# Creating a leading lighting components company

**Eric Rondolat**
CEO Philips Lighting
September 23, 2014

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# Stand-alone Lumileds and Automotive lighting with top positions in fast-growing markets

## Top positions in the key segments of combined Lumileds and Automotive

*Market field of Lumileds and Automotive lighting*

| Key segments[2] | Market position[1] | Market 2013-2018 CAGR[1] |
|---|---|---|
| Specialty | #1 | 4% to 8% |
| Automotive[3] | #2 | 2% to 6% |
| High-Power LEDs General illumination | #3 | 17% to 21% |




## Unlocking entrepreneurial drive and agility as a stand-alone company

- EUR 1.4 billion sales in 2013
- Benefitting from a strong and focused management team
- Supplying Philips and other leading players across the illumination, automotive and consumer electronics segments
- Innovation collaboration with Philips
- Platform for accelerated growth

[1] Source: customer panels, industry associations and internal analysis; [2] Also playing in Display with focused positioning; [3] LED and conventional



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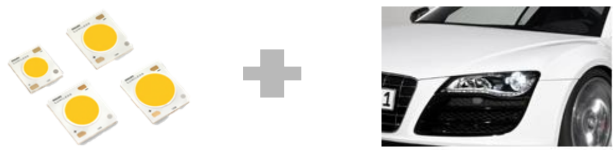
# On track to create a stand-alone leading lighting components company in H1 15

## Ready to accelerate growth & scale in this attractive and dynamic industry

- Right time in cycle after turnaround of Lumileds
- Combining Lumileds & Automotive to lead in:
  - technology
  - application know-how
  - global supply chain
  - customer access
  - intellectual property

## Process will lead up to the creation of the stand-alone entity in H1 15

*Combination of Lumileds and Automotive lighting*



- Process started on June, 2014
- Currently evaluating strategic options from interested third parties and investors

**Right window of opportunity to accelerate growth, gain scale and drive industry consolidation**

# Lighting Solutions Opportunity

**Eric Rondolat**
CEO Philips Lighting
**René van Schooten**
Light Sources & Electronics, Philips Lighting
**Amy Huntington**
Professional Lighting Solutions, Philips Lighting

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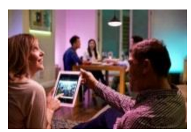
# Our strategy of connected lighting captures the attractive value of lighting solutions

| | | | |
|---|---|---|---|
| 1 | **Global leader in the lighting industry** |  | *We are a global leader in this attractive market & consistently improve operational performance* |
| 2 | **Conventional lighting pro-actively managed** |  | *Our industrial setup is flexible to cater for the conventional market decline dynamics* |
| 3 | **LED lamps optimized for value creation** |  | *We continuously take cost out and differentiate in LED lamps* |
| 4 | **LED offers are designed for connectivity** |  | *We shape the connected lighting market* |
| 5 | **Systems & services as additional profit pool** |  | *Unique position to win in the fast-growing systems & services market* |
| 6 | **Path-to-Value on track** |  | *On track to deliver on our targets with a clear Path-to-Value for 2016 and beyond* |



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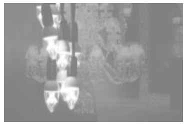

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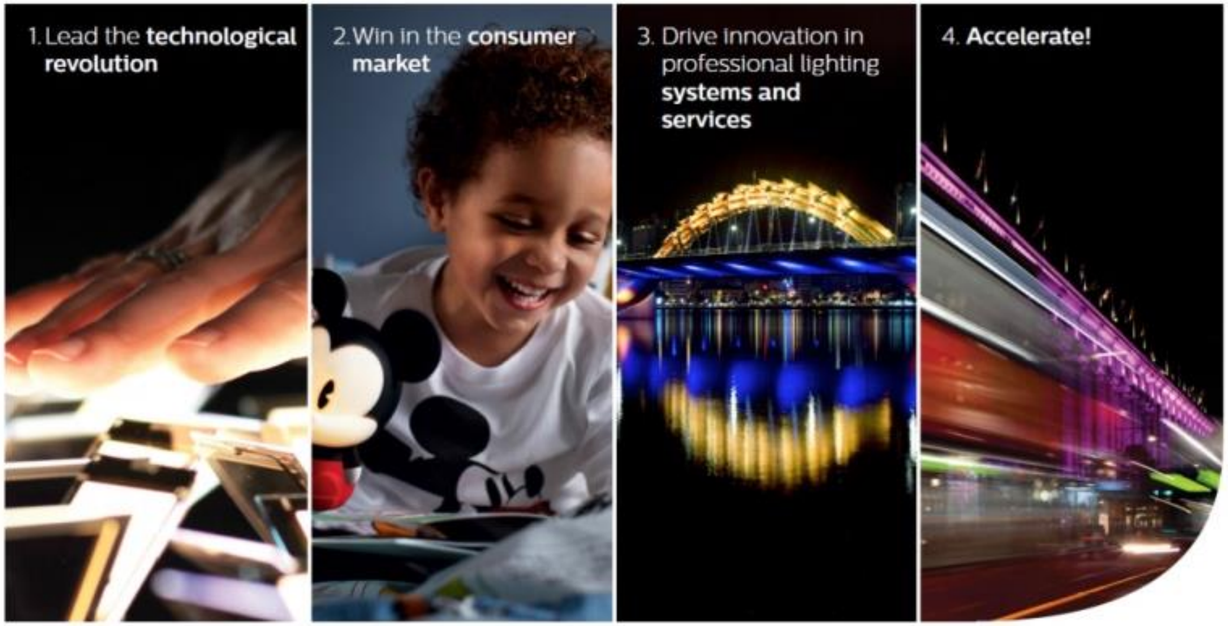
# Our guiding statement and strategy

