have an impact on results in another country. In order to reduce the transfer pricing uncertainties, monitoring procedures are carried out by Group Tax and Internal Audit to safeguard the correct implementation of the transfer pricing directives.

### **Tax uncertainties on general and specific service agreements and licensing agreements**

Due to the centralization of certain activities in a limited number of countries (such as research and development, IT, Group functions and head office), costs are also centralized. As a consequence, these costs and/or revenues must be allocated to the beneficiaries, i.e. the various Philips entities. For that purpose, service contracts such as intra-group service agreements and licensing agreements are signed with a large number of group entities. Tax authorities review these intra-group service and licensing agreements, and may reject the implemented intra-group charges. Furthermore, buy in/out situations in the case of (de)mergers could affect the cost allocation resulting from the general service agreements between countries. The same applies to the specific service agreements.

### **Tax uncertainties due to disentanglements and acquisitions**

When a subsidiary of Philips is disentangled, or a new company is acquired, related tax uncertainties may arise. Philips creates merger and acquisition (M&A) teams for these disentanglements or acquisitions. In addition to representatives from the involved business, these teams consist of specialists from various group functions and are formed, among other things, to identify hidden tax uncertainties that could subsequently surface when companies are acquired and to reduce tax claims related to disentangled entities. These tax uncertainties are investigated and

**Table of Contents**

Group financial statements 12.9

assessed to mitigate tax uncertainties in the future to the extent possible. Examples of tax uncertainties are: applicability of participation exemptions, allocation issues, and issues related to (non-)deductibility.

**Tax uncertainties due to permanent establishments**

In countries where Philips starts new operations or alters business models, the issue of permanent establishment may arise. This is because when operations in a country involves a Philips organization in another country, there is a risk that tax claims will arise in the former country as well as in the latter country.

**Earnings per share**

Philips Group

**Earnings per share** in millions of EUR unless otherwise stated<sup>1)</sup>

2013 - 2015

	2013	2014	2015
Income from continuing operations	1,034	221	414
Income (loss) attributable to non-controlling interest	3	(4)	14
<b>Income from continuing operations attributable to shareholders</b>	<b>1,031</b>	<b>225</b>	<b>400</b>
<b>Income from discontinued operations</b>	<b>138</b>	<b>190</b>	<b>245</b>
<b>Net income attributable to shareholders</b>	<b>1,169</b>	<b>415</b>	<b>645</b>
Weighted average number of common shares outstanding (after deduction of treasury shares) during the year	911,071,970	915,192,683	916,086,943
Plus incremental shares from assumed conversions of:			
Options	5,464,833	4,617,109	3,565,682
Performance shares	662,973	614,010	2,479,923
Restricted share rights	4,768,777	2,290,472	1,491,960
Convertible debentures	103,899		
Dilutive potential common shares	11,000,482	7,521,591	7,537,565
Adjusted weighted average number of shares (after deduction of treasury shares) during the year	922,072,452	922,714,274	923,624,508
<b>Basic earnings per common share in EUR<sup>2)</sup></b>			
Income from continuing operations	1.13	0.24	0.45
Income from discontinued operations	0.15	0.21	0.27
Income from continuing operations attributable to shareholders	1.13	0.25	0.44
Net income attributable to shareholders	1.28	0.45	0.70

<b>Diluted earnings per common share in EUR<sup>2,3,4)</sup></b>			
Income from continuing operations	1.12	0.24	0.45
Income from discontinued operations	0.15	0.21	0.27
Income from continuing operations attributable to shareholders	1.12	0.24	0.43
Net income attributable to shareholders	1.27	0.45	0.70
Dividend distributed per common share in euros	0.75	0.80	0.80

- 1) Shareholders in this table refer to shareholders of Koninklijke Philips N.V.
- 2) The effect on income of convertible debentures affecting earnings per share is considered immaterial
- 3) In 2015, 2014 and 2013, respectively 12 million, 19 million and 14 million securities that could potentially dilute basic EPS were not included in the computation of dilutive EPS because the effect would have been antidilutive for the periods presented
- 4) The dilutive potential common shares are not taken into account in the periods for which there is a loss, as the effect would be antidilutive

**Table of Contents**

Group financial statements 12.9

**Property, plant and equipment**

Philips Group

**Property, plant and equipment** in millions of EUR

2015

	land and buildings	machinery and installations	other equipment	prepayments and construction in progress	total
<b>Balance as of January 1, 2015:</b>					
Cost	1,803	3,127	1,745	169	6,844
Accumulated depreciation	(931)	(2,520)	(1,298)		(4,749)
<b>Book value</b>	<b>872</b>	<b>607</b>	<b>447</b>	<b>169</b>	<b>2,095</b>
Change in book value:					
Capital expenditures	13	113	62	387	575
Assets available for use	59	139	140	(338)	
Acquisitions		107	2		109
Disposals and sales	(3)	(3)	(6)		(12)
Depreciation	(83)	(252)	(196)		(531)
Impairments	(8)	(27)	(16)		(51)
Transfer (to) from assets classified as held for sale	26	(10)		(2)	14
Translation differences	37	61	21	4	123
<b>Total changes</b>	<b>41</b>	<b>128</b>	<b>7</b>	<b>51</b>	<b>227</b>
<b>Balance as of December 31, 2015:</b>					
Cost	1,864	3,260	1,873	220	7,217
Accumulated depreciation	(951)	(2,525)	(1,419)		(4,895)
<b>Book value</b>	<b>913</b>	<b>735</b>	<b>454</b>	<b>220</b>	<b>2,322</b>

Philips Group

**Property, plant and equipment** in millions of EUR

2014

	land and buildings	machinery and installations	other equipment	prepayments and construction in in	total
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<b>Balance as of January 1, 2014:</b>					
Cost	1,899	3,948	1,586	259	7,692
Accumulated depreciation	(872)	(2,885)	(1,155)		(4,912)
<b>Book value</b>	<b>1,027</b>	<b>1,063</b>	<b>431</b>	<b>259</b>	<b>2,780</b>
Change in book value:					
Capital expenditures	6	86	68	368	528
Assets available for use	79	220	132	(431)	
Acquisitions	7	6	4	2	19
Disposals and sales		(5)	(7)		(12)
Depreciation	(91)	(295)	(178)		(564)
Impairments	(26)	(74)	(21)	(1)	(122)
Transfer to assets classified as held for sale	(190)	(451)	(10)	(37)	(688)
Translation differences	60	57	28	9	154
<b>Total changes</b>	<b>(155)</b>	<b>(456)</b>	<b>16</b>	<b>(90)</b>	<b>(685)</b>
<b>Balance as of December 31, 2014:</b>					
Cost	1,803	3,127	1,745	169	6,844
Accumulated depreciation	(931)	(2,520)	(1,298)		(4,749)
<b>Book value</b>	<b>872</b>	<b>607</b>	<b>447</b>	<b>169</b>	<b>2,095</b>

Land with a book value of EUR 142 million at December 31, 2015 (2014: EUR 89 million) is not depreciated. The acquisitions through business combinations in 2015 mainly consist of the acquired machinery and installations of Volcano for EUR 104 million. Transfer from assets classified as held for sale mainly includes a property reclassified back to property, plant and equipment for EUR 56 million, as it is no longer expected to be sold in 2016.

Transfer to assets classified as held for sale in 2014 mainly relates to the combined businesses of Lumileds and Automotive. Impairment charges of EUR 49 million are related to industrial assets in Lighting in 2014.

Property, plant and equipment includes financial lease assets with a book value of EUR 203 million at December 31, 2015 (2014: EUR 192 million).



**Table of Contents**

Group financial statements 12.9

The expected useful lives of property, plant and equipment are as follows:

Philips Group

**Useful lives of property, plant and equipment** in years

Buildings	from 5 to 50 years
Machinery and installations	from 3 to 20 years
Other equipment	from 1 to 10 years

**Goodwill**

The changes in 2014 and 2015 were as follows:

Philips Group

**Goodwill** in millions of EUR

2014 - 2015

	2014	2015
<b>Balance as of January 1:</b>		
Cost	8,596	9,151
Amortization and impairments	(2,092)	(1,993)
<b>Book value</b>	<b>6,504</b>	<b>7,158</b>
<b>Changes in book value:</b>		
Acquisitions	68	636
Purchase price allocation adjustment	8	8
Impairments		
Divestments and transfers to assets classified as held for sale	(160)	
Translation differences	738	721
<b>Balance as of December 31:</b>		
Cost	9,151	10,704
Amortization and impairments	(1,993)	(2,181)
<b>Book value</b>	<b>7,158</b>	<b>8,523</b>

Goodwill increased by EUR 627 million in 2015 due to the acquisition of Volcano. The increase of EUR 721 million in translation differences was mainly due to the increase in the USD/EUR rate which impacted the goodwill denominated in USD.

