Annual Report 2016

Light Beyond Illumination

PHILIPS Lighting

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Light is an integral part of the connected world. Philips Lighting is turning light sources into points of data to connect more devices, places and people through light. In doing so, we make people safer, more productive and comfortable, businesses and cities more energy efficient and livable, and the world more sustainable. This is our commitment to deliver Light Beyond Illumination.

Forward-looking statements and risks & uncertainties
Please refer to Chapter 19, Forward-looking statements and other information, of this Annual Report for more information about forward looking statements, market and industry information, fair value information, IFRS basis of presentation, use of non-IFRS financial measures, statutory financial statements and management report.

The big picture

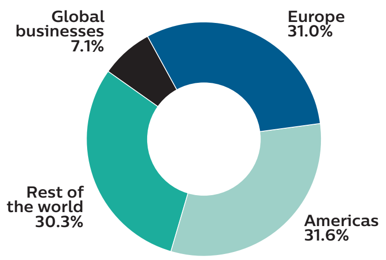
1. Performance highlights

Financial performance

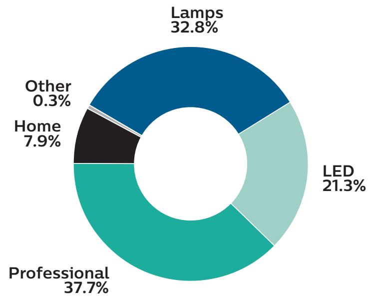
Philips Lighting

Comparable sales growth	LED-based sales	Adjusted EBITA margin	Net income	Free cash flow
2016	**2016**	**2016**	**2016**	**2016**
(2.4%)	55%	9.1%	EUR 185 million	EUR 418 million
2015	**2015**	**2015**	**2015**	**2015**
(3.5%)	43%	7.3%	EUR 240 million	EUR 632 million

Sales by geography



Sales by Business Group



Business Groups

	Lamps	LED	Professional	Home
Sales	EUR 2,333 million	EUR 1,518 million	EUR 2,683 million	EUR 559 million
Nominal sales growth	(18.1%)	13.8%	(2.7%)	8.7%
Comparable sales growth	(15.8%)	16.1%	(0.5%)	11.0%
EBITA margin	18.6%	9.2%	3.5%	(8.2%)
Adjusted EBITA margin	20.2%	9.4%	5.4%	(3.6%)

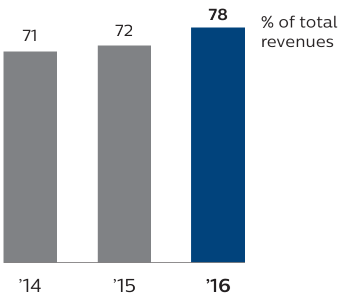
This chapter contains certain non-IFRS financial measures and ratios, such as comparable sales growth, EBITA, adjusted EBITA and free cash flow, and related ratios, which are not recognized measures of financial performance or liquidity under IFRS. These measures are further discussed in chapter 4, Corporate performance, of this Annual Report. For a reconciliation of these non-IFRS financial measures to the most directly comparable IFRS financial measures, see chapter 17, Reconciliation of non-IFRS financial measures, of this Annual Report.

Sustainability performance

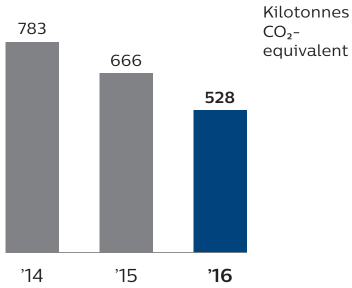
Environmental highlights

Sustainable revenues	Carbon footprint (net)	Renewable electricity	Total manufacturing waste
2016	**2016**	**2016**	**2016**
78%	406 kilotonnes	67%	40 kilotonnes
2015	**2015**	**2015**	**2015**
72%	666 kilotonnes	58%	45 kilotonnes

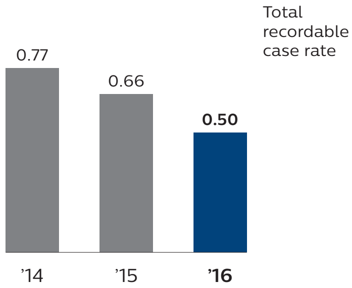
Sustainable revenues



Operational carbon footprint



Health & Safety



Social highlights

Employees (full-time equivalent)	Health & Safety, total recordable case rate	Employee net promoter score	Supplier sustainability performance
2016	**2016**	**2016**	**2016**
34,256	0.50	8	92%
2015	**2015**	**2015**	**2015**
37,399	0.66	(5)	90%

2. Message from CEO

2016: performing while transforming

"On May 27, we successfully listed Philips Lighting, writing a new chapter in our history. I am extremely proud of how we continued to transform our company while delivering a solid performance in our first year as a standalone company."

Eric Rondolat, CEO Philips Lighting

Dear Stakeholder,

When I look back at 2016, I am energized by how we worked together as a team to unlock the extraordinary potential of light for Brighter Lives and a Better World. This is the powerful purpose which drives everything we do at Philips Lighting.

2016 has been a historic year, requiring intense focus throughout the organization. We separated from Royal Philips and listed as a standalone company, marking a new chapter in a long history of innovation and global market leadership that started over 125 years ago. Our successful listing on the Euronext Stock Exchange marks the recognition of investors of our strategy and the value we will create. It is also strong testimony to the commitment of our employees worldwide.

Our strategy delivers results

Despite a challenging global economic environment, we executed our strategy relentlessly, shaping an industry that is transitioning to a new era.

- Our conventional business continued to deliver high levels of profitability, free cash flow and market share gains in support of our "last man standing" strategy despite ongoing decline in this market.

- Our total LED-based sales grew comparably over 20% to represent more than half of our sales in 2016. Our focus on innovation enabled us to accelerate our time to market and introduce game-changing innovations including the Dubai lamp, Philips SceneSwitch, Maxos trunking and the Philips Hue motion sensor, while achieving cost savings and improved profitability.
- Our systems and services offers grew comparably by over 50% in both the Professional and Home spaces, delivering unique propositions to our customers including fully connected Street lights with our cloud-based Philips CityTouch Software, Power-over-Ethernet (PoE) Lighting fixtures in office spaces, indoor positioning through light in stores and Philips Hue personalized smart lighting for homes.
- We made structural improvements to better serve our customers and will continue our progress by placing our customers at the heart of everything we do.
- We continued to optimize our industrial footprint, simplifying our ways of working and increasing our speed and agility in support of operational excellence.

Our financial performance is in line with our mid-term outlook

Our 2016 results mark a continued progression to achieve our strategic goals and medium term financial objectives to gradually improve the Adjusted EBITA margin to 11%-13%.

We continued our track record of performance improvement with a 180 basis points operating margin increase, a 110 basis points improvement in our growth profile in spite of difficult conditions in some markets and a strong EUR 418 million free cash flow.

The proposed dividend of EUR 1.10 per share - representing a 52% pay-out ratio and just above our guidance - and the decision to return up to EUR 300 million to shareholders over the next two years are clear illustrations of our confidence to generate free cash flow.

Our balance sheet is and will continue to be solid, allowing us to support the business moving forward as well as to consider value generating bolt-on acquisitions.

Our focus on customers is paramount

Our success is linked directly to the satisfaction of our customers, as measured by our Net Promoter Score. Optimizing the quality of our service and lead times, building efficient partnerships and continuously innovating were key in improving this score in 2016.

Our commitment to innovation remains core

Once again, we introduced breakthrough innovations in products and system architectures, positioning us for new market opportunities. Our bold investments in cloud-based software platforms, Power-over-Ethernet fixtures, indoor positioning technology and consumer-based personalized lighting systems will continue to enable us to strengthen our market share and drive long-term growth.

Our organization is built on our newly defined values

At the beginning of our journey as a standalone company, we defined Philips Lighting's four values, which now constitute essential pillars in our new identity: Customer First, Game Changer, Greater Together and Passion for Results.

We recorded the strongest ever evolution of our Employee Net Promotor Score with levels of participation above 75%. This clearly indicates that we are on the right track to create a unique environment in which people enjoy working, learn and achieve great results together.

Our sustainability program Brighter Lives, Better World was introduced

Sustainability lies at the very heart of our business. Through our dedicated program Brighter Lives, Better World, we set very ambitious targets for sustainable revenues and operations. One example is our commitment to become carbon neutral in our operations and generate 80% of our revenues from sustainable products, systems and services by 2020.

Our thanks

During the course of 2016 we took significant steps to strengthen our leadership in a rapidly changing world which has seen the lighting industry evolve more over the past five years than in the past century. We have worked with passion and rigor to lead change in the lighting sector and to ensure that we are uniquely positioned to capture the potential value and opportunities generated by the transformation of our industry.

On behalf of the Board of Management and the leadership team, I extend our sincere thanks to our employees for their commitment and dedication which enabled us to achieve so much in 2016. We know we can count on an exceptionally talented workforce who truly care about doing what is right for our customers.

I would also like to thank our customers for their continued trust which motivates us on a daily basis.

Finally, I would like to thank our shareholders for their confidence in our business and their ongoing support for our strategy.

More than ever, we believe we are uniquely positioned to unlock the extraordinary potential of light for Brighter Lives and a Better World

Eric Rondolat
CEO Philips Lighting

3. Our strategic focus

3.1 Creating value

Philips Lighting is the global market leader with recognized expertise in the development, manufacture and application of innovative, energy-efficient lighting products, systems and services. We have pioneered many key breakthroughs in lighting over the past 125 years and been a driving force behind several leading technological innovations. We are in a leading position as the lighting industry transitions from conventional to LED lighting technologies. This transition has continued to accelerate as the industry moves toward connected lighting.
Our track record in innovation is strong and we invest heavily in R&D to stay at the forefront of technological developments. We believe we are uniquely positioned across the lighting value chain and focus on the general lighting market.

Our strategy is based on six key strategic priorities:

- **Optimize cash from conventional products to fund our growth** – While the overall conventional market continues to decline, we expect to decrease less than the market, capture market share and deliver a strong sustainable free cash flow. Our manufacturing footprint rationalization and product portfolio simplification will bring additional efficiency gains and cost reductions.

- **Innovate in LED products commercially and technologically to outgrow the market** – We strive for continued innovation in LED lighting products and tailored marketing approaches to outgrow the market.

- **Lead the shift to systems, building the largest connected installed base** – We believe that connected lighting will be increasingly important in the general lighting market. We play a leading role in the industry shift to lighting systems in both the professional and consumer markets.

- **Capture adjacent value through new services business models** – We are seeking to realize additional revenues from our installed base through offering new value added services.

Home	Government	Cities	Offices	Industry	Stadiums	Retail
Making life easier, better, and more personal with the best lighting experiences	Reducing energy use and carbon footprint to create a sustainable environment	Empowering cities to become safe, livable, futureproof and sustainable	Optimizing building and business operations, improving workers' productivity and well-being	Improving efficiency and safety, optimizing operations	Enhancing the experience for fans with flexible lighting	Creating dynamic, personalized shopping experiences with connected systems

- **Be our customers' best business partner locally, leveraging our global scale** – We aim to capitalize on our long-standing local customer relations and global distribution network. Our global reach and client proximity allow us to deliver a product portfolio that addresses local market needs with both high volume products and differentiating propositions.

- **Accelerate! on our operational excellence improvement journey** – Under the Accelerate! program we aim to leverage operational excellence capabilities across the organization by implementing programs that are focused on minimizing waste, reducing defects and increasing the efficiency of our entire value chain while, at the same time, reducing our fixed costs.

The lighting company for the Internet of Things

Our position as an industry leader in connected lighting for the Home and Professional segments will drive Philips Lighting's reputation as the lighting company for the Internet of Things (IoT). By extending our industry leadership into the IoT, we can unlock additional value from offering new apps and services to our customers.

This is part of our broader commitment to deliver Light Beyond Illumination, turning light sources into points of data to connect more devices, places and people through light. In doing so, we make people safer, more productive and comfortable, businesses and cities more energy efficient and livable, and the world more sustainable.

Sound progress made on our strategic priorities during 2016

Strategic priorities	Proof points in 2016
• Optimize cash from conventional products to fund our growth	• Free cash flow as % of sales of Lamps improved by 12%
• Innovate in LED products commercially and technologically to outgrow the market	• LED-based sales increased from 43% to 55% of total sales
• Lead the shift to systems, building the largest connected installed base • Capture adjacent value through new services business models	• Professional Systems & Services grew by 51% • Fast growth in Home Systems sale. Growth rate increased by 40%
• Be our customers' best business partner locally, leveraging our global scale	• Customer Net Promoter Score improved by 3%
• Accelerate! on our operational excellence improvement journey	• Adjusted EBITA margin improved by 180 basis points to 9.1%; Adjusted indirect costs reduced by EUR 96m*

* This is excluding the impact of the brand license fee of EUR 36m

3.2 Sustainability

Our world is changing: population growth, resource challenges, and climate change require a shift to new technologies. We are addressing these challenges and leading the way to a more sustainable future by bringing sustainable lighting to the world, while reducing our own environmental footprint. It is our purpose to unlock the extraordinary potential of light for brighter lives and a better world. In 2016 we launched our 'Brighter Lives, Better World' program, setting ambitious targets on sustainable revenues and sustainable operations leading up to 2020.

Sustainable lighting is energy efficient, saves material resources through circular lighting and helps to meet societal needs. Currently lighting accounts for 15% of the world's electricity demand. A global shift to LED is expected to reduce this demand to 8% by 2030. In addition, light increases people's comfort, productivity, and safety.

Philips Lighting is accelerating this transition with our commitment to deliver more than 2 billion LED lamps by 2020. We also aim to lead the transition to a circular economy by providing light as a service to close the materials loop. We also strive to improve people's quality of life by providing access to light for people in off-grid areas and using lighting technology to help grow food.

We are committed to becoming 100% carbon neutral in our operations by 2020. To achieve this, we are becoming more energy efficient in our own manufacturing sites, non-industrial sites, logistics and business travel and are shifting to 100% renewable electricity by 2020. Further commitments in our sustainable operations program are to work towards zero waste to landfill and a zero injury workplace. We are passing our experience on – engaging with suppliers to share our knowledge on environmental and social responsibility, auditing and training all of our risk suppliers.

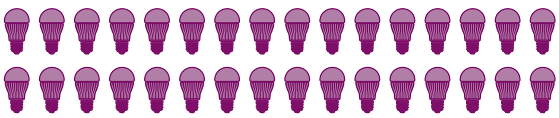
Philips Lighting 'Brighter Lives, Better World' program

Commitments for 2020

Sustainable revenues

80% of revenues come from our sustainable products, systems and services

More than 2 billion LED lamps are delivered by 2020



Sustainable operations

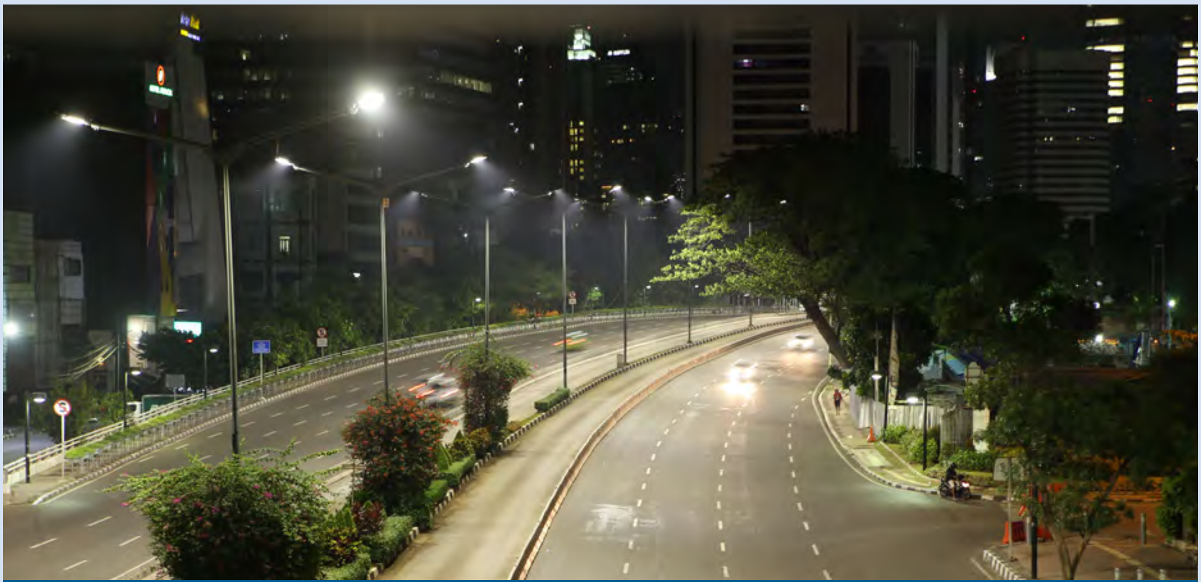
100% carbon neutrality
100% of renewable electricity

Zero waste to landfill in our operations

50% reduction in recordable injuries and illnesses

100% of our risk suppliers audited, with a minimum performance rate of 90%

3.3 Our strategy in action



Jakarta, Indonesia

Thinking forward to create a future-proof city

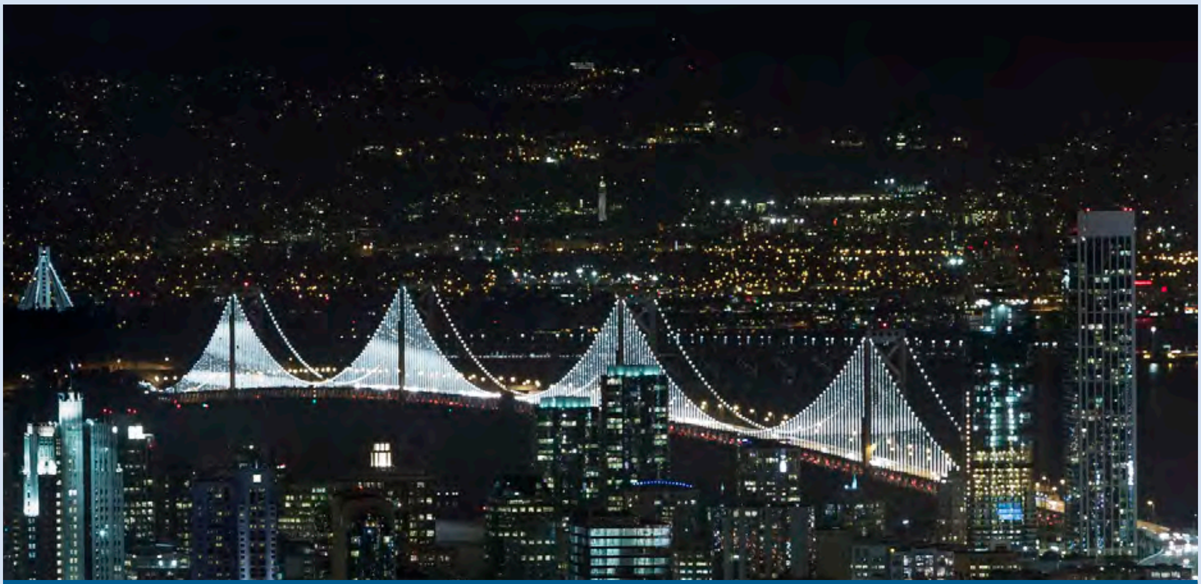
Jakarta is one of the world's most populous and fastest-growing urban centers, with over nine million inhabitants. In recent years, the city has focused on improving public services, including street lighting.

Customer challenge
City officials are transforming the Indonesian capital into a 'smart' city, where everything is connected to make Jakarta safer, more comfortable and more sustainable.

The right lighting
90,000 street luminaires were retrofitted with energy efficient LED lights connected by Philips CityTouch lighting management system. The project was installed in just seven months with approximately 430 light points connected per day.

The world's fastest street lighting retrofit and remote management project was made possible by the unique plug and play architecture of Philips CityTouch. Each light point is now connected, using sensors that collect performance data.

As a result, city officials can now monitor Jakarta's lighting infrastructure, remotely managing light levels to match different needs by district. Better lit streets and public spaces are providing citizens an improved sense of safety and security. At the same time, Jakarta can better manage its carbon footprint with estimated energy savings of up to 70% and improve public services.



Bay Lights, San Francisco, United States

Realizing social and economic impact with light

The California Department of Transportation collaborated with non-profit arts organization, ILLUMINATE and artist Leo Villareal to create a living light display on the San Francisco-Oakland Bay Bridge in celebration of its 75th anniversary. The 'Bay Lights' became an instant source of community pride, credited with revitalizing the waterfront and boosting the local economy by over USD 100 million annually.

Customer challenge
The Bay Lights was intended as a two-year installation, but given its powerful impact officials agreed to maintain it as a permanent installation. The challenge was to build on the project benefits, while creating an energy-efficient work of art to make the Bay Lights a permanent, sustainable beacon for the San Francisco Bay area.

The world's largest LED light sculpture
The new system was custom-designed to withstand local harsh weather conditions, while consuming 85% less energy compared to traditional lighting. At the same time it supports the many social and economic benefits that made the Bay Lights a success from the beginning. The installation incorporated Philips ActiveSite, a cloud-based connected lighting platform that minimizes downtime and allows for more efficient management of the landmark using remote diagnostics, reporting, data analytics and control.

The unique application of LED lighting and software designed by the artist has the ability to create 255 levels of brightness per node. With 25,000 Philips Lighting programmable white LED lights, it is believed to be the world's largest LED light sculpture.

Torre Europa, Madrid, Spain

Making buildings smart with connected, sustainable lighting

Torre Europa, Madrid's 121-meter landmark skyscraper at the heart of the city's financial business district has recently undergone extensive exterior and interior renovation.

Customer challenge

As part of extensive renovations, majority owner, Grupo Infinorsa, sought to futureproof the building by introducing technology to make Torre Europa more efficient to operate and more attractive to its users.