**Guiding statement**

- *"We are a world leading lighting company aiming at improving people's lives with Light by delivering unique value and energy efficient solutions to consumers and professional customers, every day and everywhere."*
- *"We are using **deep customer insights** and **technological innovations**, coupled with our **trusted brand** and **global leadership positions**, to lead the digital lighting revolution."*

**4-pillar strategy**



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# We are the global leader in our businesses

## We focus on three business groups

1 **Light Sources & Electronics**

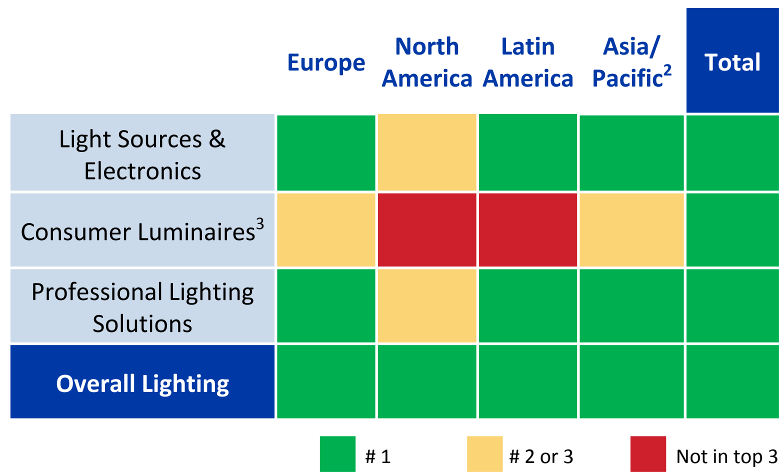
2 **Consumer Luminaires**

3 **Professional Lighting Solutions**, including:

- **Systems**: interconnected lighting products (light sources, luminaires, controls), software and system integration
- **Services**: advise, operate and/or maintain an installed lighting system through its lifecycle

## And have leadership positions across all regions

*Market share per Business Group by region – H1 14[1]*




- Largest lighting company in the world
- #1 in sold LED lighting
- #1 in connected lighting[4]

[1] Source: customer panels, industry associations and internal analysis; [2] Excluding Japan;
[3] #1 position globally as nearest competitors play only on specific regions; Excluding private labels; [4] Source: Markets and Markets, Global smart lighting market (2013–18)



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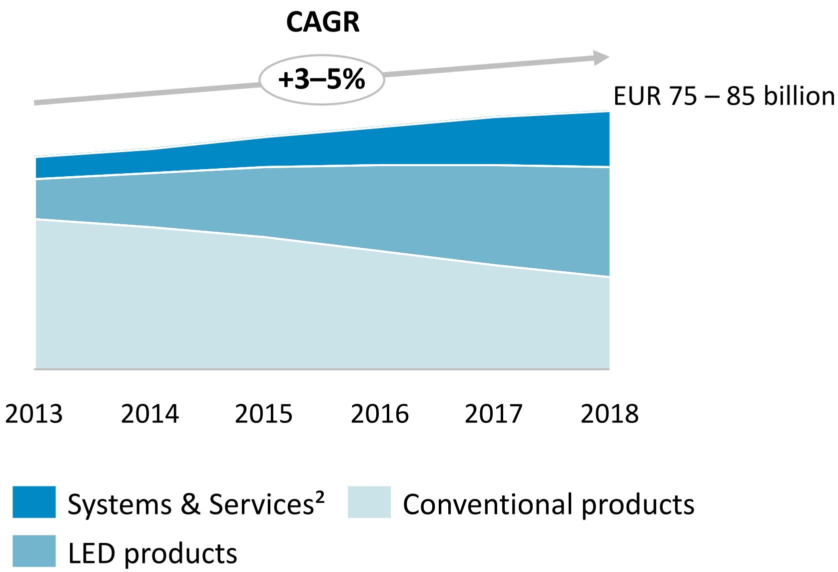
# The overall lighting market is attractive with high-margin businesses driving value

## We serve a large and attractive market expected to grow 3 - 5% CAGR between 2013 and 2018

*Global lighting market forecast[1]*




- LED penetration to reach 60–65% by 2018[3]

## The lighting industry is undergoing three major transitions in parallel

| | 2013 - 2018 CAGR[1] |
|---|---|
| 1 Conventional products | -9% to -11% |
| 2 LED products | 20% to 25% |
| 3 Systems & Services[2] | Systems: 20% to 25%<br>Services[4]: 40% to 45% |

[1] Source: Philips Lighting global market study. Excluding Automotive lighting and LED components market
[2] Only professional market and lifecycle data-enabled services only; [3] Including part of Systems & Services; [4] Data-enabled services only



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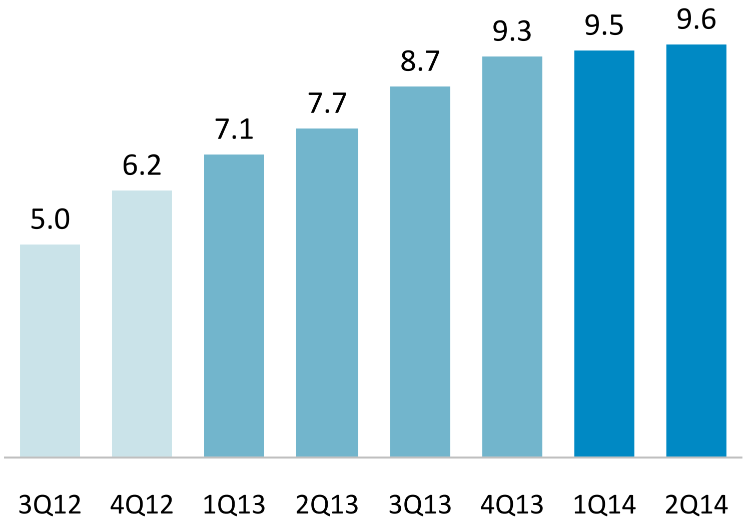
# We are consistently improving operational performance