In 2014 the movement acquisitions mainly related to the acquisition of General Lighting Company (GLC) for EUR 58 million. Divestments and transfer to assets classified as held for sale in 2014 relate to the sectors Healthcare and Lighting. In 2014 the movement of EUR 738 million in

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translation differences is mainly explained by the increase of the USD/EUR rate which impacted the goodwill nominated in USD.

In 2015, the activities of Imaging Systems in the sector Healthcare were split over three new cash-generating units: Image-Guided Therapy, Ultrasound and Diagnostic Imaging. As a result of the change, the goodwill associated with Imaging Systems was allocated over these three new units.

For impairment testing, goodwill is allocated to (groups of) cash-generating units (typically one level below operating sector level), which represent the lowest level at which the goodwill is monitored internally for management purposes.

Goodwill allocated to the cash-generating units Respiratory Care & Sleep Management, Image-Guided Therapy, Patient Care & Monitoring Solutions and Professional Lighting Solutions is considered to be significant in comparison to the total book value of goodwill for the Group at December 31, 2015. The amounts associated as of December 31, 2015, are presented below:

Philips Group

**Goodwill allocated to the cash-generating units** in millions of EUR

2014 - 2015

	2014	2015
Respiratory Care & Sleep Management	1,704	1,884
Imaging Systems	1,592	
Image-Guided Therapy		1,066
Patient Care & Monitoring Solutions	1,317	1,452
Professional Lighting Solutions	1,470	1,626
Other (units carrying a non-significant goodwill balance)	1,075	2,495
<b>Book value</b>	<b>7,158</b>	<b>8,523</b>

The basis of the recoverable amount used for the units disclosed in this note is the value in use. In the annual impairment test performed in the second quarter and in the tests performed in the second half of 2015, the estimated recoverable amounts of the cash-generating units tested approximated or exceeded the carrying value of the units, therefore no impairment loss was recognized.

Key assumptions used in the impairment tests for the units were sales growth rates, income from operations and the rates used for discounting the projected cash flows. These cash flow projections were determined using management's internal forecasts that cover an initial period from 2015 to 2019 that matches the period used for our strategic process. Projections were extrapolated with stable or declining growth rates for a period of 5 years, after which a terminal value was calculated. For terminal value calculation, growth rates were capped at a historical long-term average growth rate.

The sales growth rates and margins used to estimate cash flows are based on past performance, external market growth assumptions and industry long-term growth averages.

Income from operations in all mentioned units is expected to increase over the projection period as a result of volume growth and cost efficiencies. In anticipation of the new reporting structure in 2016, the impact of an additional allocation of central overhead costs over the projection period has been considered for units which performed an updated test in the second half of 2015.

Cash flow projections of Respiratory Care & Sleep Management, Image-Guided Therapy, Patient Care & Monitoring Solutions and Professional Lighting Solutions for 2015 were based on the key assumptions

**Table of Contents**

[Group financial statements 12.9](#)

included in the table below. These assumptions are based on the annual impairment test performed in the second quarter except for the unit Professional Lighting Solutions which performed an updated test in Q4 2015.

Philips Group

**Key assumptions in %**

2015

	compound sales growth rate <sup>1)</sup>			
	initial forecast period	extra- polation period <sup>2)</sup>	used to calculate terminal value	pre-tax discount rates
Respiratory Care & Sleep Management	6.9	5.6	2.7	11.5
Image-Guided Therapy	3.0	2.4	2.7	12.2
Patient Care & Monitoring Solutions	6.0	4.8	2.7	13.4
Professional Lighting Solutions	5.0	5.1	2.7	15.1

<sup>1)</sup> Compound sales growth rate is the annualized steady growth rate over the forecast period

<sup>2)</sup> Also referred to later in the text as compound long-term sales growth rate

The assumptions used for the 2014 cash flow projections were as follows:

Philips Group

**Key assumptions in %**

2014

	compound sales growth rate <sup>1)</sup>			
	initial forecast period	extra- polation period <sup>2)</sup>	used to calculate terminal value	pre-tax discount rates
Respiratory Care & Sleep Management	4.2	3.6	2.7	11.4
Imaging Systems	3.3	3.1	2.7	12.8
Patient Care & Clinical Informatics	4.9	3.8	2.7	12.8
Professional Lighting Solutions	10.1	6.5	2.7	13.8

<sup>1)</sup> Compound sales growth rate is the annualized steady growth rate over the forecast period

<sup>2)</sup> Also referred to later in the text as compound long-term sales growth rate

Among the mentioned units, Professional Lighting Solutions has the lowest excess of the recoverable amount over the carrying amount. The headroom of Professional Lighting Solutions was estimated at EUR 100 million. The following changes could, individually, cause the value in use to fall to the level of the carrying value:

Philips Group

#### Sensitivity analysis

	increase in pre-tax discount rate, basis points	decrease in compound long-term sales growth rate, basis points	decrease in terminal value amount, %
Professional Lighting Solutions	40	80	5.5

The results of the annual impairment test of Respiratory Care & Sleep Management, Image-Guided Therapy and Patient Care & Monitoring Solutions indicate that a reasonably possible change in key assumptions would not cause the value in use to fall to the level of the carrying value.

#### Additional information 2015

In addition to the units with significant goodwill, other cash-generating units are sensitive to fluctuations in the assumptions as set out above.

Based on the annual impairment test, it was noted that the headroom for the cash-generating unit Home Monitoring was estimated at EUR 30 million. An increase of 130 points in the pre-tax discounting rate, a 320 basis points decline in the compound long-term sales growth rate or a 19% decrease in terminal value would cause its value in use to fall to the level of its carrying value. The goodwill allocated to Home Monitoring at December 31, 2015 amounts to EUR 32 million.

Based on the most recent impairment test, it was noted that with regard to the headroom for the cash-generating unit Consumer Luminaires the estimated recoverable amount approximates the carrying value of this cash-generating unit. Consequently, any adverse change in key assumptions would, individually, cause an impairment loss to be recognized. The goodwill allocated to Consumer Luminaires at December 31, 2015 amounts to EUR 127 million.

Please refer to note 2, Information by sector and main country for a specification of goodwill by sector.

**Table of Contents**

Group financial statements 12.9

**Intangible assets excluding goodwill**

The changes were as follows:

Philips Group

**Intangible assets excluding goodwill** in millions of EUR

2015

	other intangible assets	product development	software	total
<b>Balance as of January 1, 2015:</b>				
Cost	5,721	1,853	446	8,020
Amortization/impairments	(3,371)	(964)	(317)	(4,652)
<b>Book value</b>	<b>2,350</b>	<b>889</b>	<b>129</b>	<b>3,368</b>
Changes in book value:				
Additions	50	315	70	435
Acquisitions	326			326
Purchase price allocation adjustment	(10)			(10)
Amortization	(372)	(230)	(45)	(647)
Impairments	(8)	(41)	(3)	(52)
Divestments and transfers to assets classified as held for sale		(2)		(2)
Translation differences	210	61	4	275
<b>Total changes</b>	<b>196</b>	<b>103</b>	<b>26</b>	<b>325</b>
<b>Balance as of December 31, 2015:</b>				
Cost	6,539	2,190	522	9,251
Amortization/impairments	(3,993)	(1,198)	(367)	(5,558)
<b>Book Value</b>	<b>2,546</b>	<b>992</b>	<b>155</b>	<b>3,693</b>

Philips Group

**Intangible assets excluding goodwill** in millions of EUR

2014

	other intangible	product development	software	total
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assets

<b>Balance as of January 1, 2014:</b>				
Cost	5,533	1,761	344	7,638
Amortization/impairments	(3,173)	(916)	(287)	(4,376)
<b>Book value</b>	<b>2,360</b>	<b>845</b>	<b>57</b>	<b>3,262</b>
Changes in book value:				
Additions	15	323	101	439
Acquisitions	170	2	1	173
Purchase price allocation adjustment	(8)			(8)
Amortization	(355)	(231)	(31)	(617)
Impairments	(1)	(25)	(2)	(28)
Divestments and transfer to assets classified as held for sale	(62)	(96)		(158)
Translation differences	231	71	3	305
<b>Total changes</b>	<b>(10)</b>	<b>44</b>	<b>72</b>	<b>106</b>
<b>Balance as of December 31, 2014:</b>				
Cost	5,721	1,853	446	8,020
Amortization/impairments	(3,371)	(964)	(317)	(4,652)
<b>Book value</b>	<b>2,350</b>	<b>889</b>	<b>129</b>	<b>3,368</b>

The additions for 2015 contain internally generated assets of EUR 315 million (2014: EUR 323 million) for product development, and EUR 56 million (2014: EUR 83 million) for software. The acquisitions through business combinations in 2015 mainly consist of the acquired intangible assets of Volcano for EUR 320 million.