The right lighting

The building is Spain's first to use the Philips Power-over-Ethernet connected office lighting system. 14 floors of the 32-floor building have been equipped with 5,400 connected luminaires, covering 19,600 m^2 of office space. The system collects anonymous data using sensors integrated into luminaires. Information including room occupancy and temperature can be used to adjust lighting, heating and air conditioning, or to schedule cleaning or maintenance services. As a result, projected lighting energy use is expected to be reduced by up to 70%. At the same time, workers can use smartphones to improve their personal workspaces, increasing their comfort and productivity.


Dubai Municipality, Dubai, U.A.E.

Creating a more sustainable city with the Dubai Lamp

Dubai is committed to creating the world's most sustainable city, encouraging sustainable development to help contribute to the national economy and benefit future generations.

Customer challenge
The Dubai Integrated Energy Strategy sets ambitious targets, including a 30% reduction in energy consumption by 2030, and the Dubai Carbon Abatement Strategy is aimed at reducing carbon emissions by 16% by 2021.

The right lighting
Philips Lighting and the Dubai Municipality teamed up to create the Dubai Lamp Initiative, a research partnership that resulted in the world's most energy-efficient commercially available LED lamp.

By replacing conventional lamps with the Dubai Lamp, households and enterprises can reduce electricity used for lighting by up to 90%. The Dubai Lamp also has an average lifespan of up to 15 times that of conventional lamps. Philips Lighting is preparing to supply two million Dubai Lamps across the city in 2017.

4. Corporate performance

4.1 Financial performance

4.1.1 2016 Highlights

Philips Lighting separated from Royal Philips on February 1, 2016, and was listed on the Euronext Amsterdam stock exchange on May 27, 2016.
We delivered a solid financial performance in our first year as a standalone company. Following the separation from Royal Philips a new financing structure is in place and we assumed pension liabilities pursuant to the separation. This impacted our results, and included charges related to the brand license fee, separation costs, and increased financial expenses, which were not applicable in 2015. Our free cash flow was impacted by cash outflows as a result of the separation.

Comparable sales growth in 2016 showed an improved trend compared to 2015, despite challenging macroeconomic conditions in some markets. Our increase in profitability was in line with our medium-term path of gradual improvement, with each Business Group contributing to the increase. Furthermore, we delivered solid free cash flow in 2016.

Sales amounted to EUR 7,115 million, a decrease of 4.7% on a nominal basis and a decline of 2.4% on a comparable basis. Sales were negatively impacted by a currency effect of -2.0%. Lamps reported a decline, primarily due to the transition from conventional to LED lighting. LED showed robust volume growth, while sales grew less rapidly due to price erosion and mix impact. Professional was affected by worsened market conditions in Saudi Arabia. Home delivered solid growth in both Home Systems and Home Luminaires due to continued focus on innovation.

Philips Lighting
Key figures in mEUR unless stated otherwise
2015-2016

	2015	2016
Sales	7,465	7,115
Comparable sales growth [1]	(3.5%)	(2.4%)
Gross margin	2,655	2,677
as a % of sales	*35.6%*	*37.6%*
Income from operations (or EBIT)	331	369
Net financial income/expense	(8)	(67)
Income tax expense	(83)	(119)
Net income	240	185
Adjusted gross margin [1]	2,731	2,763
Adjusted indirect costs [1]	(2,317)	(2,257)
Adjusted EBITA [1]	547	645
as a % of sales	*7.3%*	*9.1%*
Restructuring, acquisition and incidental items [1]	(109)	(166)
EBITA [1]	438	479
Earnings per share in EUR		1.26
Dividend per share in EUR [2]		1.10
Shareholders' equity	3,513	2,704
Net debt [1]	5	341
Working capital [1]	832	662
Net cash provided by operating activities	717	505
Free cash flow [1]	632	418

1) For a reconciliation to the most directly comparable IFRS financial measure, see chapter 17, Reconciliation of non-IFRS financial measures, of this Annual Report.
2) Subject to approval by the 2017 Annual General Meeting of Shareholders.

Gross margin improved from EUR 2,655 million in 2015 to EUR 2,677 million in 2016. Adjusted gross margin improved to EUR 2,763 million, driven by footprint rationalization, operational leverage and procurement savings, partly offset by price reductions. The adjusted gross margin as percentage of sales improved by 220 basis points to 38.8%.

Income from operations amounted to EUR 369 million compared to EUR 331 million in 2015. Restructuring and incidentals amounted to EUR 166 million. Restructuring costs were EUR 115 million, while incidental items included a charge of EUR 62 million for separation costs.
The company estimates that in the medium term, annual total restructuring costs incurred will amount to 1.5%-2.0% of the company's total sales in each financial year, with the majority of these restructuring costs expected to relate to the Lamps and Professional businesses.

Adjusted indirect costs decreased to EUR 2,257 million, driven by our cost reduction program and despite a EUR 36 million charge for the brand license fee. R&D expenses amounted to EUR 353 million compared to EUR 366 million in 2015. 2016 included EUR 13 million of restructuring charges compared to EUR 1 million in 2015, resulting in Adjusted R&D expenses of EUR 340 million in 2016. As a percentage of sales Adjusted R&D expenses decreased from 4.9% in 2015 to 4.8% in 2016.

Adjusted EBITA increased to EUR 645 million, resulting in a 180 basis points increase in Adjusted EBITA margin to 9.1%, in line with our medium-term path of gradual improvement, with each Business Group contributing to the increase.

Net income decreased by 22.9% to EUR 185 million, including EUR 143 million in charges, which were not applicable in 2015, for the brand license fee, separation costs, and financial expenses.

The increase in net financial expenses was primarily attributable to the new financing structure of the company following its separation from Royal Philips and interest related to pensions as we assumed pension liabilities pursuant to the separation.

Free cash flow of EUR 418 million was the result of improved profitability and strict working capital management, offset by higher cash outflows following the separation, in particular interest payments and taxes. Free cash flow also includes separation costs of EUR 62 million.

Shareholder equity at year end amounted to EUR 2,704 million, affected by transactions related to the separation from Royal Philips and including net income for the period. Following the separation from Royal Philips and the Initial Public Offering in May 2016, the company raised USD 500 million and EUR 740 million through external debt facilities, replacing short-term funding from Royal Philips. Net debt at that time amounted to EUR 950 million. At the end of the year, net debt amounted to 341 million, compared to EUR 950 million at the time of the IPO.
The reduction of net debt since the IPO was mainly driven by the robust free cash flow.
Working capital decreased by EUR 170 million to EUR 662 million, mainly driven by reduced inventories and an increase in accrued and other liabilities.

At January 1, 2016 Philips Lighting had a net pension liability of EUR 43 million. As part of the separation, Philips Lighting assumed on February 1, 2016 additional net pension liabilities of EUR 607 million from Royal Philips. The earlier announced 2016 de-risking contribution to the US pension plan of EUR 45 million which was paid to the plan in March 2016 has been adjusted downwards by EUR 3 million due to the correction in the allocation of plan assets and liabilities.
In September 2016, the company made a further contribution of EUR 4 million to the US pension plan to improve the funding level. As of December 31, 2016, the net liability of Philips Lighting was EUR 602 million.

The total number of Philips Lighting full-time equivalent employees (FTE) was 34,256 at the end of 2016, compared to 37,399 at the end of 2015.

4.1.2 Performance by Business Group

Performance Lamps

About Lamps
Lamps is the global market leader in the conventional lighting business and comprises the company's conventional lamps and lamp electronics business. It produces and sells lamps based on a wide variety of non-LED based technologies including incandescent, halogen, fluorescent and HID, as well as electronic components (electronic ballast and drivers). Consumer and Professional lamps are used in a wide variety of residential and professional applications and are bought by consumers, electrical installers and professional end-users through a wide range of channels. Lamp electronics are mainly sold to luminaire manufacturers directly and as replacement products via electrical wholesalers. Finally, Lamps sells projector lamps and drivers to the original equipment manufacturers (OEM's) market and the replacement market.

Philips Lighting
Key figures Lamps in mEUR unless stated otherwise
2015-2016

	2015	2016
Sales	2,850	2,333
Nominal sales growth (%)	*(8.6%)*	*(18.1%)*
Comparable sales growth (%) [1]	*(15.9%)*	*(15.8%)*
Income from operations (or EBIT)	403	433
EBITA [1]	405	435
Adjusted EBITA [1]	463	472
as a % of sales	*16.2%*	*20.2%*
Number of employees (in FTEs)	17,032	15,856

[1] For a reconciliation to the most directly comparable IFRS financial measure, see chapter 17, Reconciliation of non-IFRS financial measures, of this Annual Report.

Strategic priorities
Lamps aims to optimize free cash flow. While the overall conventional market continues to decline, Lamps' focus is on winning market share in key segments and markets. In addition, Lamps continues to pro-actively manage its manufacturing footprint and reduce operational costs.

2016 Business highlights
- **Reducing manufacturing footprint:** the number of operational manufacturing plants for conventional lamps was reduced to 16 sites from 21 at the end of 2015. Lamps intends to continue downscaling its manufacturing footprint in line with market developments.
- **Divestments:** as part of the business strategy, active portfolio management led to the successful divestment of the ceramics operation, the quartz and special glass business and the cinema business.

2016 Financial performance
Sales for 2016 amounted to EUR 2,333 million, a decline of 18.1% on a nominal basis and 15.8% on a comparable basis.

EBITA improved to EUR 435 million. Restructuring costs amounted to EUR 37 million in 2016, primarily related to ongoing rationalization of the manufacturing footprint. Adjusted EBITA for 2016 increased to EUR 472 million compared to EUR 463 million in 2015. The Adjusted EBITA margin improved to 20.2%, mainly driven by efficient manufacturing footprint rationalization, procurement savings and increased productivity.

Market developments
The conventional lamps market is expected to continue to decline in the coming years as a result of the transition from conventional lighting to LED lighting technologies.

Legislation to ban certain conventional technologies remains an important factor impacting the development of the conventional market, but also provides opportunities to introduce new innovations. In 2016, for example, we introduced the MASTERColour CDM MW eco lamp that serves as a direct replacement for various quartz metal halide lamps to be banned by European Union legislation.

2017 and beyond
The performance of Lamps in 2016 reflected the successful implementation of our "last man standing" strategy to continue to extract value from the conventional business, supporting our medium-term guidance to maintain our Adjusted EBITA margin at least at the level of 2015. In 2017 we will continue to execute our strategy and optimize free cash flow by leveraging our cost advantage, scale, global footprint and lean manufacturing capabilities and respond to our customer demand for conventional products.

Performance LED

About LED
Based on internal research, we believe Philips Lighting had a number one position in sales in the global LED lamps and electronics market in 2016. LED sells a wide variety of LED lamps, namely spots, bulbs and tubes, to the professional and consumer channels and OEM's. These products are replacing existing conventional lamps. In addition, we sell LED electronic components, consisting of

LED drivers and LED modules, to luminaire OEM's for professional luminaire applications in the retail, office and outdoor segments.

Philips Lighting
Key figures LED in mEUR unless stated otherwise
2015-2016

	2015	2016
Sales	1,334	1,518
Nominal sales growth (%)	*39.2%*	*13.8%*
Comparable sales growth (%) [1]	*27.0%*	*16.1%*
Income from operations (or EBIT)	66	136
EBITA [1]	70	140
Adjusted EBITA [1]	74	142
as a % of sales	*5.5%*	*9.4%*
Number of employees (in FTEs)	2,534	3,016

1) For a reconciliation to the most directly comparable IFRS financial measure, see chapter 17, Reconciliation of non-IFRS financial measures, of this Annual Report.

Strategic priorities

LED strives for growth in the B2C and B2B markets via differentiation and continued innovation (e.g. Glass spots, TLED Instant Fit, PLL replacement and others) with tailored marketing approaches and retail excellence. In addition, we are expanding and diversifying our distribution coverage and intensifying our marketing activities to grow sales and increase our market share. In the LED electronics business, we drive design-ins/innovations and provide end-to-end supply chain support to service the needs of our many professional luminaires customers (OEM's). The manufacturing of LED lamps is mainly outsourced to a number of large lighting suppliers in China who are able to step-up capacity for mass production quickly. LED electronics is both in-sourced and out-sourced where we go for a regional sourcing approach facilitating faster response to the needs of OEM's. Economies of scale and efficiency improvements are key in driving down costs in these businesses.

2016 Business highlights

- **Dubai Lamp:** together with the Dubai Municipality, Philips Lighting introduced the Dubai Lamp. It is the world's most energy efficient commercially available LED lamp. By replacing conventional lamps with the Dubai Lamp, electricity used for lighting can be reduced by up to 90%. The Dubai Lamp has an average lifespan of up to 15 times longer than conventional lamps.
- **Philips SceneSwitch:** Philips Lighting introduced the Philips SceneSwitch LED, a unique range of light bulbs that provide multiple light settings to meet the changing needs of homes and consumers. Philips SceneSwitch LED range caters to the fact that many homes have become multipurpose spaces: somewhere to work, relax and entertain. It allows people to select the light scene best suited to a given task with the flick of an existing switch and without requiring structural changes or installing a dimmer.
- **Philips CorePro LED PLC:** accelerating the transition to LED lighting, the Philips CorePro LED PLC was introduced. It is the first LED retrofit range for compact fluorescent lamps, targeted at the professional market to replace 150 million CFLni lamps across Europe, delivering 60% energy savings.

As an innovation leader, the LED business invests in R&D activities to deliver products and propositions to the market Some of the key innovations in lamps in 2016 are listed above, including Dubai Lamp and SceneSwitch.
In addition, new products were introduced in the LED electronics business where we work closely with BG Professional and our OEM partners.

2016 Financial performance

Sales were EUR 1,518 million, reflecting nominal sales growth of 13.8% and comparable sales growth of 16.1%, due to robust volume growth, while sales grew less rapidly due to price erosion and mix impact. Comparable sales trends in the Americas started softening in the second quarter. Some countries in Europe showed slower sales growth in the second half due to high LED penetration rates. Significant sales growth was achieved in Asia and Latin America.

EBITA improved to EUR 140 million compared to EUR 70 million in 2015, driven by material procurement savings, operational leverage and indirect cost reduction, partly offset by price erosion. Adjusted EBITA increased to EUR 142 million. This resulted in a significant improvement of Adjusted EBITA margin by 390 basis points to 9.4%.

Market developments

The LED market growth remains in the mid-teens level with robust volume growths partially compensated by price erosion. While the LED lamps market is dynamic and more fragmented than the conventional lamps market, the LED market, primarily in electronics, is more concentrated and stable in value growth.

2017 and beyond

Our performance in 2016 illustrated the benefit of our strategy focused on innovation and operational leverage, demonstrating we are on track for gradual improvement of our Adjusted EBITA margin to 10%-12% in the medium term.

Performance Professional

About Professional

Philips Lighting believes that it is the global leader in the Professional lighting market for products such as conventional and LED luminaires, systems and services with strong positions across key geographies. Professional products, systems and services are used in multiple market segments such as offices, commercial buildings, shops, hospitality, industry and outdoor environments including smart cities. The products in the Professional business have historically experienced a rapid shift from conventional to LED and have been integrated into broader Systems and Services capabilities.

Philips Lighting
Key figures Professional in mEUR
unless stated otherwise
2015-2016

	2015	2016
Sales	2,757	2,683
Nominal sales growth (%)	*13.9%*	*(2.7%)*
Comparable sales growth (%) [1]	*(0.7%)*	*(0.5%)*
Income from operations (or EBIT)	14	(9)
EBITA [1]	114	93
Adjusted EBITA [1]	150	145
as a % of sales	*5.4%*	*5.4%*
Number of employees (in FTEs)	10,611	10,345

[1] For a reconciliation to the most directly comparable IFRS financial measure, see chapter 17, Reconciliation of non-IFRS financial measures, of this Annual Report.

Strategic priorities

Professional focuses on strengthening its global lighting leadership position by accelerating the rollout of its leading architectures for connected lighting systems to customers in all market segments. This led to growth in the Professional Systems & Services business in 2016 of 51%. With a clear focus on innovation, Professional aims to be the first-to-market with breakthrough applications and services that build on the market penetration of our Systems and Services offering.

2016 Business highlights

- **Philips ArenaVision LED system:** the Philips ArenaVision LED system was adopted in the stadiums of football clubs that include Atlético Madrid, Juventus and VfL Wolfsburg. Philips ArenaVision LED was also installed in the Amsterdam Arena, home base of Ajax, and the Cairo Stadium Indoor Halls Complex. The system offer pitch lighting at the highest standards broadcasters require and enable pre-match light shows to entertain spectators and add to their experience. As part of the Philips ArenaExperience, Philips Lighting also provides façade lighting and lighting for hospitality areas.
- **Power-over-Ethernet (PoE):** the technology for connected, sustainable lighting was installed in the Torre Europa building in Madrid, making it the Spanish capital's smartest building.
  PoE brings together Philips Lighting's connected lighting systems with Cisco's IT networks, allowing office workers to personalize their office environment, while building managers can optimize space utilization and building efficiency by analyzing data collected by sensors in the luminaires. PoE was also chosen by Smartworld to transform its Dubai headquarters into a start-of-the-art intelligent building, enabling staff to use personalized services that help improve productivity, safety and comfort.
- **Philips CityTouch:** the Indonesian capital Jakarta was equipped with nearly 90,000 connected street lights, which can be monitored and controlled through the Philips CityTouch system. The infrastructure is one of the world's largest connected street lighting systems. Philips CityTouch has been installed in over 700 projects across 35 countries since its inception in 2012.

2016 Financial performance

Sales declined 2.7% on a nominal basis to EUR 2,683 million. This represents a decline of 0.5% on a comparable basis. Worsened market conditions in Saudi Arabia had a EUR 107 million negative impact and a 410 basis points negative contribution on comparable sales growth. Sales in Europe were affected by softness in some markets, while the Americas showed growth and other geographies posted robust comparable increases.

Professional reported EBITA of EUR 93 million in 2016. The benefits from operational optimization, strong growth in systems and services and mix improvement in products with a further increase of our LED share were offset by lower sales and write-downs on bad debt in Saudi Arabia. Adjusted EBITA amounted to EUR 145 million. Saudi Arabia negatively impacted Adjusted EBITA by EUR 47 million. Adjusted EBITA margin remained stable at 5.4%. Restructuring charges amounted to EUR 49 million, mainly related to simplification of business structures, reduction of indirect costs and industrial footprint rationalization, particularly in Europe. In Saudi Arabia we took actions throughout 2016 in response to local market conditions, addressing the cost structure and our customer coverage.

Market developments

Across professional products, systems and services, competition varies by geography as all regions have locally relevant competitors. Traditional competitors in North America and Europe remain relatively concentrated.

The growth of professional connected lighting is expected to create new opportunities in Services, including Professional, Life Cycle and Managed Services. The greater functionality of LED will drive increasing demand for Life Cycle services. The R&D activities in Professional are about creating new innovative architectures to respond to demand from key market segments such as Public, Retail & Hospitality and Offices & Industries. Innovation is mainly focused on creating more connected luminaires, IT and software components and/or new data-enabled services based on business analytics and Internet of Things platforms.

2017 and beyond

Professional continues to implement its strategy for the development of LED luminaire sales, fast growth of Systems & Services and the continued rationalization of its cost structure, supporting our ambition to increase the Adjusted EBITA margin to 11%-14% in the medium term.

Performance Home

About Home

Home is a top three player in selected home luminaires markets and a leader in connected home lighting. We develop and sell functional and decorative home luminaires, connected lighting systems and premium luminaires. For the development of its offering, Home builds on the company's strong in-house R&D capabilities, knowledge in LED and lighting applications complemented by extensive qualitative and quantitative consumer research.

In 2012, Home introduced Philips Hue, the world's first personal wireless lighting system for the home. The system enables users to control lights wirelessly through apps on smart devices, with their voice or with remote control switches, as well as to personalize their lighting to suit their preferences and needs. Currently, Philips Hue is the market leader in connected home lighting.

Philips Lighting
Key figures Home in mEUR unless stated otherwise
2015-2016

	2015	2016
Sales	515	559
Nominal sales growth (%)	*6.8%*	*8.7%*
Comparable sales growth (%) [1]	*(0.4%)*	*11.0%*
Income from operations (or EBIT)	(73)	(48)
EBITA [1]	(72)	(46)
Adjusted EBITA [1]	(57)	(20)
as a % of sales	*(11.1%)*	*(3.6%)*
Number of employees (in FTEs)	1,506	1,199

1) For a reconciliation to the most directly comparable IFRS financial measure, see chapter 17, Reconciliation of non-IFRS financial measures, of this Annual Report.

Strategic priorities

Home aims to realize profitable growth by driving the transition to LED luminaires and connected lighting. Its strategic priorities include growing its home systems business, driving profitable growth in LED luminaires in Asia and North America, turning around the profitability of consumer luminaires in Europe and creating a leaner operating model.

2016 Business highlights

- **Philips Hue:** the Philips Hue ecosystem was strengthened by the introduction of Philips Hue White Ambiance lights as well as Philips Hue White Ambiance luminaires, providing every shade of white light, a motion sensor that enables users to control their lights through movements in their home and a new GU10 lamp. Modular entered the Friends of Hue ecosystem with a range of luminaires.
- **Partnerships:** Philips Hue became the first connected lighting system that can be used with all leading smart home platforms as Amazon Alexa, Google Home and Huawei OceanConnect were added. Philips Hue was already compatible with Apple HomeKit and Samsung SmartThings.
- **Philips Hue app 2.0:** the new Philips Hue app was introduced, based upon feedback from users and built around them, their homes and their daily lives. The new app allows users to further improve their connected lighting experience in the home. Further recent upgrades included new remote control features via iOS or Android devices.