**8 consecutive quarters of profitability improvement**

*Adjusted EBITA margin (%, rolling LTM[1])*




**Supported by the success of Accelerate!**

- LED-based sales: 40% comparable growth in H1 14, representing 34% of total lighting sales
- Productivity: adjusted non-manufacturing costs as % of sales down by ~300 bps (H1 14 vs. FY 11)
- Spontaneous brand awareness: 69% for both Conventional and LED[2]
- Unfavorable currency rates
- Closing performance gaps in Professional Lighting Solutions North America and Consumer Luminaires Europe
- Addressing headwinds in China

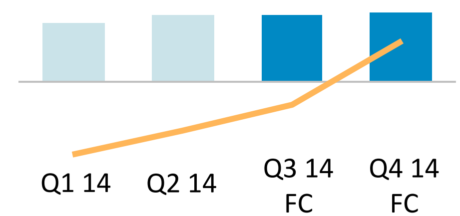
[1] Including Lumileds and Automotive lighting businesses; adjusted EBITA margin is EBITA margin excluding restructuring, acquisition-related charges and other items
[2] Philips brand equity study 2013

# Professional Lighting Solutions North America: confident we are regaining our position

| Customer reach was losing traction | We reduced complexity |
|---|---|
| *Go-to-Market* | |
| • 21 commercial organizations<br>• Duplicated go-to-market<br>• Lack of performance metrics | • Cross-business sales force<br>• Pipeline and sales quota tracked by new CRM system |
| *Portfolio management* | |
| • 43 brands, overlapping offers | • 12 brands<br>• # of factories and R&D sites reduced by 49% since 2012<br>• Strong traction on LED range |
| *Customer experience* | |
| • Unsatisfactory customer service level | • Improved End2End processes leading to 23% increase in # of quotes responded within 24 hours |

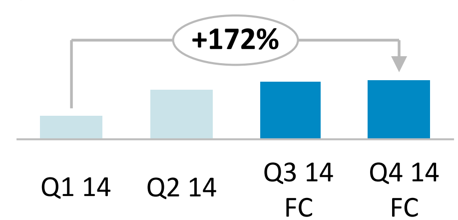
## Measures are paying off

*Sales and CSG%*




- Positive growth expected in September and Q4 14
- 40% LED penetration in H1 14, compared to 27% in H1 13

*Adjusted EBITA[1] margin*




- Positive adjusted EBITA anticipated in Q3 14



[1] Adjusted EBITA is EBITA excluding restructuring, acquisition-related charges and other items

# China: headwinds impacting 2014 performance

## Market and channel-related headwinds

## We have implemented sharp measures

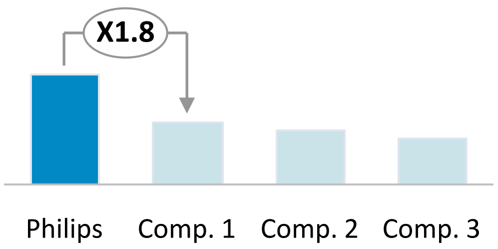
## Maintained strong #1 position while optimizing cash

*Accelerated decline of Conventional*

- Decline faster than expected: double-digit in H1 14[1]
- Retail segment strongly impacted

- Redeployed resources to LED
- Competitive entry ranges
- Adapted sales channels and capabilities to new customers and businesses

*LED lighting sales H1 14[1]*

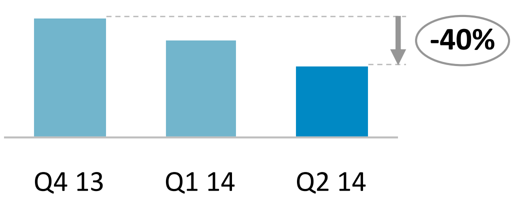



*Channel-related challenges*

- High channel inventory
- Deteriorated customer liquidity and credit conditions

- Tightened credit management
- >2.5x online sales growth in consumer market

*Customers' trade inventory*




- Unplugging bottle necks which will contribute to recovery

[1] Source: 2014 H1 GIA market report



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# Consumer Luminaires Europe repositioned for profitable growth

## Business setup adversely affected performance

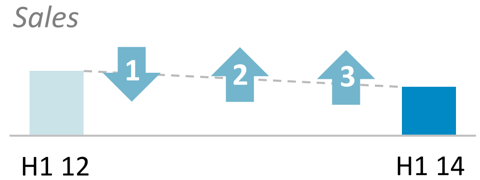
*Go-To-Market strategy*

- Unprofitable customer base
- No consumer segmentation
- Construction and home refurbishment market decline

*Cost base*

- Inefficient supply chain setup

## We strengthened fundamentals




1. Exited unprofitable accounts
2. Channel expansion: online, food, electro, kids retail
3. +147% LED-based luminaires in portfolio

- 9 Logistic centers closed since 2012
- Systematic platform design approach

## And will reap the benefits as the macro-environment improves

- Portfolio rationalization with 47% less SKUs[2] since H1 12
- Non-manufacturing cost reduced by 22% since H1 12
- Positive sales growth anticipated in H2 14
- On track to achieve breakeven on adjusted EBITA[1] in overall Consumer Luminaires in FY 14