In addition, other intangible fixed assets changed due to the finalization of purchase price accounting related to acquisitions in the prior year. Transfer to assets classified as held for sale in 2014 mainly relate to combined businesses of Lumileds and Automotive.

The impairment charges in 2015 for product development relate to various projects mainly within Healthcare.

**Table of Contents**[Group financial statements 12.9](#)

The increase of EUR 275 million in translation differences was mainly due to the increase of the USD/ EUR rate which impacted the intangibles denominated in USD.

The amortization of intangible assets is specified in note 6, Income from operations.

Other intangible assets consist of:

Philips Group

**Amortization of other intangible assets** in millions of EUR

2014 - 2015

	Balance as of December 31, 2014		Balance as of December 31, 2015	
	gross	amortization/ impairments	gross	amortization/ impairments
Brand names	1,018	(497)	1,102	(582)
Customer relationships	3,045	(1,622)	3,324	(1,925)
Technology	1,543	(1,151)	1,977	(1,373)
Other	115	(101)	136	(113)
<b>Other intangibles</b>	<b>5,721</b>	<b>(3,371)</b>	<b>6,539</b>	<b>(3,993)</b>

The estimated amortization expense for other intangible assets for each of the next five years is:

Philips Group

**Estimated amortization expense for other intangible assets**

in years

2016	357
2017	328
2018	318
2019	298
2020	281

The expected useful lives of the intangible assets excluding goodwill are as follows:

Philips Group

**Expected useful lives of intangible assets excluding goodwill**



in years

Brand names	2-20
Customer relationships	2-25
Technology	3-20
Other	1-8
Software	1-10
Product development	3-7

The weighted average expected remaining life of other intangible assets is 8.4 years as of December 31, 2015 (2014: 8.5 years).

The capitalized product development costs and software, for which amortization has not yet commenced, amounted to EUR 491 million as of December 31, 2015 (2014: EUR 450 million).

At December 31, 2015 the carrying amount of customer relationships of Respiratory Care & Sleep Management was EUR 466 million (USD 509 million) with a remaining amortization period of 8.2 years (2014: EUR 468 million, USD 569 million; 9.2 years).

At December 31, 2015 the carrying amount of developed technology related to systems for Volcano (now Image Guided Technology-Devices ) was EUR 150 million (USD 164 million) with a remaining amortization period of 14.1 years.

**Other financial assets**

The changes during 2015 were as follows:

Philips Group

**Other non-current financial assets** in millions of EUR

2015

	available- for-sale financial assets	loans and receivables	held-to- maturity invest- ments	financial assets at fair  value through profit or loss	total
<b>Balance as of January 1, 2015</b>	<b>210</b>	<b>226</b>	<b>2</b>	<b>24</b>	<b>462</b>
Changes:					
Reclassifications	(18)	(9)			(27)
Acquisitions/additions	31	35		5	71
Sales/redemptions/reductions	(23)	(13)		(1)	(37)
Impairment	(4)				(4)
Transfer from and (to) assets classified as held for sale	1	(2)			(1)
Value adjustments	31	1		3	35
Translation and exchange differences	4	(16)		2	(10)
<b>Balance as of December 31, 2015</b>	<b>232</b>	<b>222</b>	<b>2</b>	<b>33</b>	<b>489</b>

**Available-for-sale financial assets**

The Company's investments in available-for-sale financial assets mainly consist of investments in common shares of companies in various industries. The line reclassifications mainly represents an investment transferred to investments in associates due to the fact that the Group is able to exercise significant influence. The line additions/acquisitions includes investments of EUR 21 million which relate to the acquisition of Volcano (refer to note 4 Acquisitions and divestments). The remainder mainly relates to capital calls for certain investment funds. The line sales/redemptions/ reductions includes the sale of one of Volcano's investments for an amount of EUR 16 million and the sale of certain government bonds for an amount of EUR 6 million.

**Loans and receivables**

The acquisitions/additions line mainly relates to vendor loans issued to an amount of EUR 17 million in relation to the sale of an equity interest. The current portion of this loan (EUR 8 million) was in the course of 2015 reclassified to Current financial assets. The remainder of the loan will be redeemed in 2017.

**Table of Contents**

Group financial statements 12.9

**Other assets****Other non-current assets**

Other non-current assets in 2015 are comprised of prepaid pension costs of EUR 3 million (2014: EUR 2 million) and prepaid expenses of EUR 65 million (2014: EUR 67 million).

For further details see note 20, Post-employment benefits.

**Other current assets**

Other current assets include prepaid expenses of EUR 444 million (2014: EUR 411 million).

**Inventories**

Inventories are summarized as follows:

Philips Group

**Inventories** in millions of EUR

2014 - 2015

	2014	2015
Raw materials and supplies	962	1,068
Work in process	481	475
Finished goods	1,871	1,920
<b>Inventories</b>	<b>3,314</b>	<b>3,463</b>

The write-down of inventories to net realizable value amounted in 2015 to EUR 170 million (2014: EUR 217 million). The write-down is included in cost of sales.

**Receivables****Non-current receivables**

Non-current receivables are associated mainly with customer financing in Healthcare and insurance receivables in Innovation, Group & Services. The balance as per December 31, 2015 includes an allowance for doubtful accounts of EUR 1 million (2014: EUR 2 million).

**Current receivables**

The accounts receivable, net, per sector are as follows:

Philips Group

**Accounts receivables-net** in millions of EUR

2014 - 2015

	2014	2015
Healthcare	2,112	2,343
Consumer Lifestyle	791	853
Lighting	1,438	1,442
Innovation, Group & Services	135	89
<b>Accounts receivable-net</b>	<b>4,476</b>	<b>4,727</b>

The aging analysis of accounts receivable, net, is set out below:

Philips Group

**Aging analysis** in millions of EUR

2014 - 2015

	2014	2015
current	3,719	4,003
overdue 1-30 days	251	237
overdue 31-180 days	335	337
overdue > 180 days	171	150
<b>Accounts receivable-net</b>	<b>4,476</b>	<b>4,727</b>

The above net accounts receivable represent current and overdue but not impaired receivables.

The changes in the allowance for doubtful accounts receivable are as follows:

Philips Group

**Allowance for doubtful accounts receivable** in millions of EUR

2013 - 2015

	2013	2014	2015
<b>Balance as of January 1</b>	<b>230</b>	<b>204</b>	<b>227</b>
Additions charged to expense	29	48	78
Deductions from allowance <sup>1)</sup>	(33)	(46)	(25)
Other movements	(22)	21	21
<b>Balance as of December 31</b>	<b>204</b>	<b>227</b>	<b>301</b>

<sup>1)</sup> Write-offs for which an allowance was previously provided

The allowance for doubtful accounts receivable has been primarily established for receivables that are past due.

Included in above balances as per December 31, 2015 are allowances for individually impaired receivables of EUR 272 million (2014: EUR 200 million; 2013: EUR 172 million).

## Equity

### Common shares

As of December 31, 2015, the issued and fully paid share capital consists of 931,130,387 common shares, each share having a par value of EUR 0.20.

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In June 2015, Philips settled a dividend of EUR 0.80 per common share, representing a total value of EUR 730 million. Shareholders could elect for a cash dividend or a share dividend. Approximately 59% of the shareholders elected for a share dividend, resulting in the issuance of 17,671,990 new common shares. The settlement of the cash dividend resulted in a payment of EUR 298 million including tax and service charges.