2016 Financial performance

Sales in 2016 increased to EUR 559 million, with a nominal sales growth of 8.7% and comparable sales growth of 11%, driven by growth in both Home Systems and Home Luminaires due to continued focus on innovation. We saw fast growth in Home Systems in 2016. The sales growth rate increased by 40%.

EBITA loss was reduced significantly to EUR -46 million, resulting in an improvement of EUR 26 million compared to 2015. In the second half of the year, the Adjusted EBITA became positive, showing the benefits of sales growth and restructuring efforts. Adjusted EBITA loss narrowed to EUR 20 million, resulting in an improvement of EUR 37 million compared to 2015. Restructuring and incidental charges amounted to EUR 26 million, mainly related to footprint rationalization in Belgium and China.

Market developments

The consumer market is expected to benefit from the transition to LED luminaires, as well as the increasing adoption of connected home lighting systems. Within the consumer market, consumer luminaires, both conventional and LED, will remain the largest segments while home systems will continue its fast growth.

The market for home systems is still in its early stages and is expanding rapidly, in line with the growth in household penetration of smart home applications. For home systems, Europe and the Americas will remain the main markets, while Asia is an earlier stage of market development.

2017 and beyond

Our performance in 2016 supports our strategy to focus on how consumers can enrich their experiences at home with lighting, leveraging our strengths in LED and connected lighting systems for the home. Home is on track to become profitable in 2017.

Performance Other

Other reported an Adjusted EBITA loss of EUR -94 million in 2016, which compares to EUR -83 million in 2015. This represents amounts not allocated to the operating segments and mainly comprise of certain costs of group enabling functions and certain costs of the activities of Philips Lighting Innovation. Incidental items not part of Adjusted EBITA included a charge of EUR 62 million for separation costs and a gain of EUR 14 million related to a release of provisions with Royal Philips originating from the separation. The number of FTE's was 3,840 at the end of 2016.

4.1.3 Performance by geographic cluster

The ongoing transformation from conventional to LED lighting is reflected in all markets globally. Sales in Europe were 2% lower on a comparable basis than in 2015. Nominal sales were negatively impacted by unfavorable currency effects. Sales in the Americas decreased by EUR 107 million, or 1.9% on a comparable basis, mainly driven by declines in the conventional lighting market, while comparable sales trend in LED started softening in the second quarter.

In the rest of the world, sales declined by EUR 143 million, or 3.2% on a comparable basis. We saw an improved comparable sales growth trend in China, and growth in ASEAN & Pacific. This was offset by worsened market conditions in Saudi Arabia.

Philips Lighting
Sales by market in mEUR unless stated otherwise
2015-2016

	2015	2016	Change	CSG [1, 2]
Europe	2,290	2,208	(82)	(2.0%)
Americas	2,352	2,245	(107)	(1.9%)
Rest of the world	2,299	2,156	(143)	(3.2%)
Global business	524	506	(18)	(2.2%)
Total	**7,465**	**7,115**	**(350)**	**(2.4%)**

1) For a reconciliation to the most directly comparable IFRS financial measure, see chapter 17, Reconciliation of non-IFRS financial measures, of this Annual Report.
2) Comparable sales growth.

4.2 Sustainability performance

Social performance

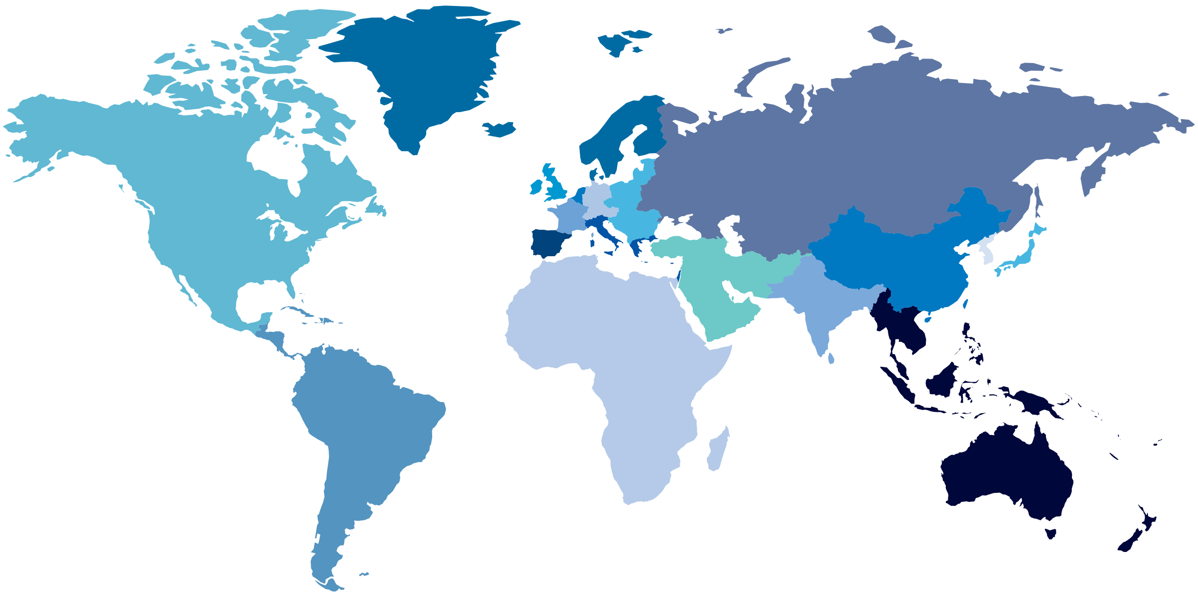
We create brighter lives for our employees, customers, suppliers, and communities. For our workforce of 34,256 FTE, we foster a diverse and inclusive culture and provide a safe and engaging workplace. In 2016 we co-created our values together with our employees to establish a common direction and company purpose.
We measure employee engagement through our Net Promoter Score, which has shown improvement each quarter with an overall score of 8. Through innovations that transform the world, we provide light for greater wellbeing, improved safety and access to light in off-grid areas.

Environmental performance

We aim to create a better world by reducing the environmental impact of what we do and through our business. With our sustainable operations program, we reduced our carbon footprint by 21% in manufacturing, non-industrial, logistics, and business travel, compared to 2015. We also reduced waste to landfill by 41% and have started to deploy our zero waste to landfill program. Energy efficient and connected lighting helps create a better world for our customers.

Through our global presence, we drive our sustainability programs across 17 markets to manage our social and environmental performance.

Sustainable performance per market



	FTE	Manufac-turing sites	Safety TRC rate	CO_2 emitted (kilotonnes CO_2)	Waste (tonnes)	Recycled (%)	Water (m^3)
Europe	**13,692**	**16**	**0.44**	**169**	**17,701**	**87%**	**607**
Benelux	4,450	4	0.40	29	3,841	89%	129
Central & Eastern Europe	6,023	6	0.36	94	5,748	79%	235
DACH (Germany, Austria, and Switzerland)	677	1	0.33	13	834	89%	9
France	973	2	1.51	15	5,123	95%	182
Iberia	668	2	0.79	6	2,042	82%	47
Italy, Israel, and Greece	284	–	–	3	–	–	–
Nordics	259	–	0.45	3	–	–	–
UK & Ireland	358	1	–	6	113	89%	5
Americas	**8,983**	**15**	**0.86**	**172**	**16,138**	**80%**	**276**
Latin America	4,972	5	0.39	32	7,155	81%	112
North America	4,011	10	1.40	140	8,983	80%	164
Rest of the world	**11,581**	**7**	**0.21**	**187**	**6,046**	**92%**	**568**
Africa	142	–	–	6	–	–	–
ASEAN & Pacific	1,036	–	0.09	21	–	–	–
Greater China	5,092	5	0.16	69	4,089	91%	536
Indian subcontinent	3,599	2	0.23	77	1,957	96%	32
Japan	50	–	–	1	–	–	–
Middle East & Turkey	1,529	–	0.83	12	–	–	–
Russia and central Asia	133	–	–	1	–	–	–

4.3 Proposed distribution to shareholders

Pursuant to Article 10 of the Articles of Association of Philips Lighting N.V., a dividend will first be declared on preference shares out of net income. The remainder of the net income, after reservations made with the approval of the Supervisory Board, shall be available for distribution to holders of ordinary shares subject to shareholder approval after year end. As of December 31, 2016, the issued share capital consists only of ordinary shares; no preference shares have been issued. Under Article 10 of the Articles of Association of Philips Lighting N.V., the Board of Management can 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 2017 Annual General Meeting of Shareholders to declare a dividend of EUR 1.10 per share (up to EUR 165 million), in cash, against the net income for 2016 and free distributable reserves.

The balance sheet presented in this report, as part of the company financial statements for the period ended December 31, 2016, is before appropriation of the result for the financial year 2016.

4.4 Outlook

In 2017, we expect further improvement in our Adjusted EBITA margin by approximately 50-100 basis points, in line with our medium term outlook to gradually improve the Adjusted EBITA margin to 11%-13%. We also remain committed to delivering solid free cash flow. While we are cautious given global economic uncertainty, we remain committed to our ambition to return to positive comparable sales growth in the course of this year.

5. Three-year overview

Philips Lighting
Three-year financial summary in mEUR unless stated otherwise
2014-2016

	2014	2015	2016
Income statement			
Sales	6,981	7,465	7,115
Comparable sales growth [1] *%*	*(0.8%)*	*(3.5%)*	*(2.4%)*
Nominal sales growth %	*(2.1%)*	*6.9%*	*(4.7%)*
Sales of LED based products [2]	34%	43%	55%
Gross margin	2,310	2,655	2,677
as a % of sales	*33.1%*	*35.6%*	*37.6%*
Income from operations (EBIT)	41	331	369
Net income (loss)	(29)	240	*185*
Adjusted EBITA [1]	476	547	645
as a % of sales	*6.8%*	*7.3%*	*9.1%*
EBITA [1]	149	438	479
Net income (loss) attributable to shareholders	(22)	226	189
Earnings per share in EUR			1.26
Dividend per share in EUR [2]			1.10
Balance sheet			
Total assets	6,332	6,443	7,455
Shareholders' equity	3,495	3,513	2,704
Net debt [1]	15	5	341
Working capital [1]	981	832	662
Investments and cash flow			
Net cash provided by operating activities	478	717	505
Net capital expenditure	(123)	(85)	(87)
Free cash flow [1]	355	632	418

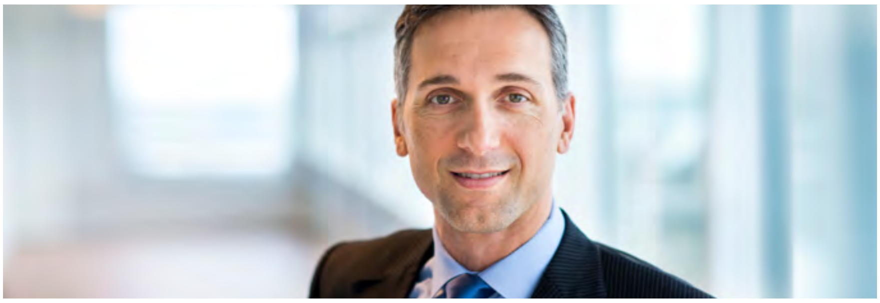
1) For a reconciliation to the most directly comparable IFRS financial measure, see chapter 17, Reconciliation of non-IFRS financial measures, of this Annual Report.
2) As % of sales.

Philips Lighting
Three-year sustainability summary
2014-2016

	2014	2015	2016
Sustainable revenues, in millions of euros	4,952	5,343	5,536
Sustainable revenues, as a % of total sales	71%	72%	78%
Sustainable innovation, as a % of total research & development spend	65%	69%	80%
Sustainable innovation, in millions of euros	255	254	281
Operational CO_2 emissions in kilotonnes CO_2-equivalent	783	666	528
Operational energy efficiency, in terajoules per million euro sales	0.94	0.70	0.63
Operational energy use in terajoules	6,536	5,213	4,460
Renewable electricity, as a % of total electricity usage	54%	58%	67%
Water intake, in thousands m^3	2,052	1,751	1,451
Total waste, in kilotonnes	54	45	40
Materials provided for recycling via external contractor per total waste, in %	80%	85%	85%
Restricted substances, in kilograms	8	7	6
Hazardous substances, in kilograms	3,597	2,708	1,916
ISO-14001 certification, as a % of all reporting organizations	86%	88%	88%
Employee net promoter score	n/a	(5)	8
Female executives, in % of total	18	20	17
Total recordable cases, per 100 FTEs	0.77	0.66	0.50
Lost workday injuries, per 100 FTEs	0.37	0.34	0.22
Fatalities	–	–	2
Initial and continual supplier conformance audits, number of audits	79	66	103
Suppliers audits, performance rate, in %	88%	90%	92%

Governance

6. Board of Management



Eric Rondolat
Born 1966, Italian/French

Chief Executive Officer
Chairman of the Board of Management since May 2016

Stéphane Rougeot
Born 1968, French

Chief Financial Officer (CFO) [1)]

René van Schooten
Born 1959, Dutch

Business Group Leader Lamps
Member of the Board of Management since May 2016

Philips Lighting N.V. is managed by a Board of Management entrusted with the management of the company.

The Board of Management operates under the chairmanship of the Chief Executive Officer and is responsible for the deployment of the company's strategy and the achievement of the operational and financial objectives of the company.

The Board of Management is accountable for its actions and decisions to the Supervisory Board and is answerable to shareholders of the company at the Annual General Meeting of Shareholders.

The Rules of Procedure of the Board of Management are published on the company's website.

Corporate governance
A full description of the company's corporate governance structure is published in chapter 10, Corporate governance, of this Annual Report.

1) The Supervisory Board will propose the appointment of Stéphane Rougeot to the Board of Management at the 2017 Annual General Meeting of Shareholders.

7. Supervisory Board

The Supervisory Board supervises the policies and management and the general affairs of Philips Lighting. It also provides advice to the Board of Management. The Supervisory Board, in the two-tier corporate structure under Dutch law, is a separate body that is independent of the Board of Management.

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 8, Supervisory Board report, and chapter 9, Remuneration report, of this Annual Report.

Arthur van der Poel
Born 1948,
Dutch

Chairman

Committee(s) [B, C]

Chairman of the Corporate Governance and Nomination & Selection Committee
Member of the Supervisory Board since 2016; first term expires in 2020
Former member of the Board of Management of Royal Philips. Chairman of the Supervisory Board of BDR Thermea Group B.V. and Chairman of the Supervisory Board of VanderLande Industries Holding B.V.

Frans van Houten
Born 1960,
Dutch

Vice-Chairman

Committee(s) [C]

Member of the Supervisory Board since 2016; first term expires in 2020
Currently Chief Executive Officer and Chairman of the Board of Management of Royal Philips.

Rita Lane
Born 1962,
American

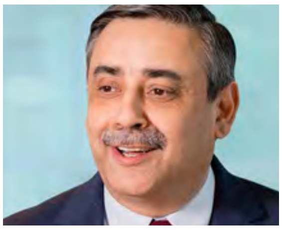
Committee(s) [A]

Member of the Supervisory Board since 2016; first term expires in 2020
Former Vice President of Operations at Apple Inc. Member of the Board of Directors of Sanmina Corp, several start-ups and non-profit organizations.

Kees van Lede
Born 1942,
Dutch

Committee(s) [A, B]

Chairman of the Audit Committee and Remuneration Committee
Member of the Supervisory Board since 2016; first term expires in 2018
Former Chairman of the Board of Management of Akzo Nobel.



Abhijit Bhattacharya
Born 1961,
Indian

Committee(s) [A, B]

Member of the Supervisory Board since 2016; first term expires in 2020
Currently Chief Financial Officer and member of the Board of Management of Royal Philips.

[A] Member of the Audit Committee.
[B] Member of the Remuneration Committee.
[C] Member of the Corporate Governance and Nomination & Selection Committee.

8. Supervisory Board report

Introduction by the Chairman

The initial public offering of Philips Lighting in May 2016 introduced a new chapter in the history of Philips Lighting, which has a heritage of more than 125 years. It also resulted in the establishment of the Supervisory Board of Philips Lighting on May 31, 2016.

The Supervisory Board supervises the policies and management and the general affairs of Philips Lighting. We also provide advice to the Board of Management. The Supervisory Board currently consists of five members: Frans van Houten and Abhijit Bhattacharya were appointed upon nomination of Royal Philips, while Rita Lane, Kees van Lede and I joined the board as independent members. Three committees cover key areas in greater detail: the Audit Committee, the Corporate Governance and Nomination & Selection Committee and the Remuneration Committee. The charters of the committees are published on the company's website.

This report provides information on how the Supervisory Board and our committees performed their duties in 2016. Since its establishment, the Supervisory Board has in 2016 particularly focused on how Philips Lighting operated in its first year as a standalone company and its business performance. We are proud that we are part of Philips Lighting in its first steps as a listed standalone company and are looking forward to continue building on its foundation for future years to come.

Key discussion topics and meetings in the period from May 31, 2016

Meetings and information

The Supervisory Board held five meetings in the period June-December 2016, all of which took place in the Netherlands. The first meeting was followed by introduction sessions by each Business Group as well as a visit to the Lighting Application Center in Eindhoven, the Netherlands. The Supervisory Board meetings were well attended, with an attendance of close to 100%. As Frans van Houten and Abhijit Bhattacharya are also members of the board of management of Royal Philips, they did not participate in the decision-making on any dividend distribution. Apart from this topic, there were no apparent conflicts of interest of material significance in 2016.

In addition to the five Supervisory Board meetings, we discussed the company's performance in two business review sessions. Each of the Supervisory Board committees regularly convened and reported back on their activities to the full Supervisory Board.
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. Our members also individually interacted with members of the Board of Management and with senior management outside the formal Supervisory Board meetings. Whenever one of our members wanted to be informed on a specific topic, he or she requested this, and follow-up was provided by the Board of Management or senior management.

In 2016, the Supervisory Board discussed a range of topics, including:

- **Strategy and innovation**
  We have had in-depth discussions on industry trends as well as opportunities and risks related to the Philips Lighting business model. On an ongoing basis, we have reviewed, challenged and advised the Board of Management on the company's strategic plan and strategic priorities to achieve its objectives. Part of our discussions have been the steps that Philips Lighting takes to address the fundamental transformation from conventional lighting to LED lighting technologies as well as strategic priorities in R&D, including related investments.

- **Business performance**
  During each Supervisory Board meeting and the business review sessions, we discussed the company's business performance. These included updates on the company's financial performance, M&A and cost saving initiatives. During these meetings in 2016 we paid special attention to the continued worsened market conditions in the Middle East and Turkey, and in particular in Saudi Arabia.

- **Financial reporting and internal controls**
  We discussed the quarterly results and the (semi-)annual financial statements for 2016, including related reports from the internal and external auditors and non-financial information. We also discussed the company's internal controls over financial reporting. For more information on the company's business control framework, including a global standard for internal control over financial reporting refer to chapter 12, Risk factors and risk management, of this Annual Report. The Board of Management provided us with updates and feedback from investors and other stakeholders following each publication of financial results.

- **Operating as an independent company**
  Philips Lighting has historically relied and, to a certain extent, still relies on Royal Philips for various financial, tax and other corporate services and IT systems to support its operations. The Supervisory Board was updated on the progress that Philips Lighting made in establishing its own services and IT systems. In addition, we discussed the company's main business risks and approach to risk management, in particular strategic risks, in the context of operating as a standalone company. We were also updated on the progress to determine a new company name. Now that it operates as a standalone company, the company has redefined its identity, which resulted in the establishment of the company's purpose and values, which were presented to and discussed by the Supervisory Board.

- **Annual operating plan for 2017**
  We have discussed and approved the company's annual operating plan for 2017.

- **Capital allocation policy**
  We have discussed the capital allocation policy of the company. In this context we also discussed expectations as to cash generation, distributions, investments in innovation and M&A as well as implications for credit ratings.

- **Talent management**
  The company's human resources department has presented its program on talent management to us. We have also discussed employees who are in key positions within the company, regarding their performance and their succession planning.

- **Sustainability**
  A regular item on our agenda is the review of the company's sustainability and corporate social responsibility programs and their respective goals. More information on these programs is provided in chapter 16, Sustainability statements, of this Annual Report.

Key activities of the Supervisory Board committees in the period from May 31, 2016

Audit Committee
The Audit Committee assists the Supervisory Board in fulfilling its supervisory responsibilities for, among others, ensuring the integrity of the company's financial statements and reviewing the company's internal controls. Kees van Lede (chair), Rita Lane and Abhijit Bhattacharya are members of this committee. The Audit Committee met three times in the period June-December 2016, upon the conclusion of each quarter, and reported its findings to the full Supervisory Board. Generally, the CEO, the CFO, the Group Controller, the Head of Internal Audit, the Chief Legal Officer and the external auditor (Ernst & Young Accountants LLP) also attend these meetings.

In 2016, the Audit Committee, as part of its standing agenda, had in-depth discussions on the company's periodic financial reports and related press releases. It also discussed with the Head of Internal Audit and the Board of Management, major areas of risk and other attention points as identified through internal audits conducted, and progress and effectiveness of associated mitigation actions. The Audit Committee reviewed the internal audit plan and programs for each quarter. It also reviewed the internal audit charter, yearly audit plan (its scope, coverage and relation to that of the external audit plan), as well as the budget, staffing, independence and organizational structure of the internal audit function. Finally, the committee discussed, with the Board of Management and the Head of Internal Audit, the company's business control framework and any changes thereto. This framework sets the standard for risk management and business controls in the company. The Audit Committee reported on these matters to the full Supervisory Board.

In regard to the company's external auditors, the discussions also covered matters related to accounting policies, financial risks, and compliance with accounting standards, as well as compliance with (financial) legal requirements and relevant legal proceedings and related provisions. Other areas of Audit Committee review included the proposed external audit scope, approach and fees, the independence of the external auditor, non-audit services provided by the external auditor (in conformity with the Philips Lighting Auditor Policy, itself also subject to review by the committee). The committee also reviewed the professional fitness and good standing of the external auditor and its engagement partners. For information on the fees of Ernst & Young Accountants LLP, please refer to note B to the Company financial statements, Audit fees. The Audit Committee also reviewed its own charter.