[1] Adjusted EBITA is EBITA excluding restructuring, acquisition-related charges and other items
[2] SKUs = Stock Keeping Units



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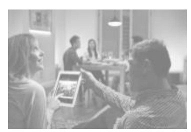

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*Unique position to win in the fast-growing systems & services market*

---

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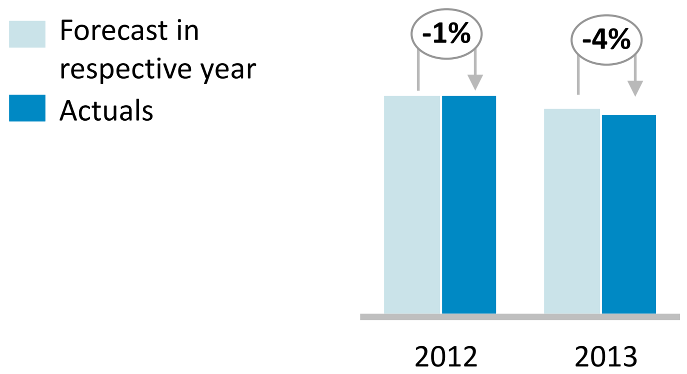
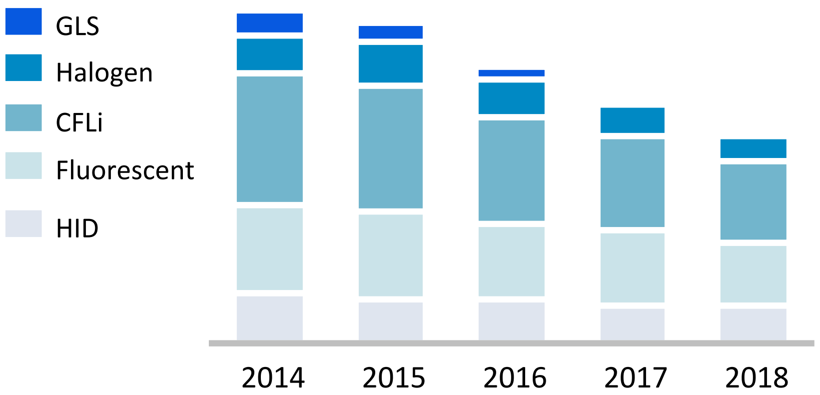
# Conventional lamps decline is slightly faster than expected and we focus on areas of growth

**Our model gives deep insights into the market dynamics**

*Conventional lamps market, indexed[1]*




*2014 forecast*




**Frequently update our granular market model which has proved to be close (only <5% off) to actuals**

**Opportunities in growth geographies[2] partially offset strong decline in mature geographies**



[1] Source: Philips global market study
[2] Growth geographies are all geographies excluding USA, Canada, Western Europe, Australia, New Zealand, South Korea, Japan and Israel

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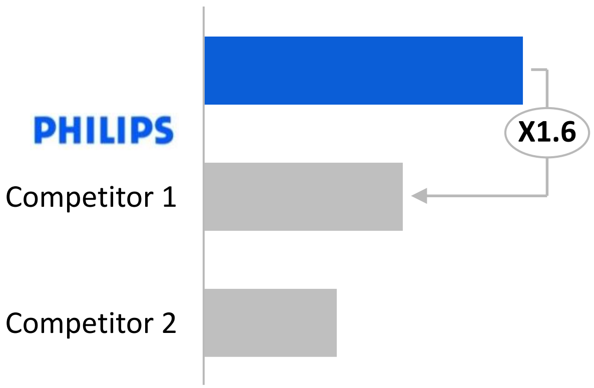
# Performance and market positions remain strong

## #1 in conventional lamps and drivers

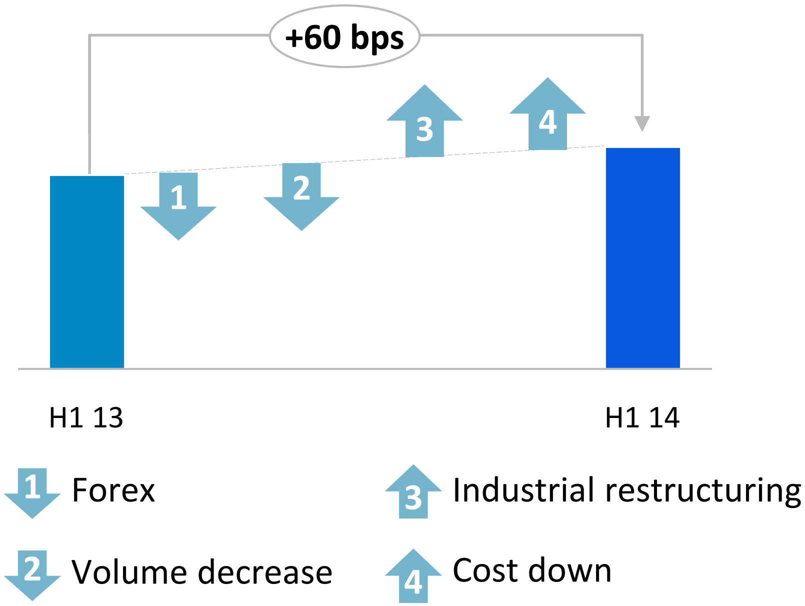
Market share, conventional lamps and drivers[1]




- Capture value by leveraging our unique CAPs[2]:
  - Global market presence
  - Leading technology and trusted brand
  - Extensive customer channels