Annual Report 2015 169

**Table of Contents**[Group financial statements 12.9](#)

The following table shows the movements in the outstanding number of shares:

Philips Group

**Outstanding number of shares** in number of shares

2014 - 2015

	2014	2015
<b>Balance as of January 1</b>	<b>913,337,767</b>	<b>914,388,869</b>
Dividend distributed	18,811,534	17,671,990
Purchase of treasury shares	(28,537,921)	(20,296,016)
Re-issuance of treasury shares	10,777,489	5,338,743
<b>Balance as of December 31</b>	<b>914,388,869</b>	<b>917,103,586</b>

**Preference shares**

The Stichting Preferente Aandelen Philips has been granted the right to acquire preference shares in the Company. Such right has not been exercised. As a means to protect the Company and its stakeholders against an unsolicited attempt to acquire (de facto) control of the Company, the General Meeting of Shareholders in 1989 adopted amendments to the Company's articles of association that allow the Board of Management and the Supervisory Board to issue (rights to acquire) preference shares to a third-party. As of December 31, 2015, no preference shares have been issued.

**Options, restricted and performance shares**

The Company has granted stock options on its common shares and rights to receive common shares in the future (see note 28, Share-based compensation).

**Treasury shares**

In connection with the Company's share repurchase programs, shares which have been repurchased and are held in treasury for (i) delivery upon exercise of options, performance and restricted share programs, and (ii) capital reduction purposes, are accounted for as a reduction of shareholders' equity. Treasury shares are recorded at cost, representing the market price on the acquisition date. When issued, shares are removed from treasury shares on a first-in, first-out (FIFO) basis.

When treasury shares are reissued under the Company's option plans, the difference between the cost and the cash received is recorded in retained earnings. When treasury shares are reissued under the Company's share plans, the difference between the market price of the shares issued and the cost is recorded in retained earnings, the market price is recorded in capital in excess of par value.

Dividend withholding tax in connection with the Company's purchase of treasury shares for capital reduction purposes is recorded in retained earnings.

The following transactions took place resulting from employee option and share plans:

Philips Group

**Employee option and share plan transactions**

2014 - 2015

	2014	2015
Shares acquired	7,254,606	
Average market price	EUR 24.53	
Amount paid	EUR 178 million	
Shares delivered	10,777,489	5,338,743
Average market price	EUR 30.26	EUR 30.35
Cost of delivered shares	EUR 326 million	EUR 162 million
Total shares in treasury at year-end	17,127,544	11,788,801
Total cost	EUR 470 million	EUR 308 million

In 2015, no additional share purchase was needed to cover our share-based compensation plan commitments.

In order to reduce share capital, the following transactions took place:



Philips Group

**Share capital transactions**

2014 - 2015

	2014	2015
Shares acquired	21,283,315	20,296,016
Average market price	EUR 23.95	EUR 24.39
Amount paid	EUR 510 million	EUR 495 million
Reduction of capital stock (shares)	21,837,910	21,361,016
Reduction of capital stock (EUR)	EUR 533 million	EUR 517 million
Total shares in treasury at year-end	3,303,000	2,238,000
Total cost	EUR 77 million	EUR 55 million

Share purchase transactions related to share plans, as well as transactions related to the reduction of share capital involved a cash outflow of EUR 506 million, which includes the impact of taxes. Settlements of share-based compensation plans involved a cash inflow of EUR 81 million.

**Dividend distribution**

A proposal will be submitted to the 2016 Annual General Meeting of Shareholders to pay a dividend of EUR 0.80 per common share, in cash or shares at the option of the shareholder, from the 2015 net income and retained earnings of the Company.

**Limitations in the distribution of shareholders' equity**

As at December 31, 2015, pursuant to Dutch law, certain limitations exist relating to the distribution of shareholders' equity of EUR 2,274 million. Such limitations relate to common shares of EUR 186 million, as well as to legal reserves required by Dutch law included under retained earnings of EUR 958 million, revaluation reserves of EUR 4 million, unrealized currency translation differences of EUR 1,058 million,

170 Annual Report 2015

**Table of Contents****Group financial statements 12.9**

available-for-sale financial assets of EUR 56 million and unrealized gains related to cash flow hedges of EUR 12 million.

The legal reserve required by Dutch law of EUR 958 million included under retained earnings relates to any legal or economic restrictions on the ability of affiliated companies to transfer funds to the parent company in the form of dividends.

As at December 31, 2014, these limitations in distributable amounts were EUR 1,515 million and related to common shares of EUR 187 million, as well as to legal reserves required by Dutch law included under retained earnings of EUR 1,059 million, revaluation reserves of EUR 13 million, available-for-sale financial assets of EUR 27 million and unrealized currency translation gains EUR 229 million. The unrealized losses related to cash flow hedges of EUR 13 million, although qualifying as a legal reserve, reduce the distributable amount by their nature.

**Non-controlling interests**

Non-controlling interests relate to minority stakes held by third parties in consolidated group companies. The Net income attributable to non-controlling interests amounted to EUR 14 million in 2015 (Net loss attributable to non-controlling interests 2014: EUR 4 million).

The non-controlling interests mainly relate to General Lighting Company (GLC), in which Alliance Holding domiciled in Kingdom of Saudi Arabia holds an ownership percentage of 49%.

**Objectives, policies and processes for managing capital**

Philips manages capital based upon the measures net operating capital (NOC), net debt and cash flows before financing activities.

The Company believes that an understanding of the Philips Group's financial condition is enhanced by the disclosure of NOC, as this figure is used by Philips' management to evaluate the capital efficiency of the Philips Group and its operating sectors. NOC is defined as: total assets excluding assets classified as held for sale less: (a) cash and cash equivalents, (b) deferred tax assets, (c) other non-current financial assets and current financial assets, (d) investments in associates, and after deduction of: (e) long-term provisions and short-term provisions, (f) accounts and notes payable, (g) accrued liabilities, (h) income tax payable, (i) non-current derivative financial liabilities and derivative financial liabilities and (j) other non-current liabilities and other current liabilities.

Net debt is defined as the sum of long- and short-term debt minus cash and cash equivalents. The net debt position as a percentage of the sum of group equity (shareholders' equity and non-controlling interests) and net debt is presented to express the financial strength of the Company. This measure is widely used by management and investment analysts and is therefore included in the disclosure. Our net debt position is managed in such a way that we expect to retain a strong investment grade credit rating.

Furthermore, the Group's aim when managing the net debt position is dividend stability and a pay-out ratio of 40% to 50% of continuing net income. Following the intended separation of the Lighting business, the dividend pay-out ratio with respect to future years could be subject to change.

Cash flows before financing activities, being the sum of net cash from operating activities and net cash from investing activities, are presented separately to facilitate the reader's understanding of the Company's funding requirements.

Philips Group

**Net operating capital composition** in millions of EUR

2013 - 2015

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	2013	2014	2015
Intangible assets	9,766	10,526	12,216
Property, plant and equipment	2,780	2,095	2,322
Remaining assets	8,699	9,041	9,423
Provisions	(2,554)	(3,445)	(3,225)
Other liabilities	(8,453)	(9,379)	(9,640)
<b>Net operating capital</b>	<b>10,238</b>	<b>8,838</b>	<b>11,096</b>

Annual Report 2015 171

**Table of Contents**

Group financial statements 12.9

Philips Group

**Composition of net debt to group equity** in millions of EUR unless otherwise stated

2013 - 2015

	2013	2014	2015
Long-term debt	3,309	3,712	4,095
Short-term debt	592	392	1,665
<b>Total debt</b>	<b>3,901</b>	<b>4,104</b>	<b>5,760</b>
Cash and cash equivalents	2,465	1,873	1,766
<b>Net debt<sup>1)</sup></b>	<b>1,436</b>	<b>2,231</b>	<b>3,994</b>
Shareholders' equity	11,214	10,867	11,662
Non-controlling interests	13	101	118
<b>Group equity</b>	<b>11,227</b>	<b>10,968</b>	<b>11,780</b>
Net debt and group equity	12,663	13,199	15,774
Net debt divided by net debt and group equity (in %)	11%	17%	25%
Group equity divided by net debt and group equity (in %)	89%	83%	75%

<sup>1)</sup> Total debt less cash and cash equivalents  
Philips Group

**Composition of cash flows** in millions of EUR

2013 - 2015

	2013	2014	2015
Cash flows from operating activities	912	1,303	1,167
Cash flows from investing activities	(862)	(984)	(1,941)
<b>Cash flows before financing activities</b>	<b>50</b>	<b>319</b>	<b>(774)</b>

In 2015, total debt increased by EUR 1,656 million. New borrowings of EUR 1,335 million were mainly due to a short-term bridge loan 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.