Corporate Governance and Nomination & Selection Committee

The Corporate Governance and Nomination & Selection Committee is responsible for the review of selection criteria and appointment procedures for the Board of Management, certain other key management positions as well as the Supervisory Board. The committee is also charged with reviewing the corporate governance of the company (for more information on corporate governance refer to chapter 10, Corporate governance, of this Annual Report). Arthur van der Poel (chair) and Frans van Houten are members of this committee. The committee met four times in the period June-December 2016 and reported its findings to the full Supervisory Board.

As mentioned at the time of the IPO, a key priority in 2016 was to expand the Board of Management with another board member, who would take the Chief Financial Officer role.
The committee consulted with the Board of Management on candidates for appointment. Following these consultations, it prepared decisions and advised the Supervisory Board thereon. This resulted in the appointment of Stéphane Rougeot as Chief Financial Officer of the Company on September 1, 2016.
The Supervisory Board will nominate Stéphane Rougeot as member of the Board of Management for appointment by the upcoming Annual General Meeting of Shareholders. If so appointed, the Company's Board of Management will consist of three members.

Furthermore, the committee also devoted specific attention to the size, composition and diversity of the Supervisory Board in particular in light of the intention of Royal Philips to sell down its shareholding in the company over the next several years. The committee discussed candidates for appointment who match the profile of the Supervisory Board. Subsequently, the committee endorsed the selection of Jill Lee and Gerard van de Aast and proposed the Supervisory Board to nominate them as Supervisory Board members.

Other matters that were discussed during the meetings of the committee included the company's corporate governance structure, the threshold applicable to matters to be dealt with by the company's investment committee, the composition of the Supervisory Board and Board of Management, changes in key personnel positions, succession planning as well as the functioning of its members, the committee's own charter, the Supervisory Board Rules of Procedure, the composition of the board of Stichting Continuïteit Philips Lighting, legislative developments, as well as the Supervisory Board's performance evaluation procedures.

Our profile aims to achieve an appropriate combination of knowledge and experience among the members of the Supervisory Board. We attach great importance to diversity in the Supervisory Board's composition. We seek to have a well-balanced mix of women and men on the Board of Management and Supervisory Board as well as in other key positions in the company. In this first year of Philips Lighting as a listed standalone company, the Supervisory Board's and the Board of Management's gender diversity did not meet our policy targets. For the Supervisory Board, two of our five members were nominated from among the members of the Royal Philips board of management. We believe we are now making good progress in implementing our diversity policy. As a result of the proposed appointment of Jill Lee as one of our two new members, the Supervisory Board will meet the set criteria for gender diversity at the end of 2017, after the scheduled step down by Kees van Lede. We note that there may be various pragmatic reasons, such as other relevant selection criteria and the availability of suitable candidates within Philips Lighting, that could play a role in the achievement of our diversity targets.

Remuneration Committee

The Remuneration Committee is responsible for preparing decisions of the Supervisory Board on the remuneration of individual members of the Board of Management and certain other key management positions. Kees van Lede (chair), Arthur van der Poel and Abhijit Bhattacharya are members of the Remuneration Committee.
In performing its duties and responsibilities, the Remuneration Committee is assisted by an external consultant and an in-house remuneration expert. Currently, apart from Abhijit Bhattacharya, no member of the Remuneration Committee is a member of the management board of another listed company.

The Remuneration Committee met four times in the period June-December 2016. The committee also consulted with the CEO, the Board of Management and certain other key management employees. Following those consultations, it prepared decisions and advised the Supervisory Board.

Matters discussed by the Remuneration Committee in 2016 included the selection and appointment of the external independent Remuneration Committee advisor and the review of the current remuneration policy, which resulted in a proposal to change the short-term incentive performance measures and to establish a new global long-term incentive plan.

Please also refer to the chapter 9, Remuneration report, of this Annual Report, for further information on the remuneration policy for the Board of Management and how it was implemented in 2016, as well as proposed changes to such remuneration policy.

Performance evaluation

We have initiated an evaluation of the performance of the Supervisory Board and its committees in 2016, to be followed up early 2017. In addition to the usual topics, the questionnaire we use also addresses how we functioned as a team, paying specific attention to the dynamics of having Royal Philips nominees on the Supervisory Board. Also after this performance evaluation, we will continue to critically look at the composition and functioning of the Supervisory Board and its committees.

We have experienced a constructive working environment in which we could fulfill our responsibilities, and regarded the size of and representation of experience and skills on our board to be adequate for this first year. To further strengthen the Supervisory Board we recommend that Jill Lee and Gerard van de Aast will soon join our board.

Jill Lee (Singaporean, 53) holds (non-)executive positions at industrial companies like Sulzer and ABB, and previously at Siemens. She spent several years heading CFO functions in China followed by global strategic positions in Germany and Switzerland.

Gerard van de Aast (Dutch, 59) is former CEO of technical services provider Imtech and construction services business VolkerWessels and he currently holds various non-executive positions in Dutch companies and is chairman of the supervisory board of the Dutch Railways.

Financial statements 2016 and dividend

Philips Lighting's Consolidated and Company financial statements for 2016, as prepared by the Board of Management, have been audited by Ernst & Young Accountants LLP as independent external auditor appointed by the General Meeting of Shareholders. Its report has been included in the independent auditor's report. We have approved these financial statements.

We recommend the General Meeting of Shareholders to adopt the financial statements for 2016. We likewise recommend to shareholders that they adopt the proposal by the Board of Management to make a distribution of EUR 1.10 per ordinary share in cash, against the net income for 2016 and free distributable reserves.

Appreciation

We recognize that 2016 was a very demanding year for Philips Lighting. We are impressed by everyone's dedication to manage the transition from conventional to LED lighting in challenging market conditions, while at the same time executing a successful IPO and become a standalone company.

We would like to thank the members of the Board of Management, with a special mention of René van Schooten who, in addition to his role as Business Group Leader Lamps, has served as Chief Financial Officer during the separation from Royal Philips and was pivotal in the success of the listing of Philips Lighting on Euronext Amsterdam. We also want to express our thanks to all employees for their continued contribution during this special year.

February 21, 2017

The Supervisory Board
Arthur van der Poel
Frans van Houten
Rita Lane
Kees van Lede
Abhijit Bhattacharya

9. Remuneration report

Introduction

The Philips Lighting remuneration policy with the exception of two components described herein is based on the remuneration policy that was prepared in accordance with Dutch Corporate Governance Code and adopted in the General Meeting of Shareholders of Royal Philips in 2013. This chapter also describes two proposed changes (the 2017 Annual Incentive and the 2017 Long-term Incentive) of the remuneration policy that will be proposed to the shareholders at the 2017 Annual General Meeting of Shareholders ("AGM") of Philips Lighting.

Philips Lighting
Total direct compensation Board of Management
in EUR
2016

	Base compensation/ salary	Annual cash incentive (on-target)	Long term equity based component (on-target)
E.H.E. Rondolat	850,000	80% of annual base	100% of annual base
C.L. van Schooten	525,000	60% of annual base	80% of annual base
S.L.A. Rougeot [1]	550,000	60% of annual base	80% of annual base

[1] Pending appointment as a member of the Board of Management in AGM 2017.

9.1 Remuneration policy

The objective of the remuneration policy applicable to members of the Board of Management is to attract, motivate and retain qualified senior executives of the highest caliber with an international mindset and the professional background essential for the successful leadership and effective management of a large global company that is cost effective and is in line with market practices.

The remuneration package of the Board of Management includes three basic building blocks: a base salary, an annual cash incentive and a long-term equity based component. These three elements together are referred to as Total Direct Compensation. The Total Direct Compensation levels are benchmarked regularly against relevant markets. The targeted Total Direct Compensation level is around the median level of various reference groups, indexes and markets. These reference groups are established based on industry, ownership type, geographical presence, business characteristics and scope parameters.

Although an important element of remuneration, pension and other benefits are not considered part of the Total Direct Compensation.

9.1.1 Base salary

The base salary of the members of the Board of Management aims to reflect the responsibility and scope of their role, taking into account their level of seniority and experience. The base salary of each member of the Board of Management is based on benchmark research by independent external remuneration experts. The base salary is determined by and can be adjusted by the Supervisory Board in accordance with the remuneration policy.

9.1.2 Annual Incentive (annual cash bonus)

All members of the Board of Management are eligible for an Annual Incentive.
The determination of the pay-out under the Annual Incentive is based on actual results versus a combination of financial and non-financial targets set, using multiple performance measures. The targets as well as relevant measures are determined annually by the Supervisory Board.

The Annual Incentive at target opportunity is set at 80% of the base salary for the Chief Executive Officer (60% for other board members) and is capped at two times the at target opportunity. The majority, 80%, of the Annual Incentive opportunity is related to financial performance measures and the remaining 20% is linked to non-financial individual/team targets.

9.1.3 Long-term incentive

As disclosed in the IPO Prospectus, in 2016 Philips Lighting did not have a long-term incentive remuneration plan that provided Philips

Lighting shares or rights to subscribe for shares, neither for members of the Board of Management nor other employees of Philips Lighting in senior management positions within the company. In view thereof, a new long-term incentive plan applicable to members of the Board of Management will be submitted for approval at the 2017 AGM. The main characteristics of the new plan are further described in section 9.3, Remuneration outlook 2017, of this Annual Report. A similar plan will apply to senior management and other key employees. It is estimated that approximately 750 employees globally will become eligible for participation in such plans.

Prior to the settlement of the IPO in May 2016, members of the Board of Management and certain other employees of the company participated in the existing long-term incentive plan of Royal Philips.

9.1.4 Claw back and value adjustment

It is noted that variable pay elements are subject to certain claw back and value adjustment provisions as provided for in the Dutch Civil Code and the Dutch Corporate Governance Code.

9.1.5 Pensions and other benefits

Members of the Board of Management are eligible to receive post-employment benefits by participating in the company's pension plan. Effective January 1, 2015 pension plans that allow pension accrual based on a pensionable salary exceeding an amount of EUR 101,519 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 current members of the Board of Management:

- 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 101,519. The Flex Pension 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 101,519;
- A temporary gross Transition Allowance, for a maximum period of eight years (first five 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.

They are also entitled to other benefits, such as expense and relocation allowances, medical insurance, life and accident insurance and company car arrangements. For more details, see note 31, Information on remuneration.

Additional arrangements

Unless relevant 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 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 provided liability insurance (D&O - Directors & Officers) for the persons concerned.

9.1.6 Service contracts

Members of the Board of Management enter into a service agreement ('overeenkomst van opdracht') with the company. The terms and conditions of these service agreements have been aligned with the relevant Code provisions. Termination of the service contract by either party is subject to a six-month notice provision.

Members of the Board of Management are engaged under contract for a period of four years, it being understood that this period expires no later than at the end of the year following the AGM held in the fourth year after the year of appointment.

9.1.7 Severance arrangements

The service contracts also contain severance provisions which provide for compensation for the loss of income resulting from a termination of employment with a maximum payment of one year's base compensation.

9.1.8 Loans

The company does not grant loans to members of the Board of Management.

9.2 Effectuation of the remuneration policy in 2016

9.2.1 Base salary

To reflect the Board Member's greater responsibilities post-IPO, the annual base salary of Eric Rondolat has been set per May 31, 2016 at EUR 850,000. The annual base salary of René van Schooten is set at EUR 525,000. The annual base salary of Stéphane Rougeot is set at EUR 550,000.

9.2.2 Annual incentive (annual cash bonus)

In 2016, for Philips Lighting the financial performance measures used in the Annual Incentive to track performance were Comparable Sales Growth (CSG), Earnings before Interest, Taxes and Amortizations (EBITA) and average Working Capital (WoCa) measured as the average WoCa over the quarters. EBITA and average WoCa are both measured as a percentage of sales.
The financial targets for 2016 were set within the context of the medium-term objectives of the company communicated at the time of the IPO of Philips Lighting shares on the Euronext exchange. Philips Lighting does not disclose these specific financial targets as these targets are considered commercially sensitive information.

Philips Lighting
Annual incentive realization in EUR
2016 (pay-out in 2017)

	realized annual incentive	as a % of base compensation (2016)
E.H.E. Rondolat	973,844	151%
C.L. van Schooten	523,691	179%
S.L.A. Rougeot [1]	144,086	131%

[1] Pro rata as of 1 September 2016

9.2.3 Long-term incentive

In 2016 Royal Philips granted performance share awards in the form of Royal Philips shares to Eric Rondolat and René van Schooten. In addition, performance share awards granted by Royal Philips in 2013 vested in 2016. In respect of the 2014 performance share awards, the Supervisory Board of Royal Philips has approved a vesting of 106.5%. The vesting of this award is based on the performance of two equally weighted components: Relative Total Shareholder Return (vesting level 52.9%) and Earnings per Share growth (vesting level 53.6%).

After the settlement of the IPO no new performance share awards have been or will be granted under the Royal Philips Long-term Incentive Plan.

The table below provides an overview of Royal Philips shares awarded and that vested in 2016:

Royal Philips
Performance shares [1]
2013-2016

	Grant date	Number of performance shares originally granted	Value at grant date [1]	End of vesting period	Number of performance shares vested in 2016	Value at vesting date in 2016
E.H.E. Rondolat	2013	30,806	650,000	2016	26,185	622,156
	2014	29,966	700,000	2017	n.a.	n.a.
	2015	28,217	725,000	2018	n.a.	n.a.
	2016	36,080	880,000	2019	n.a.	n.a.
C.L. van Schooten	2013	16,588	350,000	2016	14,100	335,016
	2014	14,983	350,000	2017	n.a.	n.a.
	2015	9,730	250,000	2018	n.a.	n.a.
	2016	15,785	385,000	2019	n.a.	n.a.

[1] Dividend performance shares not included.

9.2.4 Share ownership

On the settlement date of the IPO, Eric Rondolat purchased 25,000 Philips Lighting shares and René van Schooten purchased 12,500 Philips Lighting shares. After joining the company as Chief Financial Officer on September 1, 2016, Stéphane Rougeot purchased 5,000 Philips Lighting shares.

9.3 Remuneration outlook 2017

As disclosed in the IPO Prospectus, the remuneration policy was reconsidered after the settlement date of the IPO by the Remuneration Committee of the Supervisory Board. In light thereof, the Supervisory Board proposes the following changes to the remuneration policy for members of the Board of Management which will be submitted to the 2017 AGM.

9.3.1 Base salary

The annual compensation of the members of the Board of Management has been reviewed in 2016 as part of the regular remuneration review.
No increase of the base salary is being considered for 2017.

9.3.2 Annual incentive (annual cash bonus)

The Annual Incentive at target opportunity will be set at 80% of the base salary for the Chief Executive Officer (60% for other board members) and is capped at two times the at target opportunity.

It is proposed to incorporate the current practice in the company's remuneration policy such that 80% of the Annual Incentive is related to financial performance measures and 20% is linked to non-financial individual/team targets (at the discretion of the Supervisory Board).

To ensure continuous alignment of the performance measures with the company's strategy, a certain level of flexibility is desired for the Supervisory Board in determining the financial performance measures for the Annual Incentive, so that the Supervisory Board can respond adequately and without delay to the challenges which the company is facing.

Therefore, the Supervisory Board proposes to amend the remuneration policy such that it can choose annually two or three financial performance measures, as well as relative weightings from the following list:

Comparable Sales Growth (CSG), Adjusted Earnings before Interest, Taxes and Amortizations (EBITA), average Working Capital (WoCa), Free Cash Flow (FCF), Return on Capital Employed (RoCE) and Net Income, whereby adjusted EBITA, average WoCA and Net Income are measured as a percentage of sales.

The financial performance measures will link remuneration with focus on the company's financial priorities and will, together with their weighting, be published in the Annual Report. Annual targets may qualify as sensitive information and will, therefore, not be published.

9.3.3 Long-term incentive

Philips Lighting will also propose at the 2017 AGM, a new long-term incentive plan (LTI Plan). The main characteristics of the new LTI Plan are as follows.

For the Board of Management and certain members of senior management, the LTI Plan consists of performance shares only. Shares are conditionally granted annually. The annual at target grant value is set by reference to a multiple of base salary. For the Chief Executive Officer the annual at target grant value is set at 100 % of base salary and for the other members of the Board of Management at 80% of base salary.

Vesting of these shares is conditional on the achievement of performance conditions measured over a period of three years.
The performance condition measurement is based on three measures, Relative Total Shareholder Return (TSR) (40%), Free Cash Flow (40%) and Sustainability (20%).

9.3.4 Relative TSR

The vesting of 40% of the shares granted is subject to a TSR condition. Relative TSR measures the share price growth plus dividends paid over the three-year performance period. This performance is expressed as a %. This % is compared to the TSR performance of companies included in a peer group specifically compiled for this purpose (see table below). All the TSR performance of the companies in the peer group are ranked top to bottom and after that ranking, the position in the peer group and the pay-out curve determines the pay-out level.

Philips Lighting
TSR Group

ABB	Hitachi	Panasonic
Acuity Brands	Honeywell Int.	Philips Lighting
Cree	Hubbel	Schneider Electric
Eaton Corporation	Johnson Controls	Toshiba
Fagerhult	Legrand	Zumtobel Group

The peer group is reviewed on a regular basis to ensure that the companies in the group remain appropriate peers. Occasionally, changes need to be made, particularly if one of the companies in the peer group is taken over. The Supervisory Board will ensure that the adjusted peer group will align with the strategic objectives, the geographical spread and the business characteristics of Philips Lighting.

Philips Lighting
Performance-incentive zone for TSR in %

Ranking	15	14	13	12	11	10	9	8	7	6	5	4	3	2	1
Payout	0	0	0	0	0	60	80	100	120	140	160	180	200	200	200

9.3.5 Free cash flow

The vesting of another 40% of the annual long-term incentive grant is linked to performance measured by a free cash flow target over the three-year performance period.

9.3.6 Sustainability

The vesting of the remaining 20% of the annual long-term incentive grant is dependent on how well Philips Lighting performs against the targets set with respect to the sustainability condition.

These targets are always set at aspirational level, but will be set and fixed per vesting cycle. However, it is not always feasible to calculate the exact performance and therefore it is to the Supervisory Board's discretion to determine (based on measured performance) an appropriate pay-out level. As input to this discretionary decision, the Supervisory Board will use performance against targets as defined in Philips Lighting's sustainability ambition.

Philips Lighting
Sustainability targets

Program	2016 result	2020 target
Sustainable revenues	78% of revenues	80% of revenues
LED lamps	628 million	> 2 billion LED lamps delivered cumulatively
Carbon neutral	406 kt CO_2	0 kt CO_2
Zero waste to landfill	26% of sites	100% of sites
Safe & Healthy Workplace	TRC = 0.50	TRC = <0.35
Sustainable Supply Chain	100% of risk suppliers audited	100% of risk suppliers audited

9.3.7 Claw back

Long-term incentives are subject to claw back provisions pursuant to the Dutch Corporate Governance Code and Dutch law.

9.3.8 Change of control

In the event of a change of control of the company, the Supervisory Board at its sole discretion can decide to accelerate the vesting of any unvested awards, subject to the achievement of the performance conditions up to the date of completion of the change of control.

9.3.9 Share ownership guidelines and holding requirement

Simultaneously with the introduction of the proposed LTI Plan, a guideline for members of the Board of Management to hold a certain number of shares in the company will also be introduced, i.e. 300 % of base salary for the CEO and 200% of base salary for other members of the Board of Management. This guideline requires that all after-tax shares be retained until share ownership guidelines and holding requirements (five years after grant date) are met, after which time, shares may be sold (subject to the conditions of relevant insider trading rules).

9.3.10 Pool size

No Philips Lighting shares will vest in 2017. The number of shares to be granted on a yearly basis in aggregate to all employees under LTI Plans will be approximately 1.5 million and the first vesting of Philips Lighting shares under this new program is expected to occur in 2020.

The number of shares to be granted will depend on the eligible population, the overall at target value and the share price as the at target value is divided by the three months' average share price preceding the date of grant to determine the number of shares to be granted.

Scenario analyses are prepared regularly to estimate future pay-out levels as input to determine the IFRS costs and any hedging strategy that might be employed. Furthermore, estimated future remuneration levels are assessed against the potential achievement of strategic objectives. Based on the scenario analysis performed, the Supervisory Board has concluded that the policy supports the pay for performance philosophy.

10. Corporate governance

Introduction

Philips Lighting N.V., a public company with limited liability organized under Dutch law, is the parent company of the Philips Lighting group.

In May 2016, Royal Philips offered part of its shares in the share capital of Philips Lighting N.V. to the public and the shares in the capital of Philips Lighting N.V. were listed on Euronext Amsterdam. After settlement of the offering on May 31, 2016, Royal Philips still held - and as of February 21, 2017 still holds the majority of the shares in the share capital of Philips Lighting N.V.

In the context of the initial public offering, Philips Lighting N.V. and Royal Philips entered into an agreement containing certain arrangements regarding the continuing relationship between Philips Lighting N.V. and Royal Philips (Relationship Agreement). The Relationship Agreement, with the exception of certain specific provisions, terminates on the date that Royal Philips' holding of ordinary shares in the share capital of Philips Lighting N.V. falls below 10% of the issued and outstanding ordinary shares. The full text of the Relationship Agreement is available on the website of the company.

Philips Lighting N.V. has a two-tier governance structure consisting of a Board of Management and a Supervisory Board. The two boards are independent of each other and are accountable to the Annual General Meeting of Shareholders (AGM) for the performance of their duties.

The Board of Management and the Supervisory Board are responsible for maintaining an appropriate corporate governance structure of the company.