## Stable margin across the cycle

Adjusted gross margin, conventional lamps and drivers

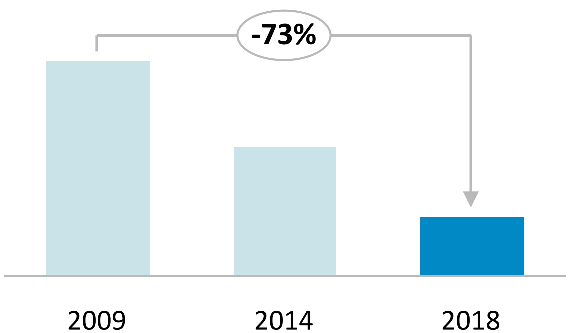



[1] Source: Philips Lighting global market study, competitor reports; [2] Capabilities, Assets and Positions

# Industrial setup for lamps & drivers is flexible to cater to the conventional market decline

## We adapt capacity in response to market demand

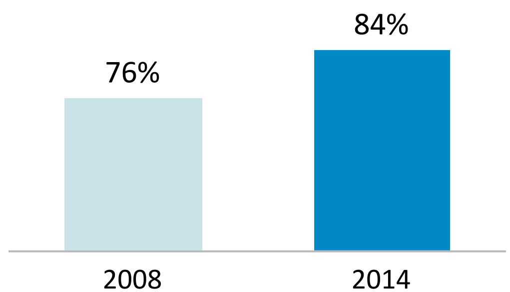
*# of manufacturing sites for LS&E*[1]




- Ability to adjust capacity with a 3-month lead time
- Closure of sites accelerated in line with market demand

## We optimize geographical footprint

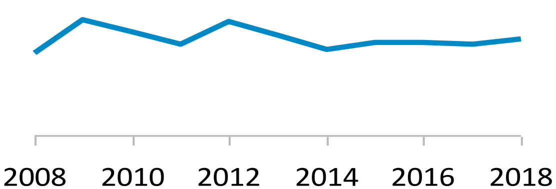
*Manufacturing headcount in low cost countries, % of total*



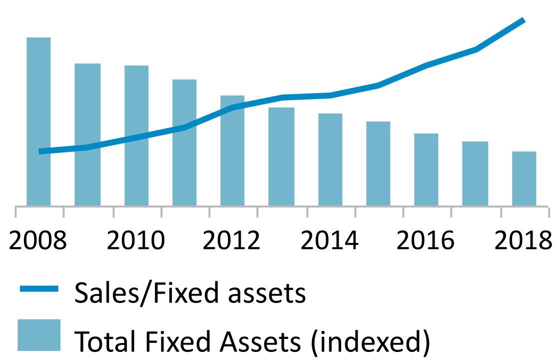

- We shift production to capture
  - cost advantages
  - sales opportunities

## Measures deliver positive results

*Free Cash Flow to sales ratio, conventional lamps and drivers*




*Fixed asset turnover ratio, conventional lamps and drivers*






[1] Light Sources & Electronics

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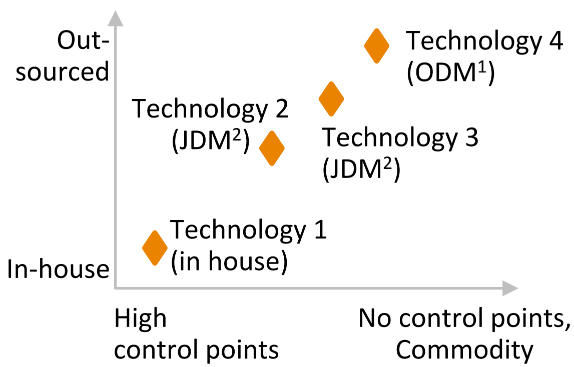
# LED lamps margins improve as we focus on cost down and differentiating innovations

## Manufacturing model is optimized to reduce costs

*Manufacturing model metrics (indicative)*




- Selectively outsource technologies as they commoditize
- Innovative products and control points remain in house

## Differentiation through innovation at all price points

*Consumer*

SlimStyle

- First 60W replacement bulb at <USD 2[3] in USA
- Unique concept where heat sink is removed

The classic LED bulb

- Produced and launched in Europe at <EUR 5
- Frosted incandescent look and feel through the use of glass bulb

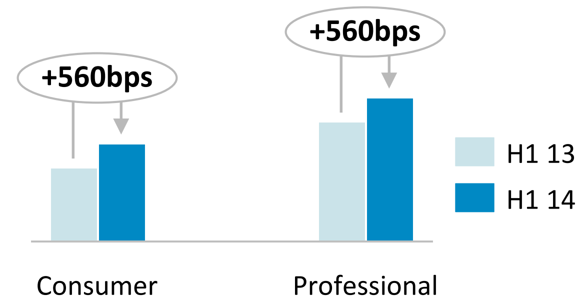
*Professional*

Instant Fit T8

- Works instantly with electronic ballast
- 15 min installation time reduction per lamp

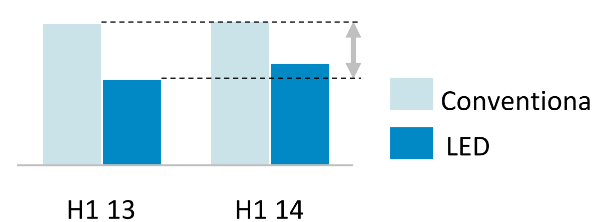
## Measures are paying off both in Consumer and Professional

*Adjusted gross margin LED Lamps*




## Gross margin difference of LED vs. Conventional lamps is narrowing

*Adjusted gross margin*






[1] Original Design Manufacturing; [2] Joint Development Manufacturing; [3] After rebates in selected states