## Debt

### Long-term debt

Philips Group

**Long-term debt** in millions of EUR unless otherwise stated

2014 - 2015

	(range of) interest rates	average rate of interest	amount outstanding in 2015	amount due in 1 year	amount due after 1 year	amount due after 5 years	average remaining term (in years)	amount outstanding in 2014
USD bonds	3.8 - 7.8%	5.6%	3,733		3,733	2,595	11.7	3,355
Bank borrowings	0.0 - 11.0%	1.7%	259	45	214	201	5.0	258
Other long-term debt	0.8 - 7.0%	3.8%	42	39	3	1	1.3	52
<b>Institutional financing</b>			<b>4,034</b>	<b>84</b>	<b>3,950</b>	<b>2,797</b>		<b>3,665</b>
Finance leases	0 - 16.4%	3.2%	211	66	145	34	3.4	195
<b>Long-term debt</b>		<b>5.2%</b>	<b>4,245</b>	<b>150</b>	<b>4,095</b>	<b>2,831</b>		<b>3,860</b>
<b>Corresponding data of previous year</b>		<b>5.2%</b>	<b>3,860</b>	<b>148</b>	<b>3,712</b>	<b>2,578</b>		<b>3,671</b>

**Table of Contents**

Group financial statements 12.9

The following amounts of long-term debt as of December 31, 2015, are due in the next five years:

Philips Group

**Long-term debts due in the next five years** in millions of EUR

2014 - 2015

2016	150
2017	53
2018	1,182
2019	18
2020	11
<b>Long term debt</b>	<b>1,414</b>
<b>Corresponding amount of previous year</b>	<b>1,282</b>

Philips Group

**Unsecured USD Bonds** in millions of EUR unless otherwise stated

2014 - 2015

	effective rate	2014	2015
Due 5/15/25; 7 3/4%	7.429%	81	91
Due 6/01/26; 7 1/5%	6.885%	136	152
Due 5/15/25; 7 1/8%	6.794%	84	94
Due 3/11/18; 5 3/4% <sup>1)</sup>	6.066%	1,028	1,144
Due 3/11/38; 6 7/8% <sup>1)</sup>	7.210%	823	915
Due 3/15/22; 3 3/4% <sup>1)</sup>	3.906%	823	915
Due 3/15/42; 5% <sup>1)</sup>	5.273%	411	458
Adjustments <sup>2)</sup>		(31)	(36)
<b>Unsecured USD Bonds</b>		<b>3,355</b>	<b>3,733</b>

<sup>1)</sup> The provisions applicable to these bonds, issued in March 2008 and in March 2012, contain a Change of Control Triggering Event. If the Company would experience such an event with respect to a series of corporate bonds, the Company may be required to offer to purchase the bonds of the series at a purchase price equal to 101% of the principal amount, plus accrued and unpaid interest, if any.

<sup>2)</sup> Adjustments relate to issued bond discounts, transaction costs and fair value adjustments for interest rate derivatives

**Secured liabilities**

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In 2015, none of the long-term and short-term debt was secured by collateral (2014: EUR nil million).

### Short-term debt

Philips Group

**Short-term debt** in millions of EUR

2014 - 2015

	2014	2015
Short-term bank borrowings	225	1,510
Other short-term loans	19	5
Current portion of long-term debt	148	150
<b>Short-term debt</b>	<b>392</b>	<b>1,665</b>

During 2015, the weighted average interest rate on the bank borrowings was 1.6% (2014: 8.3%) due to the bridging loan with low interest rate used for the Volcano acquisition.

Philips has a USD 2.5 billion Commercial Paper Program and a EUR 1.8 billion revolving credit facility that can be used for general group purposes and as a backstop of its commercial paper program and will mature in February 2018. As of December 31, 2015 Philips did not have any loans outstanding under either facility.

**Provisions**

Philips Group

**Provisions** in millions of EUR

2014 - 2015

	2014		2015	
	long-term	short-term	long-term	short-term
Provisions for defined-benefit plans (see note 20)	881	52	841	51
Other post retirement benefits (see note 20)	226	16	220	10
Product warranty	77	225	67	222
Environmental provisions	301	59	278	57
Restructuring-related provisions	150	230	69	228
Litigation provisions	480	173	518	60
Other provisions	385	190	399	205
<b>Provisions</b>	<b>2,500</b>	<b>945</b>	<b>2,392</b>	<b>833</b>

**Product warranty**

The provision for product warranty reflects the estimated costs of replacement and free-of-charge services that will be incurred by the Company with respect to products sold. The Company expects the provision to be utilized mainly within the next year.

Philips Group

**Provision for product warranty** in millions of EUR

2013 - 2015

	2013	2014	2015
<b>Balance as of January 1</b>	<b>319</b>	<b>266</b>	<b>302</b>
Changes:			
Additions	350	332	327
Utilizations	(363)	(316)	(357)
Transfer to assets classified as held for sale	(24)	(3)	
Translation differences	(16)	23	17
<b>Balance as of December 31</b>	<b>266</b>	<b>302</b>	<b>289</b>

**Environmental provisions**

The environmental provisions include accrued losses recorded with respect to environmental remediation in various countries. In the United States, subsidiaries of the Company have been named as potentially responsible parties in state and federal proceedings for the clean-up of certain sites.



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Provisions for environmental remediation can change significantly due to the emergence of additional information regarding the extent or nature of the contamination, the need to utilize alternative technologies, actions by regulatory authorities as well as changes in judgments and discount rates.

Annual Report 2015 173

**Table of Contents**

Group financial statements 12.9

Philips Group

**Environmental provisions** in millions of EUR

2013 - 2015

	2013	2014	2015
<b>Balance as of January 1</b>	<b>375</b>	<b>311</b>	<b>360</b>
Changes:			
Additions	30	29	27
Utilizations	(21)	(23)	(24)
Releases	(16)	(15)	(36)
Changes in discount rate	(40)	30	(7)
Accretion	6	8	7
Purchase price allocation adjustment	(15)		
Changes in consolidation		4	1
Reclassification			(8)
Translation differences	(8)	16	15
<b>Balance as of December 31</b>	<b>311</b>	<b>360</b>	<b>335</b>

The release of the provision in 2015 originates from additional insights in relation to factors as the estimated cost of remediation, changes in regulatory requirements and efficiencies in completion of various site work phases.

For more details on the environmental remediation reference is made to note 26, Contingent assets and liabilities.

Approximately half of this provision is expected to be utilized within the next five years. The remaining portion relates to longer-term remediation activities.

**Restructuring-related provisions**

Philips Group

**Restructuring-related provisions** in millions of EUR

2015

	Jan. 1, 2015	additions	utilizations	releases	other changes <sup>1)</sup>	Dec. 31, 2015
Healthcare	48	51	(38)	(11)	(1)	49
Consumer Lifestyle	12	30	(6)	(3)	(1)	32

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Lighting	195	84	(106)	(25)		148
Innovation, Group and Services	125	29	(39)	(49)	2	68
<b>Philips Group</b>	<b>380</b>	<b>194</b>	<b>(189)</b>	<b>(88)</b>		<b>297</b>

<sup>1)</sup> Other changes primarily relate to translation differences and assets classified as held for sale reclassifications

**The most significant projects in 2015**

In 2015, restructuring projects at Healthcare mainly took place in the US and France.

Consumer Lifestyle restructuring projects were mainly in Italy.

The most significant restructuring projects were mainly related to the industrial footprint rationalization projects in Lighting.

Restructuring projects at Lighting centered on the conventional lamps industry and Professional Lighting Solutions, the largest of which took place in France and Indonesia.

Innovation, Group & Services restructuring projects were mainly related to Group and Regional organizations and centered primarily in France and the Netherlands. The release mainly results from unforeseen changes to the IT restructuring plan in 2015.

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The movements in the provisions and liabilities for restructuring in 2014 by Sector are presented as follows:

Philips Group

### Restructuring-related provisions in millions of EUR

2014

	Jan. 1, 2014	addi- tions	utilizations	releases	other changes <sup>1)</sup>	Dec. 31, 2014
Healthcare	17	67	(27)	(9)		48
Consumer Lifestyle	21	7	(10)	(7)	1	12
Lighting	130	180	(90)	(16)	(9)	195
Innovation, Group and Services	35	110	(15)	(5)		125
<b>Philips Group</b>	<b>203</b>	<b>364</b>	<b>(142)</b>	<b>(37)</b>	<b>(8)</b>	<b>380</b>

<sup>1)</sup> Other changes primarily relate to translation differences and transfers between sectors

#### The most significant projects in 2014

In 2014, restructuring projects at Healthcare mainly took place in the US and the Netherlands.