Philips Lighting N.V.'s corporate governance framework is based on the company's Articles of Association, the requirements of the Dutch Civil Code, the Dutch Corporate Governance Code, the Dutch Financial Markets Supervision Act and any other applicable laws and regulations. Further, the Board of Management has implemented a Code of Conduct, policies, directives and authorization schedules throughout Philips Lighting in order to strengthen its governance framework.

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 AGM for discussion under a separate agenda item.

10.1 Philips Lighting organization

Currently, Philips Lighting's business is organized and managed on a functional basis by technology and end-markets through four operating Business Groups: Lamps, LED, Professional and Home. The Business Groups are responsible for the development of their strategy, product portfolio and the production and sourcing of their products.

In addition, the company's commercial organization is structured along four geographical Market Groups to manage its global sales channels. The Market Groups are principally responsible for driving and managing sales, managing customer relationships and delivering the commercial activities of the business across our markets, covering commercial activities in almost all countries in the world. The company operates in many countries via its subsidiaries and affiliated companies as well as via a limited number of branch offices, which primarily act under the Philips Lighting trade name.

These Business Groups and Market Groups are supported by centralized shared services with respect to, among other functions, legal, finance, human resources, business transformation, strategy and marketing, innovation and operations.

10.2 Board of Management

The Board of Management is entrusted with the management of the company.

Among other responsibilities, the Board of Management drives the company's management agenda, defines and deploys the strategic direction, identifies risks connected with its business activities, pursues the operational and financial objectives of the company and monitors corporate social responsibility issues relevant to the company.

In performing its duties, the Board of Management is guided by the interests of the company and its affiliated enterprises, taking into consideration the interests of its stakeholders.

The Board of Management is accountable for its actions and decisions to the Supervisory Board and is answerable to shareholders of the company at the AGM.

The Chief Executive Officer and other members of the Board of Management have regular contacts with the Chairman and other members of the Supervisory Board, attend most parts of the Supervisory Board meetings and provide the latter with all information the Supervisory Board needs to fulfill its own responsibilities.

Certain decisions of the Board of Management require Supervisory Board approval, including important proposals for capital expenditures, acquisitions, divestments, decisions concerning financial and operational objectives and strategy to achieve such objectives, changes to corporate policies, as well as the annual operating plan.

The functioning and decision-making within the Board of Management are laid down in the Rules of Procedure which can be found on the company's website.

Appointment

Members of the Board of Management are appointed by the General Meeting of Shareholders (the General Meeting) upon a nomination drawn up by the Supervisory Board which nomination may be binding.

Members of the Board of Management are appointed for a term of four years, it being understood that this term expires at the end of the AGM 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 termination date in the fourth year, unless the General Meeting resolves otherwise. Members may be suspended by the Supervisory Board and the General Meeting, and dismissed by the latter.

Remuneration

The remuneration of the individual members of the Board of Management is determined by the Supervisory Board based on the remuneration policy adopted by the General Meeting.
The composition of the remuneration of the members of the Board of Management, and the remuneration policy, are described in the remuneration report and the notes to the Consolidated financial statements.

Diversity

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 and Supervisory Board held by men, and at least 30% of the seats held by women. The relevant rule has ceased to have effect on January 1, 2016 but a bill aimed at reintroducing it was adopted on February 7, 2017. The new bill still needs to enter into force.

Conflicts of interest

Members of the Board of Management and/or Supervisory Board shall not participate in the discussions and decision-making process on a subject or transaction which they have a direct or indirect personal conflict of interest or have a conflict of interest within the meaning of the Dutch Corporate Governance Code. Relevant matters relating to conflicts of interests, if any, must be approved by the Supervisory Board and shall be mentioned in the annual report for the financial year in question. No legal acts as referred to above have occurred during the financial year 2016.

Outside directorships

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 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.

The Dutch Corporate Governance Code restricts the overall number of supervisory positions that a member of the Board of Management may hold. A member of the Board of Management may not be a member of the supervisory board of more than two listed companies. Nor may a member of the Board of Management be the chairman of the supervisory board of a listed company. Under the Code, the number of supervisory boards of Dutch listed companies of which a member of the Supervisory Board may be a member is limited to five, for which purpose the chairmanship of a supervisory board counts double.

Dutch law provides for further limitations on the overall number of supervisory positions that a member of the Board of Management or Supervisory Board (including a one-tier board) of “large Dutch companies” may hold.

A person cannot be appointed as a managing or executive director of a “large Dutch company” if he/she already holds a supervisory position at more than two other “large Dutch companies” or if he/she is the chairman of the supervisory board or one-tier board of another “large Dutch company”. Also, a person cannot be appointed as a supervisory director or non-executive director of a “large Dutch company” if he/she already holds a supervisory position at five or more other “large Dutch companies”, whereby the position of chairman of the supervisory board or one-tier board of another “large Dutch company” is counted twice.

10.3 Supervisory Board

The Supervisory Board, in the two-tier corporate structure under Dutch law, is a separate body that is independent of the Board of Management. The Supervisory Board supervises the policies and management and the general affairs of the company. The Supervisory Board also provides advice to the Board of Management.
In performing its duties, the members of the Supervisory Board are guided by the interests of the company and its affiliated enterprises, taking into consideration the interests of its stakeholders.

Appointment and composition

The members of the Supervisory Board are appointed by the General Meeting on the nomination of the Supervisory Board, which nomination may be binding. Pursuant to the Relationship Agreement, Royal Philips shall have the right, under the terms and conditions set out in the Relationship Agreement to nominate candidates for appointment as member of the Supervisory Board. The Dutch large company regime (*structuurregime*) does not apply to the Company itself.

The Articles of Association do not provide for a fixed or maximum term of appointment. In line with the Dutch Corporate Governance Code, the members of the Supervisory Board (with the exception of Kees van Lede) have been appointed for a period of four years, it being understood that the period of their appointment will expire at the end of the AGM to be held in 2020.

As per December 31, 2016, the Supervisory Board consists of five members. In accordance with the Relationship Agreement, two Supervisory Board members are appointed upon nomination of Royal Philips (each a Royal Philips nominee).

The Supervisory Board further consists of three independent members. The Supervisory Board has appointed one of its independent members as chairman. Once Royal Philips holds less than 15% of the ordinary shares there shall be no Royal Philips nominee on the Supervisory Board as Royal Philips will cause all Royal Philips nominees to resign from their position as members of the Supervisory Board with immediate effect if so requested by the company.

The Supervisory Board’s 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 in relation to the global and multi-product character of the company’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 five years ago.

The Supervisory Board meets at least six times a year. Meetings of the Supervisory Board are attended by the CEO and, if possible, by the other members of the Board of Management and the company’s general secretary, unless the Supervisory Board decides otherwise and save for certain meetings as described in the Supervisory Board Rules of Procedure.

Remuneration

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. The remuneration of a Supervisory Board member is not dependent on the results of the company. Shares or rights to shares shall not be granted to a Supervisory Board member.

Independence of the Supervisory Board

The Supervisory Board is a separate corporate 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. Each member of the Supervisory Board meets the independent requirements as stated in the Dutch Corporate Governance Code with the exception of both Royal Philips nominees, Frans van Houten and Abhijit Bhattacharya, so long as Royal Philips holds 10% or more of the ordinary shares.

Supervisory Board Committees

The Supervisory Board has established three committees: the Audit Committee, the Corporate Governance and Nomination & Selection Committee and the Remuneration Committee. Each of the committees has a preparatory and/or advisory role to the Supervisory Board. They report their findings to the full Supervisory Board, which is ultimately responsible for all decision-making. Information on the work and composition of the committees during the year is set out in the report of the Supervisory Board.

Each committee has a charter describing its role, responsibilities and functioning. These charters are included in the Rules of Procedure of the Supervisory Board and published on the company's website.

Audit Committee

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. It furthermore maintains contact with and supervises the external auditor and it prepares the nomination of an external auditor for appointment by the General Meeting.

The Audit Committee meets at least once before the publication of the quarterly and annual accounts of the company.

Corporate Governance and Nomination & Selection Committee

The Corporate Governance and Nomination & Selection Committee advises the Supervisory Board on its duties regarding the (procedures for the) selection and appointment of members of the Supervisory Board and the members of the Board of Management. The duties of the Corporate Governance and Nomination & Selection Committee include preparing the selection criteria and appointment procedures for members of the Supervisory Board and the members of the Board of Management and proposing the profile for the Supervisory Board. It also periodically assesses the size and composition of the Board of Management and the Supervisory Board, and the functioning of the individual members. The Corporate Governance and Nomination & Selection Committee also proposes on appointments and reappointments. It supervises the policy on selection criteria and appointment of senior executives within the company. At least once a year it reviews the corporate governance of the company and can make recommendations to the Supervisory Board relating to the corporate governance of the company.

The Corporate Governance and Nomination & Selection Committee meets at least twice every year.

Remuneration Committee

The Remuneration Committee is responsible for preparing proposals for the Supervisory Board on the remuneration policy for the Board of Management and on the remuneration of the individual members of the Board of Management and for overseeing the long-term incentive plans for the company's executives involving the company's shares.

The Remuneration Committee also reviews the proposed remuneration of certain senior executives designated by the Supervisory Board and the remuneration of the members of the Supervisory Board and prepares proposals for adjustments, if necessary.

Furthermore, the Remuneration Committee reviews and prepares proposals for the Supervisory Board concerning the corporate goals and objectives relevant to the annual incentive of members of the Board of Management, and reviews the performance of members of the Board of Management in light of those goals and objectives, and it prepares proposals for the Supervisory Board on the compensation levels of the members of the Board of Management, based on such review.

The Remuneration Committee prepares an annual remuneration report. The Remuneration Committee meets at least twice every year.

10.4 General Meeting of Shareholders

The main powers of the General Meeting are:

- to appoint, suspend and dismiss members of the Board of Management and of the Supervisory Board, adopt the remuneration policy and approve equity-based incentive plans for members of the Board of Management and adopt the remuneration of the members 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, as well as other important matters, such as major acquisitions or the sale of a substantial part of the company, as required by law.

The AGM is held within six months of the end of the financial year in order to discuss the annual report and decide on the adoption of the financial statements and dividend proposal as well as the discharge of the members of the Board of Management and Supervisory Board.

The AGM is called by the Board of Management or the Supervisory Board. The Board of Management is entitled to determine the record date in accordance with Dutch law. The agenda, explanatory notes thereto and the procedure for attendance are published on the company's website. Holders of ordinary shares in the aggregate representing at least 3% of the total issued share capital may submit proposals for the AGM agenda. Such proposals must be made in writing at least 60 days before the AGM to the Board of Management. Any written request must comply with the procedure stipulated by the Board of Management, which procedure is published on the company's website.

All resolutions are adopted by absolute majority, unless the law or the company's articles of association stipulate otherwise. Each ordinary share confers the right to cast one vote in the General Meeting. There are no special statutory rights attached to the shares of the company and no restrictions on the voting rights of the company's shares exist. Subject to certain exceptions provided by Dutch law or the Articles of Association, resolutions of the General Meeting are passed by an absolute majority of votes cast. A resolution to amend the Articles of Association requires a simple majority of the votes cast, if the resolution is adopted on a proposal of the Board of Management. Otherwise such resolution requires a majority of at least three-fourths of the votes cast provided that majority represents more than half of the issued share capital. Pursuant to Dutch law, no votes may be cast at a General Meeting in respect of shares which are held by the company.

Share capital and repurchase and issue of (rights to) shares

The authorized share capital of the company amounts to EUR 6 million divided into 300 million ordinary shares with a nominal value of one eurocent each and 300 million preference shares also with a nominal value of one eurocent each. As of December 31, 2016, the issued share capital amounts to EUR 1.5 million divided into 150 million ordinary shares and no preference shares. All shares are fully paid-up. The shares are in registered form. There are currently no limitations either under Dutch law or the company's Articles of Association, as to the transfer of ordinary shares in the share capital of the company.

The Board of Management, to the extent authorized by the General Meeting for a specific period, may resolve to issue or repurchase shares, subject to the approval of the Supervisory Board. Pre-emptive rights may be limited or excluded by the Board of Management if the Board of Management is designated by the General Meeting to do so.

Prior to the settlement of the IPO, the General Meeting resolved to authorize the Board of Management for a period of 18 months, subject to approval from the Supervisory Board, to issue shares or grant rights to acquire shares in the capital of the company as well as to restrict or exclude the pre-emptive rights accruing to shareholders, up to a maximum of 10% of the issued share capital or 20% in connection with or on the occasion of mergers, acquisitions and/or strategic alliances. At the same time, the Board of Management was authorized to acquire shares in the company up to 10% of the issued share capital 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.

Anti-takeover provisions and change of control

The possibility of issuing preference shares in the share capital of the company is a defensive measure. To this end, the foundation Stichting Continuïteit Philips Lighting has been granted a call option by the company to acquire preference shares. The foundation may resolve to exercise the call option at its sole discretion and does not require the consent of the company to exercise the call option. However, the foundation may not exercise the call option without the prior consent of Royal Philips for so long as Royal Philips holds 30% or more of the shares (excluding preference shares). Furthermore, the foundation may not exercise the call option until the company has appointed three members to the board of the foundation. On each exercise of the call option, the foundation is entitled to acquire, and the company shall have the unconditional obligation to issue, preference shares up to a maximum corresponding with 100% of the share capital of the company. This shall exclude the preference shares as issued and outstanding immediately prior to the exercise of the call option, less one preference share, from which maximum any preference shares already placed with the foundation at the time of the exercise of the call option must be deducted.

The call option can be exercised by the foundation in order to, for example:
- prevent, slow down or otherwise complicate an unsolicited takeover bid for and an unsolicited acquisition of shares by means of an acquisition at the stock market or otherwise
- prevent and countervail concentration of voting rights in the General Meeting of Shareholders; and/or
- resist unwanted influence by and pressure from shareholders to amend the strategy of the company.

If the foundation exercises the call option, the company issues such number of preference shares as for which the foundation exercised its call option. No preference shares have been issued as of December 31, 2016. 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 foundation's objects are to further the interests of Philips Lighting N.V., the enterprises maintained by the company and the companies affiliated with the company in a group.
The foundation will act in such a way that the interests of the company and of those enterprises are optimally safeguarded and that influences which could affect the independence, continuity or identity of the company, the enterprise maintained by the company and the companies affiliated with the company in a group in conflict with those interests are deterred to the best of the foundation's ability.

Furthermore, 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 Lighting all powers vested in them.

The company is not a party to any material agreement that takes effect, alters or terminates upon a change of control of the company following a take-over bid as referred to in section 5:70 of the Dutch Financial Markets Supervision Act, other than the credit agreement entered into with a syndicate of financial institutions which established a term loan facility and revolving credit facility and the Trade Mark License Agreement entered into with Royal Philips.
The credit agreement includes a change of control provision which allows the lenders to cancel the commitment under the facility and declare any outstanding amounts under the facility agreement immediately due and payable whereupon such amounts will become immediately due and payable.

10.5 External auditor

Under Dutch law, the external auditor of the company is appointed by the General Meeting on the proposal of the Supervisory Board, after the latter has been advised by the Audit Committee and the Board of Management. 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 for the purposes of assessing the nomination for the (re) appointment of the external auditor. The General Meeting appointed Ernst & Young Accountants LLP as external auditor of the company for the financial years 2016 through 2019.

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.

Auditor independence
The Audit Committee evaluates at least annually the external auditor's independence. The lead auditor in charge of Philips Lighting account is changed every five years. Furthermore, Dutch law requires the rotation of the external audit firm after the firm has completed the statutory audits of the company for a period of 10 consecutive years.

Prohibition on non-audit services
The Audit Committee reviews the proposed audit scope, approach and fees as well as services they provide to the company. Dutch law requires the separation of audit and non-audit services, meaning the company's external auditor is not allowed to provide non-audit services.

10.6 Dutch Corporate Governance Code

The company fully endorses the underlying principles of the Dutch Corporate Governance Code, and is committed to adhering to the best practices of the Code as much as possible.

The company fully complies with the Code and applies all its principles and best practice provisions that are addressed to the Board of Management or the Supervisory Board except for Best Practice Provision III.2.1. This provision states that all members of the Supervisory Board, with the exception of not more than one person, must be independent in the meaning of the Code. A member of the board of management of a company that holds 10% or more of the shares in the issued share capital of the company concerned does not qualify as independent. Therefore, as long as Royal Philips holds 10% or more of the ordinary shares, both Royal Philips nominees, Frans van Houten and Abhijit Bhattacharya, do not qualify as independent.

11. Investor relations

11.1 Stock performance

Philips Lighting N.V. was listed and began trading on Euronext Amsterdam on May 27, 2016 under the ticker “LIGHT”. Philips Lighting was included in the Euronext Midcap Index on September 19, 2016 and the share price had increased by 6.4% as of December 31, 2016. Options on Philips Lighting shares began trading on Euronext Amsterdam on June 21, 2016 and the market capitalization at year end 2016 was EUR 3.5 billion.

Philips Lighting
Share price since IPO in EUR
2016

11.2 Capital allocation

Dividend policy

Philips Lighting targets an annual dividend pay-out ratio of 40% to 50% of continuing net income to be paid out annually in cash. The payment of dividends, if any, and the amounts and timing thereof depends on a number of factors, including future revenue, profits, financial conditions, general economic and business conditions and prospects. Other factors that the Board of Management may deem relevant as well as other legal and regulatory requirements, many of which are beyond the control of the company may also impact payment of dividends, amounts and timing. Continuing net income is used to calculate the dividend payout for the year.
In 2016, this figure was calculated based on net income of EUR 189 million. By adding the impact of restructuring costs (EUR 115 million), incidentals (EUR 51 million) and subtracting the tax impact (EUR 36 million), our total continuing net income for 2016 was EUR 319 million.

Proposed dividend

A proposal will be submitted to the 2017 Annual General Meeting of Shareholders (AGM) to pay a cash dividend of EUR 1.10 per ordinary share, against the net income for 2016 and free distributable reserves. This represents a pay-out ratio of 52% of continuing net income.
The dividend payment is subject to approval by the AGM to be held on May 9, 2017. Dividend in cash is, in principle, subject to 15% Dutch dividend withholding tax, which will be deducted from the dividend in cash paid to shareholders. Shareholders are advised to consult their tax advisor on the applicable situation with respect to taxes on the dividend received.

Philips Lighting
Dividend dates
2016

	Ex-dividend date	Record date	Payment date
Philips Lighting shares	11 May 2017	12 May 2017	18 May 2017

Capital allocation policy

Philips Lighting continues to exercise strict financial discipline in the generation and use of cash. As part of our capital allocation policy, the company is committed to managing our financial ratios to maintain a financing structure compatible with an investment-grade profile, including disciplined management of balance sheet liabilities.

Our policy is to target an annual payment of a regular cash dividend in line with our dividend policy at 40-50% of continuing net income. Philips Lighting plans to return additional capital to shareholders as well as consider seizing non-organic opportunities primarily through small- to medium-sized acquisitions.

Capital returns to shareholders

Given our capital position while maintaining a compatible investment-grade profile and in line with our capital allocation policy, Philips Lighting will return additional capital to our shareholders. Over the period 2017-2018, the company will return up to EUR 300 million, by participating in share disposals by our main shareholder. In line therewith, on February 8, 2017, Philips Lighting repurchased 3.5 million of its shares from Royal Philips for an aggregate amount of EUR 81.9 million. Philips Lighting intends to cancel these shares.

11.3 Debt structure

In May 2016, Philips Lighting entered into a credit agreement (the “Credit Agreement”) with a syndicate of financial institutions which established the Term Loan Facility and the Revolving Credit Facility. Philips Lighting has drawn down approximately USD 500 million and approximately EUR 740 million under the Term Loan Facility. These amounts have been used to refinance intra-group financing provided by Royal Philips in connection with the separation and transaction costs. At present Philips Lighting has not drawn down any amounts under the Revolving Credit Facility.

Both the Term Loan Facility and the Revolving Credit Facility have a term of five years from the date of the Credit Agreement. The loans under the Term Loan Facility will be repaid at the end of the term and may also be repaid without penalty at the option of Philips Lighting during the term.

Interest rates

The loans under the Term Loan Facility bear interest at a variable rate, based on the relevant applicable EURIBOR or LIBOR plus a margin. The margin is initially 0.75% and is subject to adjustment based on a net leverage ratio.

Financial covenant

The Credit Agreement includes a financial covenant providing that the Philips Lighting must maintain a Net Leverage Ratio in respect of any test period ending on or after December 31, 2016 of not greater than 3.00x consolidated Adjusted EBITDA.

11.4 Shareholder base

Philips Lighting had a free float of 28.8% and 150 million of ordinary shares outstanding on December 31, 2016. The Dutch Financial Markets Supervision Act requires persons holding a capital and/or voting interest of 3% or more in Philips Lighting to disclose such to the Netherlands Authority for the Financial Markets (AFM). The AFM processes these disclosures in its publicly available register, which can be found at www.afm.nl. The AFM register includes the following shareholders having an interest of 3% or more as per December 31, 2016:

Philips Lighting
Shareholder structure
December 31, 2016

	% holding
Philips Lighting shareholders	
Koninklijke Philips N.V.	71.2%
Schroders Plc	3.0%

Source: AFM.

On February 8, 2017, Royal Philips sold 26 million Philips Lighting shares, reducing its stake in the issued and outstanding share capital to 55.2%. As a result, the free float increased to 44.8%.

11.5 Financial calendar

Philips Lighting
Financial calendar
2017-2018

Q1 2017 financial report	April 21, 2017
Annual shareholders meeting 2017	May 9, 2017
First half 2017 financial report	July 21, 2017
Q3 2017 financial report	October 19, 2017

11.6 Annual General Meeting of Shareholders

The agenda and the explanatory notes to the Agenda for the Annual General Meeting of Shareholders on May 9, 2017, will be published on the company’s website.