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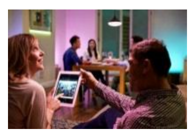
| 4 | **LED offers are designed for connectivity** |  | *We shape the connected lighting market* |
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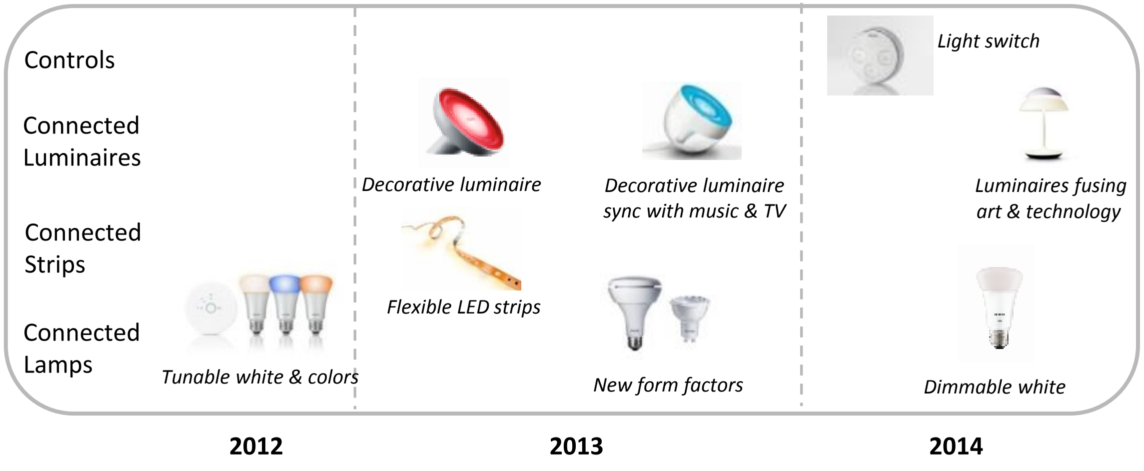
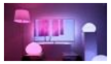
# Philips Hue opens new attractive value spaces in connected lighting for consumers

## The most comprehensive portfolio of products connectable to the smart home ecosystem




## Growing Hue portfolio connects seamlessly with leading home automation offerings

| | Smart home integrators | | Smart home Telco/ISP[3] | Entertainment companies | |
|---|---|---|---|---|---|
| Home automation partnerships[4] | Apple | Zonoff | Deutsche Telekom | Logitech  | TP Vision  |

## Rapidly growing as we expand our distribution worldwide

- 224 million smart homes by 2019[1]:
  - Lighting is one of the top aspects of home automation[2]
  - The only application present in every room and used every day
- 43% sales increase in H1 14
- Hue sold in over 30 countries, bridges installed in 150 countries
- ~200 Hue 3rd-party apps in August 2014

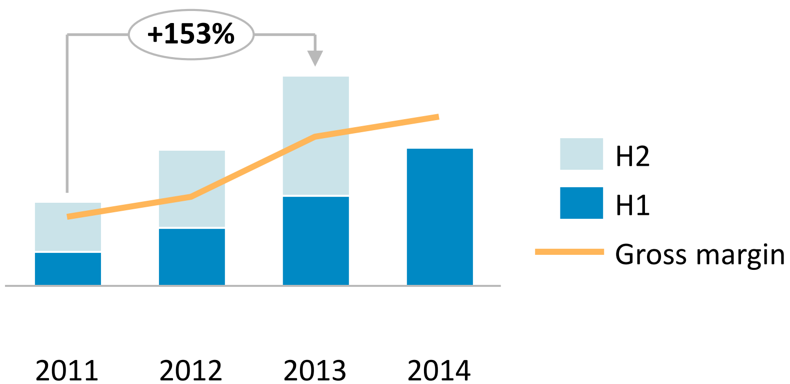


[1] Source: Strategy analytics; [2] Source: HIS; [3] ISP = Internet Service Provider; [4] Pictures of partners are not owned by Philips, all rights reserved

# LED modules & drivers are a success story and an important enabler for our connected lighting strategy

## LED modules & drivers has a track record of outstanding performance

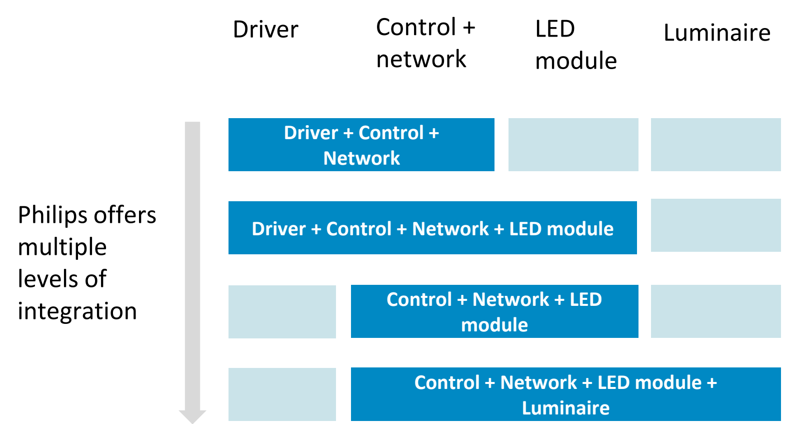
*Sales and gross margin, indexed*




- Rapid market growth (2013-2018 CAGR ~27%)
- Cost roadmaps updated quarterly
- Supply Chain designed for OEM[1] :
  - Proximity
  - Flexibility
  - Lowest integral cost

## New business opportunity enabled by digitalization

*New types of modularization for connected luminaires*




Philips Xitanium Sensor Ready: latest solution combining driver, control and network for wireless connected battens