Consumer Lifestyle restructuring projects were mainly in the Netherlands.

The most significant restructuring projects related to Lighting and IG&S and were driven by industrial footprint rationalization and the Accelerate! transformation program.

Restructuring projects at Lighting centered on Light Sources & Electronics and Professional Lighting Solutions, the largest of which took place in Belgium, the Netherlands and France.

Innovation, Group & Services restructuring projects mainly were related to IT and group and country overheads and centered primarily in the Netherlands, US and Belgium.

The Company expects the provision will be utilized mainly within the next year.

**Table of Contents**[Group financial statements 12.9](#)

The movements in the provisions and liabilities for restructuring in 2013 are presented by sector as follows:

Philips Group

**Restructuring-related provisions** in millions of EUR

2013

	Jan. 1, 2013	addi- tions	utilizations	releases	other changes <sup>1)</sup>	Dec. 31, 2013
Healthcare	77	14	(50)	(23)	(1)	17
Consumer Lifestyle	48	11	(27)	(10)	(1)	21
Lighting	198	64	(110)	(19)	(3)	130
Innovation, Group and Services	62	16	(30)	(15)	2	35
<b>Philips Group</b>	<b>385</b>	<b>105</b>	<b>(217)</b>	<b>(67)</b>	<b>(3)</b>	<b>203</b>

<sup>1)</sup> Other changes primarily relate to translation differences and transfers between sectors

**The most significant projects in 2013**

In 2013, In Healthcare, the largest projects were undertaken in Customer Services, Home Healthcare Solutions and Imaging Systems in the United States, Italy and the Netherlands to reduce the operating costs and simplify the organization.

Consumer Lifestyle restructuring charges were mainly related to Personal Care (primarily in the Netherlands and Austria) and Coffee (mainly Italy).

The most significant restructuring projects related to Lighting and were driven by the industrial footprint rationalization.

Restructuring projects at Lighting centered on Luminaires businesses and Light Sources & Electronics, the largest of which took place in the United States, France and Belgium.

Innovation, Group & Services restructuring projects mainly focused on the Financial Operations Service Unit, primarily in Italy, France and the United States.

**Litigation provisions**

The Company and certain of its group companies and former group companies are involved as a party in legal proceedings, including regulatory and other governmental proceedings.

Philips Group

**Litigation provisions** in millions of EUR

2013 - 2015

	2013	2014	2015
<b>Balance as of January 1</b>	<b>238</b>	<b>236</b>	<b>653</b>
Changes:			
Additions	48	563	66
Utilizations	(17)	(32)	(25)
Transfer to other current liabilities		(138)	(161)
Changes in discount rate			8
Releases	(15)	(23)	(25)
Accretion		6	12
Translation differences	(18)	41	50
<b>Balance as of December 31</b>	<b>236</b>	<b>653</b>	<b>578</b>

**2015**

The majority of the ending balance as of December 31, 2015 relates to the patent infringement lawsuit by Masimo Corporation as mentioned in the 2014 paragraph.

The majority of the transfers to other current liabilities relates to certain parts of the Cathode Ray Tube (CRT) antitrust litigation as mentioned in note 26, Contingent assets and liabilities for which the Company was able to reach a settlement. These settlements were subsequently paid out in 2015.

The movement of EUR 50 million in translation differences is mainly explained by the increase of the USD/EUR rate which impacted the litigation provisions nominated in USD.

The Company expects to use the provisions within the next three years. For more details reference is made to note 26, Contingent assets and liabilities.

**2014**

The additions and ending balance in 2014 include the patent infringement lawsuit by Masimo Corporation in the United States District Court for the District of Delaware against Philips in which Masimo was awarded a compensation of USD 467 million (EUR 366 million) in 2014.

The majority of the remaining additions and remaining ending balance as of December 31, 2014 relates to certain parts of the CRT antitrust litigation for which the company concluded it was able to make a reliable estimate of the cash outflow or was able to reach settlement.

The transfer to other current liabilities in the schedule above relates to certain parts of the CRT antitrust litigation where the Company was able to reach settlement. Settlements in excess of provisions recognized previously were recognized as an increase of other current liabilities as disclosed in note 22, Other liabilities. These settlements were subsequently paid out in 2015.

As a result of the aforementioned changes in estimates for the CRT antitrust litigation, the results of other business expenses of EUR 271 million in 2014 as included in note 6, Income from operations mainly relate to certain parts of the CRT antitrust litigation for which the company concluded it was able to make a reliable estimate of the cash outflow or where the Company was able to reach settlement.

For more details reference is made to note 26, Contingent assets and liabilities.

**Table of Contents**

Group financial statements 12.9

**Other provisions**

Philips Group

**Other provisions** in millions of EUR

2013 - 2015

	2013	2014	2015
<b>Balance as of January 1</b>	<b>529</b>	<b>519</b>	<b>575</b>
Changes:			
Additions	198	213	198
Utilizations	(224)	(153)	(186)
Releases	(48)	(37)	(35)
Reclassification	80	17	14
Liabilities directly associated with assets held for sale	(3)	(13)	(1)
Accretion		6	7
Changes in consolidation	(1)	(1)	24
Translation differences	(12)	24	8
<b>Balance as of December 31</b>	<b>519</b>	<b>575</b>	<b>604</b>

The main elements of other provisions are: provision for post-employment benefits and obligatory severance payments of EUR 47 million (2014: 50 million), onerous contract provisions for unfavorable supply contracts as part of divestment transactions, onerous (sub) lease contracts and expected losses on existing projects / orders totaling EUR 106 million (2014: 103 million), provision for employee jubilee funds EUR 71 million (2014: EUR 74 million), self-insurance liabilities of EUR 70 million (2014: EUR 65 million), provisions for rights of return of EUR 52 million (2014: EUR 52 million), provision for possible taxes/social security of EUR 99 million (2014: EUR 97 million) and provision for decommissioning costs of EUR 52 million (2014: EUR 36 million).

Provisions of EUR 24 million have been assumed as a result of the acquisition of Volcano.

The provision for self-insurance liabilities is expected to be used within the next five years. More than half of the provision for possible taxes/social security and provision for decommissioning costs and less than half of the provision for employee jubilee funds is expected to be utilized within next five years. All other provisions are expected to be utilized mainly within the next three years, except for provision for rights of return, which the Company expects to use within the next year.

**Post-employment benefits**

Employee post-employment plans have been established in many countries in accordance with the legal requirements, customs and the local practice in the countries involved.

Most employees that take part in a Company pension plan are covered by defined contribution (DC) pension plans. The Company also sponsors a number of defined benefit pension plans. The benefits provided by these plans are based on employees' years of service and compensation levels. The Company also sponsors a limited number of defined benefit retiree medical plans.

The benefits provided by these plans are typically covering a part of the healthcare insurance costs after retirement.

The largest defined benefit pension plans are in:

The Netherlands (settled per May 1, 2015),

The United Kingdom (UK) (settled per December 31, 2015) and

The United States (US)

At the start of 2015 these plans accounted for more than 90% of the total defined benefit obligation and plan assets. Philips is one of the sponsors of Philips Pensionskasse VVaG in Germany, which is a multi-employer plan and is accounted for as a DC plan.

### **The Netherlands**

For the pension plan in the Netherlands (the Flexplan) the Company has no other financial obligation to the Pension Fund than to pay an agreed fixed contribution for the annual accrual of active members. The pensionable age is 67 year. The Flexplan is executed by a Company Pension Fund. A mandatory cap imposed by Dutch legislation of EUR 100 thousand applies on the pension salary for future pension accrual.

Employees earning more than this cap receive a wage allowance and can join a voluntary net pension saving scheme, at their own expense, for the salary part above the cap. The net pension saving scheme and some related risk insurances are executed by an external provider other than the Company Pension Fund.

Up to May 2015, the Company accounted for the Flexplan as a defined benefit (DB) pension plan as it still ran actuarial and investments risks by means of being entitled to a discount arrangement. This discount arrangement would result in potential future variable pension contributions to be paid by the Company.