For the 2017 Annual General Meeting of Shareholders a record date of April 11, 2017 will apply. Those persons who, on that date, hold shares in the Company, and are registered as such in one of the registers designated by the Board of Management for the Annual General Meeting of Shareholders, will be entitled to participate in, and vote at, the meeting.

11.7 Investor relations contact information

Philips Lighting’s Investor Relations aims to ensure that relevant, timely and accurate information is made available to the capital markets. The Investor Relations team maintains an ongoing dialogue with sell-side equity analysts, as well as institutional and retail shareholders. Visit http://www.lighting.philips.com/main/investor for financial reports, investor presentations, IR policy and other information for both retail and institutional shareholders.

12. Risk factors and risk management

12.1 Our approach to risk management and business control

The following section presents an overview of our approach to risk management and business controls and our view of the nature and extent of the principal risks to our business. Our risk management focuses on the following risk categories: Strategic, Operational, Compliance and Financial risks. These categories are further described in sections 12.2 to 12.7. The risk overview highlights the main risks known to Philips Lighting, 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 the business. Some risks not yet known to us, or currently believed by us not to be material, could ultimately have a major impact on our businesses, objectives, revenues, income, assets, liquidity and/or capital resources.

Risk management and controls form an integral part of the business planning and review cycle. The company's risk management and controls are 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. They make management responsible for identifying critical business risks and for the implementation of appropriate risk responses. Philips Lighting's risk management approach is embedded in the areas of corporate governance, Business Control Framework and General Business Principles.

Corporate governance

Corporate governance is the system by which a company is directed and controlled. Good corporate governance derives from, among other things, solid internal controls and high ethical standards.

The quality of Philips Lighting's systems of business controls and the findings of internal and external audits or management self-assessment are reported to and discussed quarterly by the Audit Committee of the Supervisory Board, Business Groups, Market Groups and Functions (Finance and IT). Internal auditors monitor the quality of the business controls through risk-based operational audits, inspections of financial reporting controls and compliance audits. These audit committees are also involved in determining the desired company-wide internal audit planning as approved by the Audit Committee of the Supervisory Board. An in-depth description of Philips Lighting corporate governance structure can be found in chapter 10, Corporate governance, of this Annual Report.

Philips Lighting Business Control Framework

The company's Business Control Framework (BCF) sets the standard for risk management and business controls in the company. 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 and related disclosure, as well as compliance with laws and regulations. Philips Lighting 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 Lighting continuously evaluates and improves its BCF to align with business dynamics and good practice. Apart from materiality thresholds reconsidered in light of the IPO, there were no major changes in the BCF.

As part of the BCF, Philips Lighting has implemented a global standard for internal control over financial reporting (ICS). The ICS, together with the 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 engaged in the key financial processes perform self-assessment on 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 the control environment. The findings of management's evaluation are reported to the Board of Management and the Audit Committee of 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 Groups, Market Groups, Markets and Functional management to the Board of Management. 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 statement, including its conclusions regarding the effectiveness of internal control over financial reporting, can be found in chapter 13, Statement of the Board of Management, of this Annual Report.

Philips Lighting General Business Principles

The company's General Business Principles (GBP) incorporate the fundamental principles for all 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. For further reading go to: http://www.lighting.philips.com/main/investor/governance.

In order to increase the level of GBP awareness and to create engagement, Philips Lighting has established a network of GBP Compliance Officers in each country where the company has a presence. The activities and responsibilities of this network are mainly focused on providing expertise and support on GBP-related issues to all managers and employees. In addition, all employees are requested to either complete several e-learnings on the GBP and related legal compliance domains or to participate in face-to-face GBP trainings. Philips Lighting will continue to further strengthen its communication efforts in order to increase awareness of the GBPs during 2017.

The GBP form an integral part of labor contracts in virtually every country in which Philips Lighting 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 Procurement Codes of Ethics, and all executives are asked to sign off on the GBP to confirm their awareness and compliance with the respective codes. Philips Lighting's Chief Legal Officer keeps oversight, together with Royal Philips Legal Compliance, on the development and implementation of the GBP, including the monitoring of their effectiveness.

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 Lighting Ethics Line. The Philips Lighting Ethics Line enables employees and 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 Lighting BCF, 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)[1] 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 Board of Management through the Quarterly Certification Statement process.

The results from the monitoring facilities that are in place are given in chapter 16, Sustainability statements, of this Annual Report.

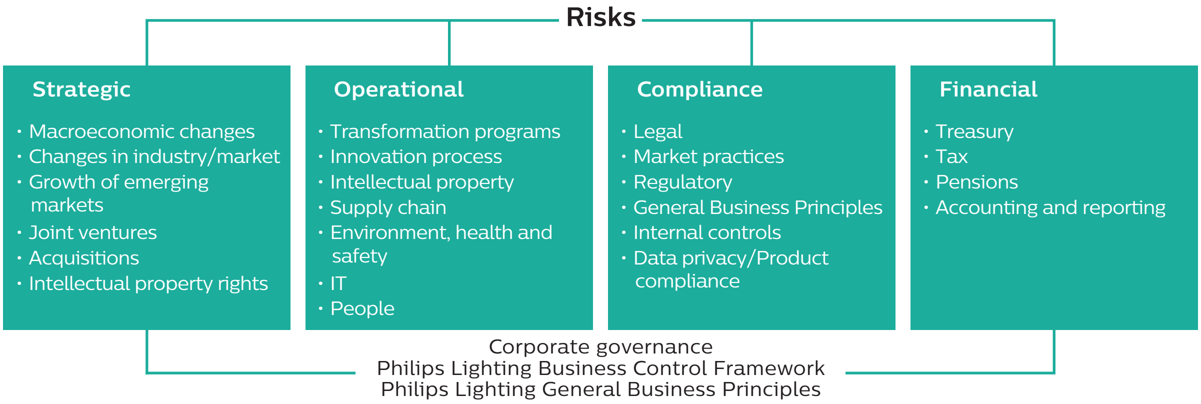
[1]) SOX applies to Philips Lighting as a subsidiary of Royal Philips which is subject to section 404 of the US Sarbanes-Oxley Act.

Financial Code of Ethics

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 and CFO, and to most of financial and accounting professions in Philips Lighting.

12.2 Risk categories and factors

Risk 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 Lighting's business activities, risks and opportunities are identified in a structured way, combining elements of top-down and bottom-up approaches. Risks are reported on a regular basis as part of the Business Performance Management process. Known relevant risks including those associated with business opportunities are prioritized in terms of potential impact and likelihood, considering quantitative and/or qualitative aspects. The bottom-up identification and prioritization process is supported by dedicated workshops or as integral part of the annual strategic review planning cycle with the respective management at Lighting, Business, Market Group and Function levels. During 2016, several risk management workshops were held. The top-down element allows potential new risks, including those associated with business 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 Group and Lighting level. During 2016, as part of separation from Royal Philips, Philips Lighting has established its own governance on risk management process. Supervisory board, Finance and IT audit committees were established in 2016, in addition to the existing Business Group and Market Group Audit committees. Risk management governance and process are agreed and further standardized across all businesses.

Philips Lighting has a structured risk management process to address the following risk categories: strategic, operational, compliance and financial risks. Risk appetite is different for each of the various risk categories:

- Strategic risks and opportunities may affect Philips Lighting's strategic ambitions. Strategic risks include economic and political developments and the effects of actions taken to anticipate and respond to market circumstances. Philips Lighting is prepared to take some strategic risks, balancing the need to capture return from opportunities and manage risks. This may include investing in certain markets, in R&D and managing the portfolio of businesses, in acquisitions and divestments in a highly uncertain global political and economic environment.
- 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. Philips Lighting aims to minimize downside risks to maintain the high quality of its products, systems 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 Lighting has a zero-tolerance policy towards non-compliance in relation to breaches of its GBP.

- Within the area of financial risks, Philips Lighting identifies risks related to treasury, accounting and reporting, pensions and tax.
- Philips Lighting does not classify these risk categories in order of importance. Philips Lighting's risk appetite is described in various chapters of this Annual Report, including note 32, Details of treasury/other financial risks.

Philips Lighting describes the risk factors within each risk category in order of Philips Lighting's 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 known to Philips Lighting – those risks which may hinder the company in achieving its strategic and financial business objectives. The risk overview may not, however, include all the risks that may ultimately affect Philips Lighting. 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 Lighting's business, strategic objectives, revenues, income, assets, liquidity, capital resources or achievement of Philips Lighting's goals. Furthermore, a risk factor described as less significant than other risk factors may ultimately prove to have more significant adverse consequences than higher risk factors. Over time Philips lighting may change its view as to the relative significance of each risk factor.

12.3 Strategic risks

As the business of the company is global, its operations are exposed to economic and political developments in countries across the world that could adversely impact its financial condition and operating results.

Philips Lighting's business environment is influenced by political and economic conditions in the domestic and global markets. Philips Lighting experienced the impact of changes in macroeconomic development in various geographies during 2016 – in particular, in China where economic growth was at the lowest level in the last 25 years. 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. This has been felt 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, systems and services offered by Philips Lighting. 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, particularly the exit of the UK, or secession of regions from European countries (e.g. Cataluña and Scotland). Economic and political uncertainty may have a material adverse impact on Philips Lighting's financial condition or results or operations and may also make it more difficult for Philips Lighting to budget and forecast accurately. The company 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, nationalization of assets or restrictions on the repatriation of returns from foreign investments. Given that growth geographies are increasingly important in Philips Lighting operations, the above-mentioned risks are also expected to grow and could have a material adverse effect on Philips Lighting financial condition and operating results.

Philips Lighting 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 operating results.

Fundamental shifts in the industry, such as the ongoing transition from traditional to LED lighting and faster adoption of lighting systems and services based on LED lighting technologies may drastically change the business environment. This rapid technological change and the transition from conventional lighting technologies to LED lighting technologies has had, and is expected to continue to have, significant effects on Philips Lighting's business model. It is difficult to predict the extent and speed of the transition from conventional lighting technologies to LED lighting technologies and the significant price erosion which characterizes the market for LED lamps. In addition, the LED lamps market may experience accelerated saturation, shifting faster to integrated luminaries. If Philips Lighting is unable to recognize these changes in good time, or is late in adjusting its business models or its manufacturing footprint, or if circumstances arise such as pricing actions by competitors, then the transition to LED lighting could have an adverse material effect on Philips Lighting growth ambitions, financial condition and operating results.

Philips Lighting overall performance in the coming years is dependent on realizing its growth ambitions in growth geographies.

Growth geographies are increasingly important in the global market. In addition, Asia is an important production, sourcing and design center for Philips Lighting. Philips Lighting 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 Lighting needs to maintain and grow its position in growth geographies, invest in local talent, understand developments in end-user preferences and localize the portfolio in order to stay competitive. Philips Lighting's failure to achieve these could have a material adverse effect on growth ambitions, financial condition and operating result. The growth ambitions of Philips Lighting may be adversely affected by economic volatility inherent in growth geographies and the impact of changes in macroeconomic circumstances on growth economies.

Acquisitions could expose Philips Lighting to integration risks and challenge management in continuing to reduce the complexity of the company.

Philips Lighting acquisitions (such as acquisition of a 51% interest in General Lighting Company (GLC), to gain access to the lighting market in the Kingdom of Saudi Arabia in 2014) may expose the company 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 Lighting may incur significant acquisition, administrative and other costs in connection with these transactions, including costs related to the integration of acquired businesses.

Further, 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. Goodwill recorded on the consolidated balance sheet amounted to EUR 1,899 million as of December 31, 2016. Professional reported limited headroom in the 2016 annual impairment test and therefore adverse changes could cause an impairment loss to be recognized. Impairment of these assets may have a material adverse effect on Philips Lighting operating results and equity (see also note 15, Goodwill).

12.4 Operational risks

Philips Lighting has realized and expects further cost savings will be required to maintain or improve profitability margins and cash generation. Its ability to continue implementing cost-saving initiatives may not be successful, and could have an adverse effect on Philips Lighting's financial condition and operating result.

Philips Lighting has previously implemented or is currently implementing certain business transformation programs intended to ensure sustainable performance by transforming processes, operations, organization or culture, particularly cost-saving initiatives for non-manufacturing costs, for certain parts of its Professional luminaires business in North America and Home business in Europe. Philips Lighting's past and current business transformation programs have been or are costly, and Philips Lighting is exposed to potential expense in connection with its current and future business transformation programs, as well as the risk that these programs may not be successfully implemented or continued and may not improve the overall performance of Philips Lighting's business.

Failure to achieve improvements in Philips Lighting systems and product creation process and/or increased speed in innovation-to-market could hamper Philips Lighting's profitable growth ambitions.

Making further improvements in Philips Lighting systems and product creation process, ensuring timely delivery of new systems and products at lower cost and upgrading of customer service levels to create sustainable competitive advantage are important in realizing Philips Lighting's 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 systems and product creation, however, depends on a number of factors, including timely and successful completion of development efforts, market acceptance, Philips Lighting's ability to manage the risks associated with new products and

production ramp-up issues, the ability of Philips Lighting 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 Lighting cannot determine in advance the ultimate effect that new systems and product creations will have on its financial condition and operating results. If Philips Lighting fails to accelerate its innovation-to-market processes and fails to ensure that end-user insights are fully captured and translated into systems and product creations that improve product mix and consequently contribution, it may face an erosion of its market share and competitiveness, which could have an adverse material effect on its financial condition and operating results.

If Philips Lighting 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 Lighting is continuing the process of creating a leaner supply base with fewer suppliers, while maintaining dual/multiple sourcing strategies where possible. This strategy requires close cooperation with suppliers to enhance, among other things, time to market and quality. In addition, Philips Lighting is continuing initiatives to reduce assets through outsourcing. These processes may result in increased dependency on external suppliers and providers. Although Philips Lighting 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 Lighting's activities are conducted outside 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, among other things, regional conflicts, disruptive weather events due to climate change or natural disasters. A general shortage of materials, components or subcomponents as a result of events such as natural disasters also involves the risk of unforeseeable fluctuations in prices and demand, which could have a material adverse effect on its financial condition and operating results.

Philips Lighting sets high quality standards for its products, but it is possible that products may contain defects or otherwise not perform as expected. Quality defects may reduce sales, result in costs associated with warranty or product liability claims or require recall of affected items.

Manufacturing of Philips Lighting's products involves complex processes, and defects have in the past, and could in the future, occur in Philips Lighting's products. In addition, it is possible that certain of Philips Lighting's products may not perform as expected (e.g., in terms of estimated life span and energy savings). These defects or shortfalls may cause Philips Lighting to incur significant warranty, support and replacement costs. Furthermore, Philips Lighting may become subject to actions by regulatory authorities related to alleged failures of products. These actions may result in fines or costs incurred in connection with product recalls or the defense. Costs incurred in conducting recalls and exchanging defective or non-performing products may significantly exceed the cost of the product.

Additionally, failures or malfunctions of Philips Lighting's products may lead to claims for property damage and personal injury. In particular, Philips Lighting is on occasion put on notice and may become subject to liability claims by individual claimants or their insurers when fires may have been related to products manufactured and/or marketed by Philips Lighting. Although to date such claims have not resulted in material loss to Philips Lighting, it, on the same basis as other lamp and luminaire manufacturers, expects that it will continue to be subject to legal proceedings seeking to hold liable for property damage and personal injury resulting from fires alleged to have been caused by the failure or malfunction of products manufactured and/or marketed by Philips Lighting.

Reputational and adverse effects on business due to activities in Environment, Health & Safety or our people's behavior

Philips Lighting is exposed to developments which could affect its reputation. Such developments could be of an environmental or social nature. These may be connected to the behavior of individual employees or suppliers or could relate to adherence to regulations related to labor, health and safety, environment or chemical management. Reputational damage could materially impact Philips Lighting's financial condition and operating results

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 Lighting 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 Lighting 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 Lighting 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 Lighting's 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 other 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 liabilities to customers and partners. Furthermore, enhanced protection measures can involve significant costs. Although we have experienced cyber-attacks and, 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 Lighting will be as successful in avoiding damages from cyber-attacks. Additionally, successful outsourcing of business processes is highly dependent on secure and well-controlled IT systems.

Due to the fact that Philips Lighting 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, is critical to company's success. This is particularly valid for competence in the areas of digital, Internet of Things, end user sales and marketing. The loss of specialized skills could also result in business interruptions. There can be no assurance that Philips Lighting will continue to be successful in attracting and retaining the highly qualified employees and key personnel needed in the future.

Philips Lighting will need to establish a new company and brand name in the marketplace in the future, when the use of Philips company name and brand is terminated. Inability to establish a new corporate and brand identity would have an adverse effect on its financial condition and operating results.

Following the separation from Royal Philips, Philips Lighting has secured the right to use the Philips company name and a license to use the Philips brand for a limited period of time and under certain conditions.

When the right of use or license is terminated, including at the end of its respective term, Philips Lighting will need to spend significant time, effort and resources to establish a new company and brand name in the marketplace. Philips Lighting cannot guarantee that this effort will ultimately be successful. If Philips Lighting's efforts to establish a new corporate and brand identity are unsuccessful, its financial condition and operating results will be materially adversely affected.

12.5 Compliance risks

Legal proceedings covering a range of matters are pending in various jurisdictions against Philips Lighting and its current and former subsidiaries. Due to the uncertainty inherent in legal proceedings, it is difficult to predict the final outcome.

Philips Lighting, including a certain number of its current and former subsidiaries, is involved in legal proceedings. 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

Lighting's financial position and operating results could be affected materially by adverse outcomes.

Please refer to note 28, Contingent liabilities, for additional disclosure relating to specific legal proceedings.

Philips Lighting is exposed to governmental investigations and legal proceedings with regard to possible non-compliance with General Business Principles (GBP). Also its 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 Lighting operates

Philips Lighting's attempts to realize its growth ambitions could expose it to the risk of non-compliance with the Philips Lighting GBP (which includes compliance with competition laws, anti-bribery and anti-corruption laws) This risk is heightened in growth geographies as the legal and regulatory environment is less developed in growth geographies compared to mature geographies. Philips Lighting's financial condition and operating results could be materially affected by governmental investigations and litigation, as well as any related claims.

Philips Lighting has established subsidiaries in over 67 countries and is subject to compliance with local laws and regulations. These subsidiaries are also exposed to changes in governmental regulations and enforcement and unfavorable political developments. The failure to comply with applicable law and regulation, including as a result of any such changes, may affect the realization of business opportunities or impair Philips Lighting's local investments.

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. Furthermore, such flaws could affect the reliability of our public disclosures.

Correct and complete disclosure provides investors and other market professionals with significant information for a better understanding of Philips Lighting's businesses. Material mistakes or omissions 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 Lighting share price.

Philips Lighting is exposed to non-compliance with data privacy and product regulations and laws.

Philips Lighting's brand image and reputation would be adversely impacted by non-compliance with various data protection and product regulations and laws. In light of Philips Lighting's system solution strategy, data privacy laws are increasingly important. Philips Lighting is also exposed to the risk that its products, including components or materials procured from suppliers, may prove to be non-compliant with safety laws or regulations, such as those pertaining to substances or collection and recycling requirements. Such non-compliance could result in a ban on the sale or use of these products although, so far, there are no major cases reported.

12.6 Financial risks

Philips Lighting 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 Lighting to raise or re-finance debt in the capital markets or could lead to significant increases in the cost of such borrowing in the future.

Philips Lighting operates in more than 100 countries and its earnings are, therefore, exposed to fluctuations in exchange rates of foreign currencies against the euro, our reporting currency. Philips Lighting's sales are sensitive, in particular, to movements in the US dollar, Chinese renminbi and a wide range of other currencies from developed and emerging markets. However, Philips Lighting's sourcing and manufacturing spend is concentrated in the Eurozone, US and China. The net (revenues less spend) sensitivity of income from operations to US dollar and Chinese renminbi is most significant.

The credit risk of financial and non-financial counterparties, with outstanding payment obligations, creates exposure for Philips Lighting, particularly in relation to accounts receivable with customers and liquid assets, 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 Lighting's financial condition and operating results.

Philips Lighting's 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 Lighting 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.

Philips Lighting 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 Lighting's financial condition and operating results.

For further analysis, please refer to note 32, Details of treasury / other financial risks.

Philips Lighting is exposed to various tax risks and uncertainties which could impact the local tax results.

Philips Lighting is exposed to a number of different tax uncertainties, which could result in double taxation, penalties and interest payments. The company typically sees tax risks and uncertainties in the following fields:

- transfer pricing with regard to intercompany cross-border deliveries of goods and services
- tax losses and tax credits carried forward
- permanent establishments; and
- potential changes in tax law that could result in higher tax expense and payments.

All these factors could adversely affect Philips Lighting's financial condition and operating results.

In the field of transfer pricing, Philips Lighting is closely monitoring the OECD and Base Erosion & Profit Shifting developments in order to be compliant with changing local/international tax laws and regulations. Philips Lighting already reports income in the countries where the value is created, in accordance with internationally accepted standards and applying the 'arm's length' principle.

In the field of tax losses and tax credits carried forward, the value of these tax attributes 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 case of losses carried forward with an indefinite term.
The ultimate realization of the Philips Lighting'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 10, Income taxes.

Philips Lighting 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 markets and demographic developments, creating volatility in Philips Lighting's financials.

A significant number of (former) employees in Europe and North and Latin America are 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 Lighting 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.

For important critical reporting risk areas identified within Philips Lighting we refer to the 'Critical accounting judgements and key sources of estimation uncertainty' section in note 2, Significant accounting policies, as the company assessed that reporting risk is closely related to the use of estimates and application of judgment.

12.7 Post separation risk

Philips Lighting is exposed to risks associated with separation from Royal Philips.

Post-separation from Royal Philips, Philips Lighting continues to rely on Royal Philips to perform certain services, particularly in respect of IT under service level agreement. The majority of the service level agreements ended on February 1, 2017 with some exceptions extended until June 1, 2017. After the transition period ends, if Philips Lighting is unable to timely replace the relevant systems or services with an adequate internal solution or external service provider at reasonable costs, Philips Lighting may incur operational difficulties or losses.