[1] OEM = Original Equipment Manufacturing



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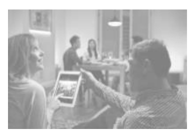
| 4 | LED offers are designed for connectivity |  | *We shape the connected lighting market* |
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# LED façade lighting, Allianz Arena: concrete example of an End2End project in systems

**idea-to-market** → **market-to-order** → **order-to-cash**

**1** *Lead generation & specification*

- Allianz Arena’s needs
  - Dramatic effects
  - Operational savings

**3** *Proposal development*

- Fast and flexible responses
- Convincing mock-ups on site

**5** *Project execution*

- System Design and supply – Philips
- Luminaires under production – Philips
- Project management – Philips
- Installation & Commissioning – Partner
- Onsite support & Services – Partner

09/2012 — 03/2014 — 05/2014 — 09/2014 — 03/2015

**2** *Architecture development*

- Customized luminaire with new-to-the-world optics developed

**4** *Contract award*

- High media coverage

**6** *Project completion*

- Opening at the Arena’s 10-year anniversary



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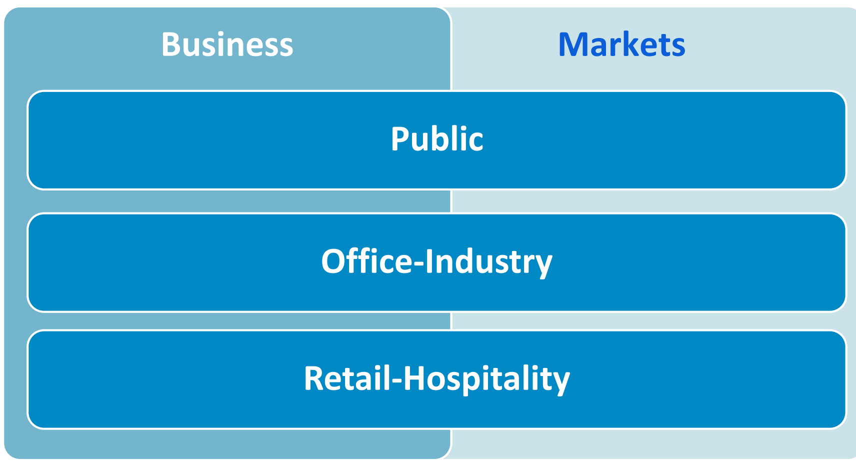
# Systems: our segment and architecture approach leads to accelerated profitable growth

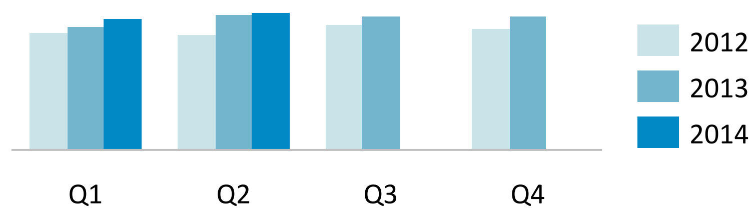
## Offer creation and sales organized by customer segments




- Flexible, open architectures
- Easy to deploy operate and maintain – plug and play
- Value beyond illumination and energy efficiency, leading to customer business improvement

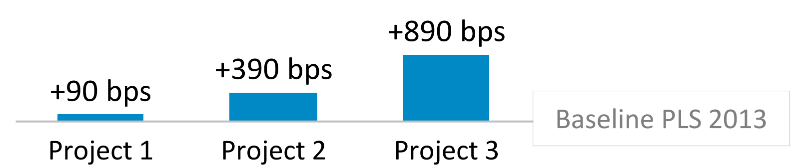
## Consistent year-on-year PLS[1] margin improvement

*Gross margin (Indexed)*




## Systems margin is accretive to overall PLS margins

*Gross margin increase, selected projects*




- Innovation and value-based selling
- Project and risk management

[1] Professional Lighting Solutions



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# Services: create and scale by leveraging our position in systems

## Lighting Services – Our unique positioning

**Professional Services**

*audit*

**Lifecycle Services**

*maintenance*

**Managed Services**

*performance commitment*

**Data-enabled**

*Data storage*
*Data visualization*
*Enhanced monitoring and management*

## Washington Metro Area Transit Authority


- 13-year contract with predictable annual expense
- 15k luminaires controlled & maintained, 25 garages
- Data-enabled maintenance
- 48-hour response time
- USD 2.6 million annual cost savings
- Enhanced safety of 54,000 customers daily



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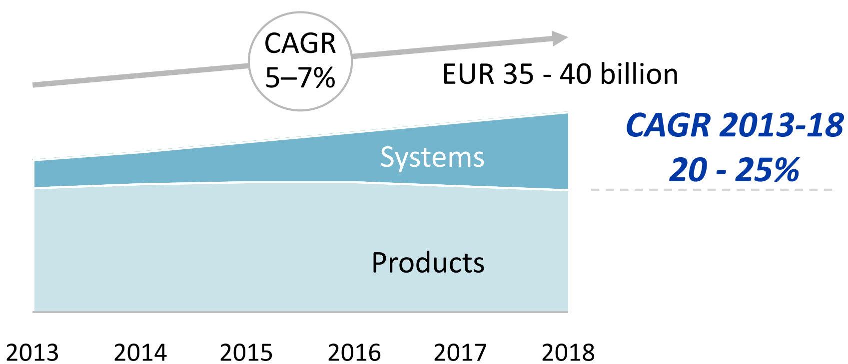
# Double-digit growth in professional systems & services improves overall lighting market attractiveness