Beginning of May 2015, the Company surrendered its right to future discounts and as a result the plan qualified as a defined contribution plan. Reason for surrendering the discount arrangement was a significant reduction in 2015 of the outlook for a potential discount due to increased pension obligations and a regulatory deficit at the fund (because of a lower regulatory discount rate and higher solvency buffers due to change in investment strategy), combined with the need to avoid unwanted complexity of an allocation of the Dutch fund as a DB plan as part of the separation. Consequently, the plan was classified as a DC plan. This triggered the accounting settlement of the plan which at the time had a EUR 20 million surplus. As the surplus was not recognized in the balance sheet due to the asset ceiling test, and because no further payments were made directly related to the settlement, as per the Company's accounting policy the Company did not recognize a settlement result in the income statement but in remeasurements for pensions in the Consolidated statements of Comprehensive Income.



**Table of Contents**

Group financial statements 12.9

At the end of 2013 the Company agreed to transfer a one-off EUR 600 million to the Company Pension Fund of which EUR 433 million was paid in 2014; the remainder of EUR 167 million (excluding interest) was paid in the first quarter of 2015.

**United Kingdom**

The UK plan is executed by a Company Pension Fund currently being wound up. In the UK plan the accrual of new benefits ceased in 2011. A legally mandatory indexation for accrued benefits still applies. The Company does not pay regular contributions, other than an agreed portion of the administration costs.

In November 2015 the Trustee of the UK Fund entered into two further bulk insurance contracts - buy-in contracts - which provide for payment in respect of all remaining parts of the Fund's pensioners not covered under earlier buy-in contracts. Subsequently, the Company requested the Trustee for a wind-up of the UK Fund in December 2015 resulting in a complete buy-out of the plan. As part of the buy-out, an additional payment of EUR 305 million was made by the Company to the insurance company taking over the plan liabilities. The buy-out triggers a complete settlement of the UK defined benefit plan. The existing surplus before the extra payment was EUR 375 million. As this surplus was not recognized in the balance sheet, due to the asset ceiling test, per the Company's accounting policy the Company did not recognize this as a settlement result in the income statement but in remeasurements for pensions in the Consolidated statements of Comprehensive Income. However, the above mentioned payment of EUR 305 million for EUR 274 million is booked as a related settlement loss in the income statement and for EUR 31 million as a past service cost in the income statement being the increase in the DBO for a plan change required by the Insurers. Before and during the wind up of the Fund several other de-risking actions were held resulting in a settlement loss of EUR 27 million and a past service cost gain of EUR 14 million.

**United States**

The US defined benefit plan covers certain hourly workers and salaried workers hired before January 1, 2005. Indexation of benefits is not mandatory. The Company pays contributions for the annual service costs as well as additional contributions to cover a deficit. The assets of the US plan are in a Trust governed by Trustees.

The accrual for salaried workers in the US plan as decided in 2013 would end per December 31, 2015 after which the remaining members become eligible for the existing US DC plan. In 2015 the end date was accelerated to July 1, 2015 triggering a EUR 1 million past service cost gain.

In 2015 in preparation of the split of the Company into Lighting Solutions and HealthTech the benefits of a group of former US employees not having worked for any of the current businesses were transferred to a separate plan covered by ERISA section 4044, which ensures a correct split of the plan assets among others based on the maturity of the plan. In October 2015 all the benefits of this plan were transferred to a consortium of three insurance companies. The Company made a EUR 141 million contribution to the plan to enable the transfer. The transfer to the insurance companies triggered a settlement of the plan. The difference between the DBO and settlement price at transfer date amounted to EUR 33 million and is recognized as a settlement loss in the income statement. The effects of ERISA section 4044 for the surviving defined benefit plan will be adjusted by a contribution to the surviving plan early in 2016 which is included in the 2016 cash projection further on in this note. A de-risking action held in the remaining pension plan providing lump sums resulted in a EUR 6 million settlement gain.

**Risks related to defined-benefit plans**

The remaining defined benefit plans expose the Company to various demographic and economic risks such as longevity risk, investment risks, currency and interest rate risk and in some cases inflation risk. The latter plays a role in the assumed wage increase and in some smaller plans where indexation is mandatory.

Pension fund Trustees are responsible for and have full discretion over the investment strategy of the plan assets. In general Trustees manage pension fund risks by diversifying the investments of plan assets and by (partially) matching interest rate risk of liabilities.

The Company has an active de-risking strategy in which it constantly looks for opportunities to reduce the risks associated with its defined benefit plans. Liability driven investment strategies, lump sum cash-out options, buy-ins, buy-outs and the above mentioned 2015 change to DC for the Dutch plan and the other settlements are examples of that strategy. The larger plans are either governed by independent Boards or by

Trustees who have a legal obligation to evenly balance the interests of all stakeholders and operate under the local regulatory framework.

### **Balance sheet positions**

The net balance sheet position presented in this note can be explained as follows:

The surplus in our plan in Brazil is not recognized as a net defined benefit asset because in Brazil the regulatory framework prohibits refunds to the employer.

The deficit of the US defined benefit plan presented under other liabilities and the provisions of the unfunded plans therefore count for the largest part of the net balance sheet position.

The measurement date for all defined-benefit plans is December 31.

**Table of Contents**

Group financial statements 12.9

**Summary of pre-tax costs for post-employment benefits**

The below table contains the total of current- and past service costs, administration costs and settlement results as included in Income from operations and the interest cost as included in Financial expenses.

**Defined benefit plans: Pensions**

Movements in the net liabilities and assets for defined benefit pension plans:

Philips Group

**Pre-tax costs for post-employment benefits** in millions of EUR

2013 - 2015

	2013	2014	2015
Defined-benefit plans	297	245	561
included in operating cost	220	182	487
included in financial expense	71	59	72
included in discontinued operations	6	4	2
Defined-contribution plans including multi-employer plans	142	148	299
included in operating cost	134	144	293
included in discontinued operations	8	4	6

Philips Group

**Defined-benefit obligations** in millions of EUR

2014 - 2015

	2014			2015		
	Netherlands	other	total	Netherlands	other	total
<b>Balance as of January 1</b>	<b>14,294</b>	<b>7,911</b>	<b>22,205</b>	<b>17,616</b>	<b>9,465</b>	<b>27,081</b>
Service cost	174	65	239	77	60	137
Interest cost	478	361	839	120	345	465
Employee contributions	5	4	9	5	4	9
Actuarial (gains) / losses						
demographic assumptions	(80)	197	117			
financial assumptions	3,487	782	4,269	1,796	(271)	1,525
experience adjustment	23	25	48	(176)	27	(149)
(Negative) past service cost	(68)	(1)	(69)		14	14

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Acquisitions		12	12			
Divestments					(12)	(12)
Settlements		(9)	(9)	(19,197)	(5,193)	(24,390)
Benefits paid	(699)	(506)	(1,205)	(234)	(553)	(787)
Exchange rate differences		624	624		635	635
Miscellaneous	2		2		(1)	(1)
<b>Balance as of December 31</b>	<b>17,616</b>	<b>9,465</b>	<b>27,081</b>	<b>7</b>	<b>4,520</b>	<b>4,527</b>
<b>Present value of funded obligations at December 31</b>	<b>17,609</b>	<b>8,532</b>	<b>26,141</b>		<b>3,635</b>	<b>3,635</b>
<b>Present value of unfunded obligations at December 31</b>	<b>7</b>	<b>933</b>	<b>940</b>	<b>7</b>	<b>885</b>	<b>892</b>

Philips Group

**Plan assets** in millions of EUR

2014 - 2015

	2014			2015		
	Netherlands	other	total	Netherlands	other	total
<b>Balance as of January 1</b>	<b>14,843</b>	<b>6,728</b>	<b>21,571</b>	<b>17,847</b>	<b>8,016</b>	<b>25,863</b>
Interest income on plan assets	508	330	838	123	311	434
Admin expenses paid	(9)	(6)	(15)	(3)	(6)	(9)
Return on plan assets excluding interest income	2,534	674	3,208	1,233	(315)	918
Employee contributions	5	4	9	5	4	9
Employer contributions	665	199	864	245	302	547
Divestments					(7)	(7)
Settlements		(8)	(8)	(19,217)	(5,623)	(24,840)
Benefits paid	(699)	(445)	(1,144)	(233)	(492)	(725)
Exchange rate differences		540	540		520	520
<b>Balance as of December 31</b>	<b>17,847</b>	<b>8,016</b>	<b>25,863</b>		<b>2,710</b>	<b>2,710</b>
Funded status	231	(1,449)	(1,218)	(7)	(1,810)	(1,817)
Unrecognized net assets	(238)	(554)	(792)		(90)	(90)
<b>Net balance sheet position</b>	<b>(7)</b>	<b>(2,003)</b>	<b>(2,010)</b>	<b>(7)</b>	<b>(1,900)</b>	<b>(1,907)</b>