13. Statement of the Board of Management

We have prepared this Annual Report in accordance with International Financial Reporting Standards (IFRS) as endorsed by the European Union (EU), the statutory provisions of Part 9, Book 2 of the Dutch Civil Code and additional Dutch disclosure requirements for annual reports.

To the best of our knowledge:
- The Consolidated financial statements and Philips Lighting N.V. financial statements included in this Annual Report give a true and fair view of the assets, liabilities, financial position and profit or loss of Philips Lighting N.V. and its consolidated undertakings
- The management report included in this Annual Report 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 Philips Lighting N.V. and the undertakings included in the consolidation taken as a whole, and describes the principal risks and uncertainties that the company faces

The Board of Management is responsible for the establishment and adequate functioning of a system of governance, risk management and internal controls in the company. 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 Board of Management 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 12, Risk factors and risk management, of this Annual Report. Significant changes and improvements in the Company's risk management and internal control system are discussed with the Supervisory Board's Audit Committee.

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 Committees are integral parts of the company's risk management approach. On the basis thereof, we confirm that with regard to financial reporting risks:
- the internal risk management and control systems provide a reasonable level of assurance that the financial reporting included in this Annual Report does not contain any errors of material importance
- the internal risk management and control systems have worked properly during 2016.

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-compliance with rules and regulations.

February 21, 2017

Board of Management
Eric Rondolat
René van Schooten

Corporate statements

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14. Consolidated 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 for the year 2016 have been endorsed by the EU, except that the EU did not adopt some paragraphs of IAS 39 applicable to certain hedge transactions. Philips Lighting N.V. has no hedge transactions to which these paragraphs are applicable. Consequently, the accounting policies applied by Philips Lighting N.V. also comply fully with IFRS as issued by the IASB.

The following sections and chapters of this Annual Report:

- chapter 3, Our strategic focus
- chapter 4, Corporate performance
- chapter 6, Board of Management
- chapter 7, Supervisory Board
- chapter 9, Remuneration report
- chapter 10, Corporate governance
- section 11.4, Shareholder base
- chapter 12, Risk factors and risk management
- chapter 13, Statement of the Board of Management
- section 16.2, Social statements
- chapter 17, Reconciliation of non-IFRS financial measures
- chapter 18, Definitions and abbreviations
- chapter 19, Forward-looking statements and other information

form the management report within the meaning of section 2:391 of the Dutch Civil Code.

For 'Additional information' within the meaning of section 2:392 of the Dutch Civil Code, please refer to section 10.1, Philips Lighting organization and section 15.5, Independent auditor's report, of this Annual Report.

Ernst & Young Accountants LLP has issued an auditor's report on the Consolidated financial statements and the Company financial statements, in accordance with Dutch law, including the Dutch standards on auditing, of Philips Lighting N.V., which is set out in section 15.5, Independent auditor's report, of this Annual Report.

14.1 Consolidated statements of income

Philips Lighting
Consolidated statements of income in mEUR unless otherwise stated
For the years ended December 31

		2015	2016
[5]	Sales	7,465	7,115
	Cost of sales	(4,810)	(4,438)
	Gross margin	**2,655**	**2,677**
	Selling expenses	(1,751)	(1,750)
	Research and development expenses	(366)	(353)
	General and administrative expenses	(233)	(248)
	Impairment of goodwill	–	(2)
[9]	Other business income	48	60
[9]	Other business expenses	(22)	(15)
[5]	**Income from operations**	**331**	**369**
[11]	Financial income	3	11
[11]	Financial expenses	(11)	(78)
	Income before taxes	323	302
[10]	Income tax expense	(83)	(119)
	Income after taxes	**240**	**183**
	Results relating to investments in associates	–	2
	Net income	**240**	**185**
	Attribution of net income for the period:		
	Net income attributable to shareholders of Philips Lighting N.V.	226	189
	Net income attributable to non-controlling interests	14	(4)
[12]	**Earnings per ordinary share attributable to shareholders** [1]		
	Weighted average number of ordinary shares outstanding used for calculation (in thousands):		
	• Basic		150,000
	• Diluted		150,000
	Net income attributable to shareholders per ordinary share in EUR:		
	• Basic		1.26
	• Diluted		1.26

The accompanying notes are an integral part of these Consolidated financial statements.

1) Since Philips Lighting N.V. did not have any issued share capital in the previous reporting period, no earnings per share is calculated.

14.2 Consolidated statements of comprehensive income

Philips Lighting
Consolidated statements of comprehensive income in mEUR unless otherwise stated
For the years ended December 31

	2015	2016
Net income for the period	**240**	**185**
Pensions and other post-employment plans:		
• Remeasurements		(8)
• Income tax effect on remeasurements		1
Total of items that will not be reclassified to profit or loss		(7)
Currency translation differences:		
• Net current period change, before tax	58	66
• Income tax effect		
Cash flow hedges:		
• Net current period change, before tax	4	2
• Income tax effect	(1)	-
Total of items that are or may be reclassified to profit or loss	61	68
Other comprehensive (loss) income for the period	**61**	**61**
Total comprehensive income for the period	**301**	**246**
Total comprehensive income (loss) attributable to:		
• Shareholders of Philips Lighting N.V.	278	247
• Non-controlling interests	23	(1)

The accompanying notes are an integral part of these Consolidated financial statements.

14.3 Consolidated balance sheets

Philips Lighting
Consolidated balance sheets in mEUR unless otherwise stated
As of December 31

		2015		2016	
	Non-current assets				
[3][14][27]	Property, plant and equipment:				
	• At cost	2,620		2,522	
	• Less accumulated depreciation	(1,986)		(1,956)	
			634		566
[3][15]	Goodwill		1,844		1,899
[3][16]	Intangible assets, excluding goodwill:				
	• At cost	2,192		2,238	
	• Less accumulated amortization	(1,336)		(1,470)	
			856		768
	Non-current receivables		20		25
[4]	Investments in associates		23		26
[33]	Other non-current financial assets		8		11
[10]	Deferred tax assets		259		472
	Other non-current assets		15		28
	Total non-current assets		**3,659**		**3,795**
	Current assets				
[18]	Inventories		988		886
[19]	Other current assets		46		52
[33]	Derivative financial assets		9		29
[10]	Income tax receivable		25		50
[29]	Receivables:				
[17]	• Accounts receivable	1,519		1,489	
	• Other current receivables	80		111	
			1,599		1,600
[13]	Assets classified as held for sale		34		3
[20]	Cash and cash equivalents		83		1,040
	Total current assets		**2,784**		**3,660**
	Total assets		**6,443**		**7,455**

		2015		2016	
	Equity				
	Owner's net investment	3,384			
[26]	Shareholders' equity				
	Preference shares, nominal value EUR 0.01 per share: • Authorized: 300,000,000 shares • Issued: none				
	Ordinary shares, nominal value EUR 0.01 per share: • Authorized: 300,000,000 shares • Issued and fully paid: 150,000,000 shares			2	
	Share premium			2,369	
	Retained earnings			139	
	Currency translation differences	127		190	
	Cash flow hedges	2		4	
			3,513		2,704
[26]	Non-controlling interest		103		104
	Total equity		**3,616**		**2,808**
	Non-current liabilities				
[25]	Long-term debt		2		1,224
[21][22]	Long-term provisions		350		881
[10]	Deferred tax liabilities		126		35
[23]	Other non-current liabilities		159		150
	Total non-current liabilities		**637**		**2,290**
	Current liabilities				
[25]	Short-term debt		86		157
[33]	Derivative financial liabilities		7		26
[10]	Income tax payable		6		57
[27][29]	Account and notes payable		1,051		1,024
[24]	Accrued liabilities		459		502
[21][22]	Short-term provisions		263		244
[13]	Liabilities directly associated with assets classified held for sale		6		1
[24]	Other current liabilities		312		346
	Total current liabilities		**2,190**		**2,357**
	Total liabilities and total equity		**6,443**		**7,455**

The accompanying notes are an integral part of these Consolidated financial statements.

14.4 Consolidated statements of cash flows

Philips Lighting
Consolidated statement of cash flows in mEUR unless otherwise stated
For the years ended December 31

		2015	2016
	Cash flows from operating activities		
	Net income (loss)	240	185
	Adjustments to reconcile net income (loss) to net cash provided by operating activities:	380	447
	• Depreciation, amortization and impairments of non-financial assets	315	291
	• Impairment of goodwill and other non-current financial assets	4	7
	• Net gain on sale of assets	(26)	(12)
	• Interest income	(3)	(6)
	• Interest expense on debt, borrowings and other liabilities	7	48
	• Income tax expense	83	119
	Decrease (increase) in working capital	209	119
	• Decrease (increase) in receivables and other current assets	–	(27)
	• Decrease (increase) in inventories	29	104
	• Increase (decrease) in accounts payable, accrued and other current liabilities	180	42
	Increase (decrease) in non-current receivables, other assets and other liabilities	(29)	(66)
	Increase (decrease) in provisions	(79)	(71)
	Interest paid	(2)	(29)
	Income taxes paid	(26)	(96)
	Other items	24	16
	Net cash provided by operating activities	**717**	**505**
	Cash flows from investing activities		
	Net capital expenditures	(85)	(87)
	• Additions of intangible assets	(38)	(30)
	• Capital expenditures on property, plant and equipment	(98)	(79)
	• Proceeds from disposal of property, plant and equipment	51	22
	Cash used for derivatives and current financial assets	–	(5)
	Proceeds from other non-current financial assets	31	3
	Purchases of other non-current financial assets	(11)	(7)
	Proceeds from sale of interests in businesses, net of cash disposed of	–	34
	Net cash used for investing activities	**(65)**	**(62)**
	Cash flows from financing activities		
	Funding by (distribution to) Royal Philips	(626)	(1,400)
	Dividend paid	0	(10)
	Capital contribution from Royal Philips	0	692
[25]	Proceeds from issuance (payments) of debt	(12)	1,225
	Net cash (used for) provided by financing activities	**(638)**	**506**
	Net cash provided by continuing operations	**14**	**949**
	Effect of changes in exchange rates on cash and cash equivalents	(6)	8
	Cash and cash equivalents at the beginning of the year	75	83
[20]	**Cash and cash equivalents at the end of the year**	**83**	**1,040**

The accompanying notes are an integral part of these Consolidated financial statements.

14.5 Consolidated statements of changes in equity

Philips Lighting
Consolidated statement of changes in equity in mEUR unless otherwise stated
For the years ended December 31

	Owner's net investment	Share capital	Share premium	Retained earnings	Currency translation differences	Cash flow hedges	Total share-holders' equity	Non-controlling interests	Equity
Balance as of January 1, 2015	3,418				78	(1)	3,495	88	3,583
Net income	226						226	14	240
Other comprehensive income (loss)					49	3	52	9	61
Total comprehensive income (loss)	**226**	**-**	**-**	**-**	**49**	**3**	**278**	**23**	**301**
Movement in non-controlling interests							-	(8)	(8)
Funding by (distribution to) Royal Philips	(260)						(260)		(260)
Balance as of December 31, 2015	**3,384**	**-**	**-**	**-**	**127**	**2**	**3,513**	**103**	**3,616**
Net income				189			189	(4)	185
Other comprehensive income (loss)				(7)	63	2	58	3	61
Total comprehensive income (loss)	**-**	**-**	**-**	**182**	**63**	**2**	**247**	**(1)**	**246**
Movement in non-controlling interests							-	2	2
Capital contribution from Royal Philips	692						692		692
Transfer settlements above book value, net of tax	(555)						(555)		(555)
Funding by (distribution to) Royal Philips	(1,193)						(1,193)		(1,193)
Share issuance and formation of Philips Lighting	(2,328)	2	2,369	(43)			-		-
Balance as of December 31, 2016	**-**	**2**	**2,369**	**139**	**190**	**4**	**2,704**	**104**	**2,808**

The accompanying notes are an integral part of these Consolidated financial statements.

14.6 Notes

[1] Basis of preparation

Separation from Royal Philips

On February 1, 2016, Koninklijke Philips N.V. ('KPNV') and Philips Lighting Holding B.V. entered into the Separation Agreement and a set of ancillary agreements, together effectuating the Separation of their respective businesses and providing a framework for the relationship between Royal Philips and Philips Lighting thereafter (the 'Separation'). An addendum to the Separation Agreement was entered into on May 4, 2016. Furthermore the Separation Agreement and ancillary agreements were assigned to the Company prior to May 31, 2016.

The Separation Agreement contains the allocation basis for assets, liabilities, employees and contracts of the former Royal Philips between the new Royal Philips and Philips Lighting. The assets and liabilities that have been allocated to Philips Lighting have been transferred to Philips Lighting either by way of an asset transfer, demerger, contribution or indirectly through a transfer of the shares in the legal entity in which the relevant asset or liability resided. Conversely, legal entities forming part of Philips Lighting have transferred certain assets and liabilities that were allocated to Royal Philips, to subsidiaries of Royal Philips. Assets and liabilities have been transferred between Royal Philips and Philips Lighting on an 'as is' basis (i.e. net book value) and on a going concern basis.

The Separation was substantially completed on February 1, 2016 with the exception of certain delayed transfers which were completed by May 31, 2016. The excess between the fair value and the carrying value of the net assets transferred, net of tax, is recorded as an equity contribution from Royal Philips, as this was a transaction under common control.

Basis of preparation

The Consolidated financial statements have been prepared in accordance with the 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.

The references to 'Philips Lighting' throughout these financial statements are to the combined Lighting business of Royal Philips for the periods prior to Separation and to the Company and its consolidated subsidiaries for the periods after the Separation.

For periods presented prior to the completion of the Separation, the Consolidated financial statements have been prepared as if the Lighting business had been part of the Company for all such periods, and as if the Company existed as a separate group.

Prior to the Separation, the entities forming the Philips Lighting business were all direct or indirect subsidiaries under the common control of Royal Philips and were not a legal group for consolidated financial reporting purposes in accordance with IFRS 10.

The Consolidated financial statements have been prepared under the historical cost convention, unless otherwise indicated. All amounts are in millions of euros unless otherwise stated.

Basis of preparation - prior period information/ until the finalization of the separation

The 2015 comparative information is derived from the Combined financial statements as disclosed in the IPO Prospectus. Transactions and balances prior to the completion of the Separation that were reported by Royal Philips as part of the continuing operations of the Lighting business of Royal Philips have been directly attributed to Philips Lighting. However, transactions and balances prior to the completion of the Separation that were up to the finalization of the mentioned separation reported by Royal Philips as part of Philips innovation, group & services (IG&S) have been attributed to Philips Lighting based on specific identification or allocation.

Management believes the allocation methods applied in the comparative period to be a reasonable reflection of the utilization of services provided by Royal Philips. However, different allocation methods could have resulted in different outcomes. The allocation methods are therefore not necessarily representative of the financial positions, results of operations or cash flows that would have been reported if Philips Lighting operated on its own or as an entity independent from Royal Philips during the periods presented. Actual future cost levels may thus deviate from historical presentation.

Statements of income

Royal Philips charged central IG&S costs, such as IT, finance and accounting, HR, real estate and other central support services, to its sectors mainly based on activity (headcount, floor area, etc.), sales or gross margin.

Historically, a significant portion of the IG&S costs were already charged to the Lighting Sector.
The combination of the Lighting-related activities of IG&S mainly resulted in additional allocation of previously unallocated costs to Philips Lighting. Previously unallocated costs mainly comprise Royal Philips funded research programs, Royal

Philips overheads and other items such as restructuring and foreign exchange results. The allocation to Philips Lighting of previously unallocated costs is based on activity.

Royal Philips funded research costs were allocated according to the project-level administration of the business for which the activity has been performed.

Royal Philips overheads includes central finance functions including treasury and tax, human resources, strategy, business transformation, brand, communication and digital, legal and general management including the Royal Philips Executive Committee. The costs of overheads have been allocated based on estimated activity levels and the relation of these functions to Philips Lighting and Royal Philips.

Other items of IG&S, such as restructuring costs, foreign exchange results and other items, have been allocated to Philips Lighting based on its relative share in overall costs of IG&S.

Employee benefit expenses and other operational costs were allocated to Philips Lighting based on activity. Depreciation and amortization were assigned to Philips Lighting based on the split of related assets.

Interest expense recorded did not include any allocation of interest incurred by Royal Philips or interest on funding provided as part of the owner's net investment.

Income tax

Prior to the Separation, Philips Lighting operations were typically included with other Royal Philips operations in a consolidated tax group for the majority of their jurisdictions. Our income tax for periods prior to the Separation, is computed and reported using the separate return method. Philips Lighting management estimated the income taxes for each of the jurisdictions in which they operate. This involves estimating their actual current tax exposures and assessing temporary and permanent differences resulting from differing treatment of items, such as reserves and accruals, for tax and accounting purposes.

Philips Lighting management considered the separate tax return method to be reasonable, but it does not necessarily lead to the tax result that would have been incurred if the Philips Lighting entities were separate taxable entities. The separate taxable entities assumption implies that current and deferred taxes of all Philips Lighting entities were calculated on a separate tax return basis and any resulting deferred tax assets are evaluated for utilization following this assumption.

In certain jurisdictions, Philips Lighting operations were part of a larger Royal Philips consolidated group tax return. Accordingly, income tax associated with these tax groups was reported in the Consolidated financial statements of Royal Philips and paid by Royal Philips. The effects of being included in the Royal Philips consolidated tax returns, including the utilization of any historical net operating losses, have been recorded as part of owner's net investment in business equity. The Statement of cash flows presents taxes actually paid by tax groups within Philips Lighting; the effects of being included in the Royal Philips consolidated tax returns have not been included.

Statements of cash flows/Funding structure

The Statements of cash flows have been prepared using 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. For a number of reasons, principally the effects of translation differences and acquisitions and disposals, certain items in the Statements of cash flows did not correspond to the changes between balance sheets amounts for the respective items. Cash deposits of Royal Philips were pooled and transferred to a Central Treasury function on a daily basis wherever possible and were presented as intercompany balances. Amounts for cash, cash equivalents and debt were reflected only for those activities of Philips Lighting that operated or existed in separate dedicated Philips Lighting legal entities. For all other activities, changes in cash and debt balances with Royal Philips have been presented as part of owner's net investment. Owner's net investment represents the funding from (payment to) Royal Philips.

Pensions

Until February 1, 2016, Royal Philips was the sponsor of defined benefit plans that are either externally or internally funded. These pension obligations were not reflected in the prior period financial statements of Philips Lighting as the legal obligation did not exist prior to separation in 2016. The service cost in Royal Philips defined benefit plans were allocated to the participating companies, including Philips Lighting.

[2] Significant accounting policies

Critical accounting judgements and key sources of estimation uncertainty

The preparation of the Consolidated financial statements in conformity with IFRS, as endorsed by the EU, requires management to make judgements, estimates and assumptions that affect the application of accounting policies, the reported amounts of assets, liabilities, income and expenses and assumptions that affect amounts reported in the Consolidated financial statements. These estimates inherently contain a degree of uncertainty. Actual results may differ from these estimates.

These estimates and judgements are evaluated on an ongoing basis and are based on historical experience, current and expected future outcomes, third-party evaluations and various other assumptions that are considered reasonable under the circumstances. The results of these estimates form the basis for making judgements about the carrying values of assets and liabilities, as well as identifying and assessing the accounting treatment with respect to commitments and contingencies. Philips Lighting 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 judgements and estimates are

Goodwill and other intangible assets

Philips Lighting has recognized significant balances of goodwill, customer relationships, brand names and technology as intangible assets. Furthermore, 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 Philips Lighting has sufficient resources and the intention to complete development.

Impairment of goodwill and intangible assets not yet ready for use

Goodwill, intangible assets not yet ready for use are not amortized but tested for impairment annually and whenever impairment indicators require impairment testing. Philips Lighting performed and completed annual impairment tests in the second and last quarters of the current financial year. In the prior period, the tests were performed and completed in the second quarter of the financial year.
An impairment loss is recognized in the Consolidated statements 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 costs of disposal. 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 carrying amount of an asset may not be recoverable.
Recoverability of assets to be held and used is assessed by a comparison of the carrying amount of an asset with the greater of its value in use and fair value less cost of disposal. 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 Consolidated statements of income.

Deferred tax asset recoverability and other tax liabilities

The evaluation of the recoverability of deferred tax assets requires judgement about the future taxable profitability of the legal entity holding the tax loss carry forward. A lack of future taxable profits or taxable profits below the level of current estimates, may cause deferred tax assets to be impaired.

Other tax liabilities include liabilities for uncertain tax positions which are recognized when it is probable that additional tax will be due. Actual tax assessments in relation to these other tax liabilities may significantly deviate from estimates.

In determining the amount of current and deferred income tax, Philips Lighting takes into account the impact of other tax liabilities and whether additional taxes and interest may be due. This assessment relies on estimates and assumptions and may involve a series of judgements about future events. New information may become available that causes Philips Lighting to change its judgement regarding the adequacy of existing tax liabilities; such changes to tax liabilities will impact the income tax expense in the period that such a determination is made.

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. Revenues of transactions that have separately identifiable components are recognized separately based on their relative fair values. Determining fair value and particularly determining the relative fair value in case of multiple elements may require significant judgement.

In instances where Philips Lighting offers discounts or other sales incentives, and when it is probable that discounts will be granted, the company makes an estimate of the discount which is then recognized as a reduction of revenue as the sales are recognized. Judgement is required in determining the probability that discounts will be granted. The estimate is updated throughout the term of the contract.

Useful lives of intangible and tangible fixed assets

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. Amortization of capitalized development expenditure is charged to the Consolidated statements of income on a straight-line basis over the estimated useful lives of the intangible assets.

Inventory valuation and obsolescence provision

Due to price erosion and technological developments, inventory valuation requires forward looking estimates on future sales levels, future price erosion and related expected gross margin percentages. On each reporting date, management performs an analysis of net realizable values and determines the lower of cost and net realizable value to measure its inventories.