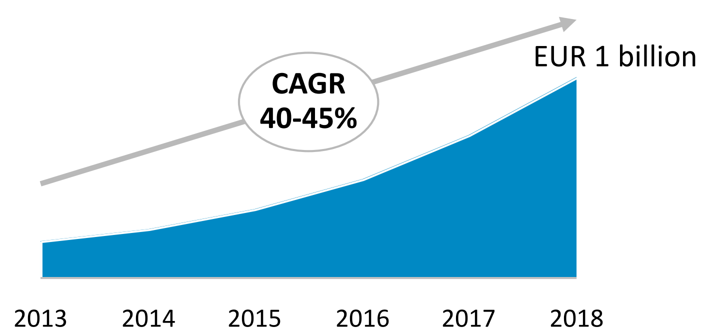
## Systems will expand the addressable market by EUR 3 - 4 billion

*Professional lighting solutions market forecast*




## Data-enabled services will further expand the market by EUR 1 billion

*Data-enabled services market forecast*




### Expected to represent 40% of the professional lighting solutions market by 2018

- Leverage lighting assets in new ways
- Value beyond illumination and improved customer business performance

### Data transmitted through digital light points enables asset-light service offers

- Data can be analyzed to provide actionable insights
- Optimized management and monitoring of performance

**Uniquely positioned to capture the high growth and accretive market opportunities of systems and services**

Note: Systems installation market (EUR 7-8 billion by 2018) excluded in addressable market, where we mainly leverage our partner network
Source: Philips internal study, market reports, expert interviews



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# Our strategy of connected lighting captures the attractive value of lighting solutions

1 **Global leader in the lighting industry**

*We are a global leader in this attractive market & consistently improve operational performance*

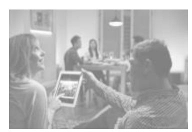
2 **Conventional lighting pro-actively managed**

*Our industrial setup is flexible to cater for the conventional market decline dynamics*

3 **LED lamps optimized for value creation**

*We continuously take cost out and differentiate in LED lamps*

4 **LED offers are designed for connectivity**



*We shape the connected lighting market*

5 **Systems & services as additional profit pool**

*Unique position to win in the fast-growing systems & services market*

6 **Path-to-Value on track**

*On track to deliver on our targets with a clear Path-to-Value for 2016 and beyond*



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# The Accelerate! journey will continue

Value

### 2011 – 2013
**Accelerating performance improvement**

- ✓ Strengthen operational performance
- ✓ Profitable leadership in LED lighting
- ✓ Invest in systems and services for profitable growth
- ✓ Industrial footprint rationalization
- ✓ Adapt to the economic environment
- ✓ Make Lumileds profitable

### 2014 – 2016
**Continued implementation of the PBS[1]**

- Create of a stand-alone leading lighting component entity (Lumileds and Automotive)
- Transition into a separate legal structure
- Deliver on structure cost savings and offer cost optimization through DfX[2]
- Lead Consumer Luminaires Europe and Professional Lighting Solutions North America to sustainable profitability
- Win the golden tail and accelerate industrial footprint rationalization
- Strengthen LED leadership across portfolio
- Grow connected lighting business for Consumer
- Grow the Systems businesses for Professional
- Develop the Services Business

Time

[1] Philips Business System; [2] Design for X; X = cost, quality, manufacturing, etc.



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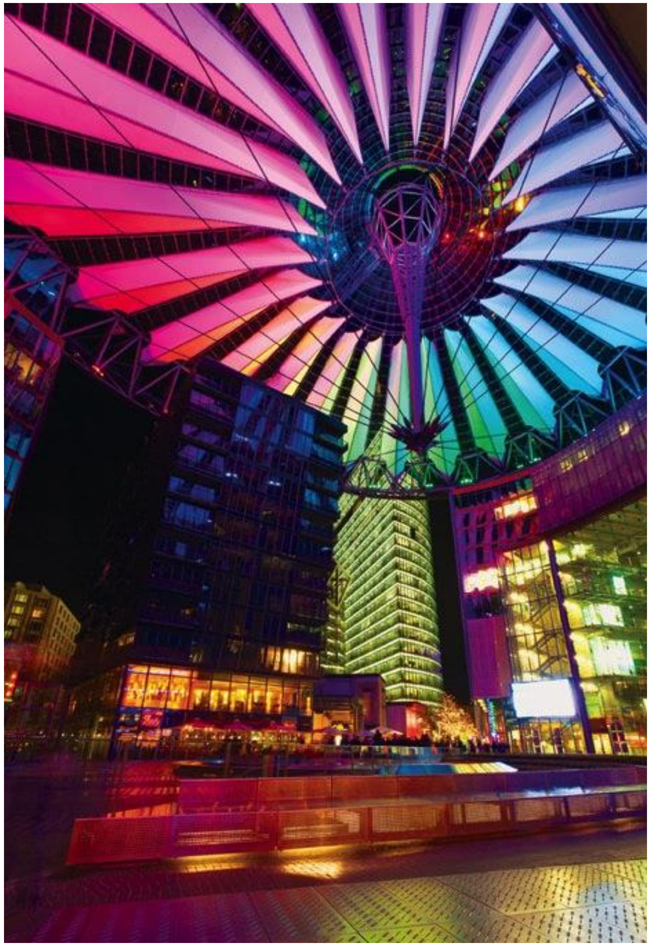
# Building the future of Lighting Solutions

- **We manage the decline of conventional lighting** by proactively adjusting our footprint and portfolio to **sustain profitability and leadership**
- We are already **well advanced** to capture value beyond illumination and develop new profit pools
  - **Driving leadership in LED** through breakthrough innovations
  - **Establishing winning connected ecosystems** in both Home and Professional verticals
  - **Capturing attractive growth** and creating new business models **in professional systems and services**
- We continue on our Accelerate! journey to **achieve operational excellence** across our businesses





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