178 Annual Report 2015

**Table of Contents**

Group financial statements 12.9

The classification of the net balance is as follows:

Philips Group

**Net balance of defined-benefit pension plans** in millions of EUR

2014 - 2015

	2014			2015		
	Netherlands	other	total	Netherlands	other	total
Prepaid pension costs under other non-current assets		2	2		3	3
Accrued pension costs under other liabilities		(1,072)	(1,072)		(1,018)	(1,018)
Provision for pensions under provisions	(7)	(926)	(933)	(7)	(885)	(892)
Provision in assets held for sale		(7)	(7)			
<b>Net balance of defined-benefit plans</b>	<b>(7)</b>	<b>(2,003)</b>	<b>(2,010)</b>	<b>(7)</b>	<b>(1,900)</b>	<b>(1,907)</b>

Philips Group

**Changes in the effect of the asset ceiling** in millions of EUR

2014 - 2015

	2014			2015		
	Netherlands	other	total	Netherlands	other	total
<b>Balance as of January 1</b>	<b>555</b>	<b>428</b>	<b>983</b>	<b>238</b>	<b>554</b>	<b>792</b>
Interest on unrecognized assets	19	28	47	2	27	29
Remeasurements	(336)	73	(263)	(240)	(493)	(733)
Exchange rate differences		25	25		2	2
<b>Balance as of December 31</b>	<b>238</b>	<b>554</b>	<b>792</b>	<b>90</b>	<b>90</b>	<b>90</b>

**Plan assets allocation**

The asset allocation in the Company's pension plans at December 31 was as follows:

Philips Group

**Plan assets allocation** in millions of EUR

2014 - 2015

	2014		2015	
	Netherlands	other	Netherlands	other
<b>Matching portfolio:</b>				
- Debt securities	10,663	5,051		1,523
- Other		1,299		
<b>Return portfolio:</b>				
- Equity securities	5,088	388		740
- Real estate	1,784	13		9
- Other	312	1,265		438
<b>Total assets</b>	<b>17,847</b>	<b>8,016</b>		<b>2,710</b>

Asset values related to buy-in contracts are now included in the Matching portfolio under Other.

The assets in 2015 contain 51% (2014: 17%) unquoted assets, the increase compared to 2014 fully related to the exclusion of the UK and NL plan assets. Plan assets in 2015 do not include property occupied by or financial instruments issued by the Company.

**Assumptions**

The mortality tables used for the Company's major schemes are:

Netherlands: Prognosis table 2014 including experience rating TW2014.

UK: SAPS 2002- Core CMI 2011 projection

US: RP2014 HA/EE Fully Generational scaled with MP2014

In the US the issued MP-2015 mortality improvement scale, not adopted by the Company yet due to the limited extra period (2 years) of observation, would lower the DBO by about EUR 40 million.

The weighted averages of the assumptions used to calculate the defined-benefit obligations as of December 31 were as follows:

Philips Group

**Assumptions used for defined-benefit obligations in %**

2014 - 2015

	2014		2015	
	Netherlands	other	Netherlands	other

Discount rate	2.1%	3.7%	4.0%
Rate of compensation increase	2.0%	3.0%	2.7%

The Discount rate for the Netherlands at the moment of the change to DC was 1.55%. Due to the nature of the pension plan in the Netherlands until May 1, 2015 an assumption was required for the future pension accrual rate. If the fixed premium did not cover the cost of the target accrual of 1.85% per annum a lower percentage must be applied for which the cost will be covered by the fixed premium. The Fund in the Netherlands has set aside part of the EUR 600 million received for active members accrual or indexation. The accrual rate for the next 5 years starting 2015 was expected to be 1.85% but per 31 December 2014 the average future accrual rate used to calculate the defined-benefit obligation and service cost was fixed at 1.74% as after the five year period a lower percentage would apply assuming the current fixed premium level. Per May 1, 2015 this no longer applies due to the change to DC.

The average duration of the defined-benefit obligation of the pension plans is 10 years (2014: 12 years).

**Table of Contents**

Group financial statements 12.9

**Defined-benefit plans: retiree medical plans**

Movements in the net liability for retiree medical plans:

Philips Group

**Liability for retiree medical plans** in millions of EUR

2014 - 2015

	2014	2015
<b>Balance as of January 1</b>	<b>213</b>	<b>241</b>
Service cost	2	
Interest cost	11	12
Actuarial (gains) or losses arising from:		
Demographic assumptions	3	
Financial assumptions	9	(2)
Experience adjustment	(3)	(17)
Past service cost		
Benefits paid	(15)	(13)
Exchange rate differences	21	9
<b>Balance as of December 31</b>	<b>241</b>	<b>230</b>
Present value of funded obligations as of December 31		
Present value of unfunded obligations as of December 31	241	230
Funded status	(241)	(230)
<b>Net balances</b>	<b>(241)</b>	<b>(230)</b>
Classification of the net balance is as follows:		
Provision for other postretirement benefits	(241)	(230)

The weighted average assumptions used to calculate the defined-benefit obligations for retiree medical plans as of December 31 were as follows:

Philips Group

**Weighted average assumptions for retiree medical plans** in %

2014 - 2015

2014	2015
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Discount rate	5.0%	5.1%
Compensation increase (where applicable)	0.0%	0.0%

Assumed healthcare cost trend rates at December 31:

Philips Group

**Assumed healthcare cost trend rates in %**

2014 - 2015

	2014	2015
Healthcare cost trend rate assumed for next year	7.0%	7.5%
Rate that the cost trend rate will gradually reach	5.3%	5.3%
Year of reaching the rate at which it is assumed to remain	2024	2025

The average duration of the defined-benefit obligation of the retiree medical plans is 8 years (2014: 8 years).

### Investment policy in our largest pension plans

It must be acknowledged that trustees of the Philips pension plans are responsible for and have full discretion over the investment strategy of the plan assets.

The plan assets of the Philips pension plan in the US are invested in a well diversified portfolio. The interest rate sensitivity of the fixed income portfolio is closely aligned to that of the plan's pension liabilities. Any contributions from the sponsoring company are used to further increase the fixed income part of the assets. As part of the investment strategy, any additional investment returns of the return portfolio are used to further decrease the interest rate mismatch between the plan assets and the pension liabilities.

### Cash flows and costs in 2016

The Company expects considerable cash outflows in relation to post-employment benefits which are estimated to amount to EUR 660 million in 2016, consisting of:

EUR 209 million employer contributions to defined benefit pension plans

EUR 372 million employer contributions to defined contribution pension plans

EUR 61 million expected cash outflows in relation to unfunded pension plans and

EUR 18 million in relation to unfunded retiree medical plans.

The employer contributions to defined benefit pension plans are expected to amount to EUR 174 million for the US and EUR 35 million for other countries. For the funding of the deficit in the US plan the Group adheres to the minimum funding requirements of the US Pension Protection Act.

The service and administration cost for 2016 is expected to amount to EUR 43 million, consisting of EUR 42 million for defined-benefit pension plans and EUR 1 million for defined-benefit retiree medical plans. The interest expense for 2016 is expected to amount to EUR 66 million, consisting of EUR 55 million for defined-benefit pension plans and EUR 11 million for defined-benefit retiree medical plans. The cost for defined-contribution pension plans in 2016 is expected to amount to EUR 204 million in the Netherlands and EUR 168 million in other

countries.

### **Sensitivity analysis**

The table below illustrates the approximate impact on the defined benefit obligation (DBO) if the Company were to change key assumptions. The DBO was recalculated using a change in the assumptions of 1% which overall is considered a reasonably possible change. The impact on the DBO because of changes in discount rate is normally accompanied by offsetting movements in plan assets, especially when using matching strategies.

180 Annual Report 2015

**Table of Contents**

Group financial statements 12.9

Philips Group

**Key assumptions** in millions of EUR

2015

	Defined benefit obligation		
	Pension Netherlands	Pension other	Retiree medical
<b>Increase</b>			
Discount rate (1% movement)		(468)	(18)
Wage change (1% movement)		23	
Inflation (1% movement)		115	
Longevity (see explanation)		80	7
Medical benefit level (1% price increase)			13
<b>Decrease</b>			
Discount rate (1% movement)		550	20
Wage change (1% movement)		(20)	
Inflation (1% movement)		(104)	

Philips Group

**Key assumptions** in millions of EUR

2014

	Defined benefit obligation		
	Pension Netherlands	Pension other	Retiree medical