Estimation of allowances for doubtful accounts

Philips Lighting determines the present value of estimated future cash flows through the use of allowances for doubtful accounts receivable, based on an individual or collective assessment of the collectability of trade and other receivables. Allowances for doubtful accounts receivable are applied to trade and other receivables where events or changes in circumstances indicate that the balances may not be collectible. The identification of doubtful debtors requires the use of judgement and estimates. Where the expectation is different from the original estimate, such difference will impact the carrying amount of receivables and doubtful debt expense in the period in which such estimate is changed.

Provisions

In order to recognize a provision, it is necessary to reliably estimate the present obligation. Further judgement is required to determine the likelihood of an outflow of economic benefits.

Fair value of derivatives and other financial instruments

Philips Lighting manages their exposure on foreign currency purchases and sales using forward foreign exchange contracts, which are reported at fair value. The fair value of derivatives is calculated as the present value of the estimated future cash flows based on observable interest yield curves, basis spread and foreign exchange rates. These calculations are tested for reasonableness by comparing the outcome of the internal valuation with the valuation received from the counterparty.

Contingent liabilities

Philips Lighting has certain guarantees, environmental remediation and legal proceedings at the reporting dates. Significant judgement is required in determining whether it is probable that an outflow of resources will be required to settle, in which case an accrual for the potential settlement is recognized if this can be reliably estimated.

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, then the estimated 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 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 separately based on their relative fair values.

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.

Shipping and handling billed to customers is recognized as revenues. Service revenue related to repair and maintenance activities for goods sold is recognized ratably over the service period or as services are rendered. 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 or sales. Expenses incurred for shipping and handling of internal movements of goods are also recorded as cost of sales.

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 Philips Lighting 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 Philips Lighting 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 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 Consolidated statements of income over the period necessary to match them with the costs that they are intended to compensate.

Income taxes

Income tax comprises current and deferred tax. Income tax is recognized in the Consolidated statements 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, Philips Lighting has a present legal or constructive obligation, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of 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 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 Philips Lighting's provisions is as follows:

- Restructuring-related provisions - The provision for restructuring relates to the estimated costs of initiated reorganizations which involve the realignment of certain parts of the support, industrial and commercial organization. When such reorganizations require discontinuance and/or closure of lines of activities, the anticipated costs of closure are included in the restructuring provisions. A liability is recognized for those costs only when Philips Lighting has a detailed formal plan for the restructuring and have raised a valid expectation with those affected that they will carry out the restructuring by starting to implement the plan or announcing its main features to those affected by it. Before a provision is established, Philips Lighting recognizes any impairment loss on the assets associated with the restructuring.
- 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 provisions is regularly reviewed and adjusted for new facts and changes in law.
- 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.
- 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 flows are no longer uncertain. Settlements which are agreed for amounts in excess of existing provisions are reflected as increases of Other liabilities.
- Onerous contract provision - Provisions are recognized for a contract if it is onerous. The present obligation under the contract is measured and recognized as a provision. An onerous contract is a contract under which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

Goodwill

The measurement of goodwill at initial recognition is described under accounting policy, Business combinations, 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 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.

Philips Lighting 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, cost can be reliably measured, Philips Lighting has sufficient resources and the intention to complete development.

The development expenditure capitalized comprises all directly attributable costs (including the cost of materials and direct labor). Other development expenditures and expenditures on research activities are recognized in the Consolidated statements of income. Capitalized development expenditure is stated at cost less accumulated amortization and impairment losses. Amortization of capitalized development expenditure is charged to the Consolidated statements of income on a straight-line basis over the estimated useful lives of the intangible assets.

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 for 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 Consolidated statements of income – is reclassified from the fair value reserve in Equity (through Other comprehensive income) to the Consolidated statements 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 Consolidated statements 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 amount that would have been determined if no impairment loss had been recognized. Reversals of impairment are recognized in the Consolidated statements of income, except for reversals of impairment of available-for-sale securities, which are recognized in Other comprehensive income.

Other policies

Basis of consolidation

The Consolidated financial statements comprise the financial statements of Philips Lighting 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 Philips Lighting. Philips Lighting 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 Philips Lighting 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 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 Consolidated statements of income.

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, Philips Lighting 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 Consolidated statements of income. If Philips Lighting 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 Philips Lighting has significant influence, but no control. Investments in associates are accounted for using the equity method of accounting and are initially recognized at cost. Philips Lighting's investments in associates include goodwill identified on acquisition, net of any accumulated impairment loss.

Philips Lighting's share of the net income of these companies is included in Results relating to investments in associates in the Consolidated statements of income, after adjustments to align the accounting policies with those of Philips Lighting, 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 Consolidated statements of income as part of Other results relating to investments in associates. When Philips Lighting'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 Philips Lighting has incurred legal or constructive obligations or made payments on behalf of the associate. Unrealized gains on transactions between Philips Lighting and its associates are eliminated to the extent of Philips Lighting's interest in the associates. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Re-measurement differences of equity stakes resulting from gaining control over the investee previously recorded as associate are recorded under results relating to investments in associates.

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.

Non-current assets held for sale are carried at the lower of carrying amount or fair value less cost to sell. Comparatives in the Balance sheet are not represented when a non-current asset is classified as held for sale.

Foreign currencies

Foreign currency transactions

The financial statements of all reporting units included in the Consolidated financial statements are measured using the currency of the primary environment in which the reporting unit operates (functional currency). The Euro (EUR) is the presentation currency of Philips Lighting. 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 re-measured. 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 Consolidated statements 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 Consolidated statements of income, except for available-for-sale equity investments which are recognized in Other comprehensive income, except on impairment in which case foreign currency differences that have been recognized in Other comprehensive income are reclassified to the Consolidated statements of income.

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 Consolidated statements of income.

Non-monetary items denominated in foreign currencies that are measured at fair value are translated to the functional currency using the exchange rate at the date the fair value was determined. Non-monetary assets and liabilities in foreign currencies measured at 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 Shareholders' equity. However, if 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 Consolidated statements of income as part of the gain or loss on disposal. When Philips Lighting 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 Philips Lighting 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 Consolidated statements of income.

Non-derivative financial instruments

Non-derivative financial instruments are recognized initially at fair value when Philips Lighting becomes a party to the contractual provisions of the instrument. Subsequent to initial recognition non-derivative financial instruments are measured at amortized cost or fair value. Regular way purchases and sales of financial instruments are accounted for at the trade date. Dividend income is recognized when declared and interest income are recognized when they accrue. 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.

Netting of financial assets and liabilities

If Philips Lighting has a legal right to offset financial assets with financial liabilities and if Philips Lighting intends either to settle on a net basis or to realize the asset and settle the liability simultaneously, financial assets and liabilities are presented in the Consolidated balance sheets as a net amount. The right of set-off is available today and not contingent on a future event and it is also legally enforceable for all counterparties in a normal course of business, as well as in the event of default, insolvency or bankruptcy.

Derivative financial instruments, including hedge accounting

Philips Lighting uses derivative financial instruments principally to hedge its foreign currency risks and, to a more limited extent, for 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 upon 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.

Philips Lighting 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 Consolidated statements 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 Consolidated statements 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 Consolidated statements of income.

Philips Lighting 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, Philips Lighting discontinues hedge accounting prospectively. When hedge accounting is discontinued because it is expected that a forecasted transaction will not occur, Philips Lighting continues to carry the derivative on the Consolidated balance sheets at its fair value, and gains and losses that were accumulated in equity are recognized immediately in the Consolidated statements of income. If there is a delay and it is expected that the transaction will still occur, the amount in equity remains there until the forecasted transaction affects income. In all other situations in which hedge accounting is discontinued, Philips Lighting continues to carry the derivative at its fair value on the Consolidated balance sheets, and recognizes any changes in its fair value in the Consolidated statements 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 Consolidated statements of income.

Philips Lighting presents financial assets and financial liabilities on a gross basis as separate line items in the Consolidated balance sheets. Master netting agreements may be entered into when Philips Lighting 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 to 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.

Receivables

Receivables are carried at the lower of amortized cost or the present value of estimated 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 a 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 uncollectable because of bankruptcy or other form of receivership at the debtors.

The allowance for the risk of non-collection of trade receivables 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 certain country or region.

Derecognition of financial assets

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is primarily derecognized (i.e., removed from the Consolidated statement of financial position) when:

- The rights to receive cash flows from the asset have expired
  or
- Philips Lighting has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a ‘pass-through’ arrangement; and either (a) Philips Lighting has transferred substantially all the risks and rewards of the asset, or (b) Philips Lighting has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When Philips Lighting has transferred its rights to receive cash flows from an asset or has entered into a passthrough arrangement, it evaluates if, and to what extent, it has retained the risks and rewards of ownership. When it has neither transferred nor retained substantially all of the risks and rewards of the asset, nor transferred control of the asset, Philips Lighting continues to recognize the transferred asset to the extent of its continuing involvement. In that case, Philips Lighting also recognizes an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that Philips Lighting has retained. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that Philips Lighting could be required to repay.

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 Philips Lighting 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 Shareholder's equity.

When an investment is derecognized, the gain or loss accumulated in equity is reclassified to the Consolidated statements 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 Philips Lighting manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Philips Lighting'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 Consolidated statements of income. Attributable transaction costs are recognized in the Consolidated statements of income as incurred.

Trade and other payables
Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Trade payables are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities. Trade and other payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

Equity
Ordinary shares are classified as equity. Incremental costs directly attributable to the issuance of shares are recognized as a deduction from equity.

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.

Property, plant and equipment
Property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. The useful lives and residual values are evaluated annually.
The costs of property, plant and equipment comprise of all directly attributable costs (including the cost of materials and direct labor). Government grants for assets are deducted from the cost of the related asset.
Depreciation of property, plant and equipment, other than freehold land, is calculated using the straight-line method, taking into account the residual values and estimated useful lives. Freehold land is not depreciated. 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 of 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 Philips Lighting is the lessee and has substantially all 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 cost is charged to the Consolidated statements 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 asset or the lease term.

Leases in which Philips Lighting is the lessee and in which substantially all risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments under operating leases (net of any incentive received from the lessor) are recognized in the

Consolidated statements of income on a straight-line basis over the term of the lease.

Inventories

Inventories are stated at the lower of cost and 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.

Impairment of non-financial assets

Impairment of goodwill and intangible assets not yet ready for use

Goodwill and intangible assets not yet ready for use are not amortized but tested for impairment annual and whenever impairment indicators require. An impairment loss is recognized in the Consolidated statements of income whenever and to the extent that the carrying amount of a cash-generating unit exceeds the unit's recoverable amount.

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 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 costs 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 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 Consolidated statements of income.

Debt and other liabilities

Debt and other liabilities other than provisions are measured initially at fair value and subsequently are measured at amortized cost using the effective interest method.

Employee benefits

Pension obligations

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 Consolidated statements 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 Philips Lighting has no legal or constructive obligation to pay further amounts, however for which contributions paid by Philips Lighting 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 defined benefit obligation at the balance sheet date. The net pension liability is presented as a long-term provision, no distinguishment is made for the short-term portion. The 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 Philips Lighting'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 Willis 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). Philips Lighting recognizes all remeasurements in Other comprehensive income.

Philips Lighting 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 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 Philips Lighting 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 Consolidated statements of income.

Short-term employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. Philips Lighting recognizes a liability and an expense for bonuses and incentives based on a formula that takes into consideration the profit attributable to Philips Lighting's shareholders after certain adjustments.

Philips Lighting recognizes a liability and an expense for bonuses and other current employee benefits on an accrual basis. Furthermore, a provision is recognized where contractually obliged or where there is a past practice that has created a constructive obligation.

Philips Lighting'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 Consolidated statements of income in the period in which they arise.

Termination benefits

Termination benefits are payable when employment is terminated by Philips Lighting before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. Philips Lighting recognizes termination benefits when they are demonstrably committed to a termination and when they have a detailed formal plan to terminate the employment of current employees without possibility of withdrawal. In the case of an offer made to encourage voluntary redundancy, the termination benefits are measured based on the number of employees expected to accept the offer.

Share-based compensation expenses

The share-based compensation plans for Philips Lighting employees have been granted by Royal Philips, and settled with equity instruments of Royal Philips as historically Philips Lighting did not have its own share capital. As of December 31, 2016, Philips Lighting has not granted any share-based compensation to employees to be settled with Philips Lighting's own equity, and has not issued any (restricted) shares to employees.

The share-based payment plan, for which Royal Philips has the obligations to settle, is accounted for in Philips Lighting as an equity-settled plan. The grant-date fair value of equity-settled share-based payment awards granted to employees is recognized as personnel expense, with a corresponding increase in Equity, over the vesting period of the award. Philips Lighting 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.

Based on the recharge arrangement between Royal Philips and Philips Lighting, in place since the separation at February 1, 2016, Royal Philips recharges Philips Lighting for an amount equal to the personnel expense calculated in accordance with IFRS 2. The recharge is booked in Equity and offsets the increase booked for the initial booking of the expense. Hence, the net impact on Equity from these bookings is nil.

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 and loss, net gains on the re-measurement to fair value of any pre-existing available-for-sale interest in an acquiree, and net gains on foreign exchange impacts that are recognized in the Consolidated statements of income.

Interest income is recognized on an accrual basis in the Consolidated statements of income, using the effective interest method. Dividend income is recognized in the Consolidated statements of income on the date that Philips Lighting's right to receive payment is established, which in the case of quoted securities is normally the ex-dividend date.

Financial expense comprises interest expenses on borrowings, unwinding of the discount of 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 and loss, impairment losses recognized on financial assets (other than trade receivables), net interest expenses related to defined benefits plans and net losses on hedging instruments that are recognized in the Consolidated statements of income.

Financial guarantees
Philips Lighting 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.

Consolidated statements of cash flows
The Consolidated statements of cash flows are prepared using the indirect method. Cash flows in foreign currencies have been translated into Euro using the exchange rate at the date of the cash flow. Cash flows from derivative instruments that are accounted for as fair value hedges or 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 consistent with the nature of the instrument.

Earnings per share
Philips Lighting presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the Net income (loss) attributable to shareholders by the weighted average number of ordinary 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 ordinary shares outstanding during the period, adjusted for own shares held, for the effects of all dilutive potential ordinary shares, which comprises of restricted shares, performance shares and share options granted to employees. As of December 31, 2016, Philips Lighting has not granted any share-based compensation to employees to be settled with Philips Lighting's own equity, and has not issued any (restricted) shares to employees.

Changes in accounting policies and disclosures
Other changes
As of December 31, 2016 the unfunded pension liabilities are presented as long-term provisions together with provisions for defined benefits and other post-employment benefits. As the balance at December 31, 2015 was nil, no amounts were reclassified in comparative figures.

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 Philips Lighting beginning on or after January 1, 2016 or later periods, and Philips Lighting has not early adopted them. Those which may be the most relevant to the Philips Lighting 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 Philips Lighting Consolidated 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 endorsed by the EU. Philips Lighting is currently in the process of implementing the new standard, and based on its current assessment of the potential impact of adoption of IFRS 9 based on its positions at December 31, 2016 and hedging relationships designated during 2016 under IAS 39, the following is noted:

Classification
At this moment Philips Lighting does not believe that the new classification requirements will have a material impact on its accounting for trade receivables, loans, investments in debt securities and investments in equity securities. On the classification of financial liabilities under IFRS 9 Philips Lighting's current assessment did not indicate any material impact.

Impairment
Philips Lighting believes that timing of recognition of the expected credit losses is likely to be accelerated compare to the current IAS 39 requirements for assets in the scope of the IFRS 9

impairment model. However, Philips Lighting has not yet finalized the impairment methodologies that it will apply under IFRS 9.

Hedge accounting

Philips Lighting's current plan is that it will elect to apply the new hedge accounting requirements of IFRS 9 rather than to make the accounting policy choice to continue the IAS 39 requirements.

Under IFRS 9 Philips Lighting should ensure that hedge accounting relationships are aligned with Philips Lighting's risk management objectives and strategy, including a more qualitative and forward-looking approach to assessing hedge effectiveness. Under the new model, it is possible that more risk management strategies, particularly those involving hedging a risk component (other than foreign currency risk) of a non-financial item, will be likely to qualify for hedge accounting. Philips Lighting currently does not undertake hedges of such risk components. Under IAS 39, the change in fair value of the forward element of the forward exchange contracts (forward points) is recognized immediately in profit or loss. On adoption of IFRS 9, Philips Lighting may elect for the forward points to be separately accounted for as a cost of hedging. In this case, they would be recognized in OCI and accumulated in a cost of hedging reserve as a separate component within equity and accounted for subsequently, like gains and losses accumulated in the cash flow hedge reserve.

Philips Lighting's current assessment indicated that the types of hedge accounting relationships that Philips Lighting currently designates should be capable of meeting the requirements of IFRS 9 if Philips Lighting completes certain planned changes to its internal documentation and monitoring processes. While Philips Lighting will have to finalize the detailed assessment, it would appear that Philips Lighting's current hedge relationships would qualify as continuing hedges upon the adoption of IFRS 9. Accordingly, Philips Lighting does not expect a significant impact on the accounting for its hedging relationships.

Transition

Changes in accounting policies resulting from the adoption of IFRS 9 will generally be applied retrospectively, however the guidance allows certain exemptions on retrospective application. Philips Lighting has not made a decision yet in relation to the exemptions and elections that IFRS 9 allows.

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.

Philips Lighting has completed an initial assessment of the potential impact of the adoption of IFRS 15 on its Consolidated financial statements.

Sale of goods

Currently, the majority of the company's revenue is recognized when goods are delivered to the customer, which is the point in time at which customer accepts goods and the related risks and rewards of ownership are transferred. Revenue is only recognized at this moment after other requirements are met, such as no continuing management involvement with goods, revenue and costs can be reliably measured and recovery of the considerations is probable.

Under IFRS 15, revenue will be recognized when a customer obtains control of the goods. Currently Philips Lighting considers the fulfillment of a performance obligation, including formal acceptance from customers, when determining the moment of revenue recognition. Based on an assessment of the requirements of the new standard, including an assessment of the indicators that control has passed, Philips Lighting concludes that no material difference in the revenue recognition for the sale of products will arise from implementation of the new standard.

Philips Lighting may offer discounts or other sales incentives, including volume discounts. Currently, if it is probable that discounts will be granted, then the estimated discount is recognized as a reduction of revenue as the sales are recognized. IFRS 15 provides guidance on variable consideration, requiring the company to assess whether, and to what extent, it can include an amount of variable consideration in the transaction price at contract inception. As an example, for volume rebates, the new standard requires the entity to estimate the volumes to be purchased and the resulting discount in determining the transaction price and to update that estimate throughout the term of the contract. As this is in line with the current accounting treatment, Philips Lighting concludes that implementation of the new standard will not have a material impact.

Transactions that have separately identifiable components

Revenues of transactions that have separately identifiable components are currently recognized separately based on their relative fair values. These revenues mainly occur in Professional. Philips Lighting currently makes an assessment on a contract by contract basis of how to recognize revenue. Guiding principle is that risk and rewards are transferred, and other requirements are met, such as no continuing management involvement with goods, revenue and costs can be reliably measured and recovery of the considerations is probable. As a consequence, for some contracts, recognition of revenue is therefore postponed until all performance obligations under the contract are fulfilled and installation is complete as well as until the customer has accepted all deliveries under the contract.

Under IFRS 15, the total consideration of a sale transaction will be allocated to multiple elements based on their relative stand-alone selling prices. These prices will be determined primarily based on the country list prices (including standard discounts where applicable) at which the company sells the elements in separate transactions.

For a selection of contracts with separately identifiable components, Philips Lighting performed an initial comparison of current revenue recognition and the revenue that would be recognized under the new standard.
The company found that by applying the guidance in the new standard for assessing whether a performance obligation is distinct within the context of the contract, as well as applying the criteria in the new standard for determining whether the performance obligation is satisfied over time or a point in time, in certain circumstances revenue recognition under the new standard may differ from current practice. However, similar to current practice, an assessment needs to be made on a contract-by-contract basis. Philips Lighting will therefore extend the impact assessment to cover the relevant population. At this time however, based on current findings, the company does not expect the impact of implementation of the new standard to be material for the financial statements as a whole.

Philips Lighting also performed an initial comparison of the fair value and the stand-alone selling prices of the elements. Since these amounts are broadly the same, Philips Lighting does not expect this to lead to material differences in the revenue recognition for these multiple elements arrangements.

Royalty income

Currently, royalty income, which is generally earned based upon 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.

Under IFRS 15, revenues from the license of intellectual property should be recognized based on a right to access the intellectual property or right to use the intellectual property approach. Under the first option, revenue should be recognized over time, while under the second option revenue should be recognized at a point in time.

As under the new standard, the guidance for recognizing revenue from sale- or usage-based royalties is mostly the same as how Philips Lighting currently recognizes revenue from these type of contracts, which represent the majority of license contracts, Philips Lighting does not expect the implementation of the new standard to have a material impact.

Transition

IFRS 15 must be applied for periods beginning on or after January 1, 2018. It is endorsed by the EU (except Clarifications to IFRS 15 issued by the International Accounting Standards Board in April 2016).

Philips Lighting does not plan to early adopt IFRS 15 and will therefore apply the new standard for the first time in its Consolidated financial statements for the year ending December 31, 2018. Philips Lighting has not yet completed the decision making progress on which transition method will be applied.

IFRS 16 Leases

For lessees, IFRS 16 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. If the interest rate implicit in the lease cannot be readily determined, then the incremental borrowing rate should be used for discounting. 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 adopted for periods beginning on or after January 1, 2019, with earlier adoption permitted if abovementioned IFRS 15 has also been adopted. IFRS 16 is not yet endorsed by the EU.

Philips Lighting is currently assessing the impact of the new standard. So far, the most significant impact identified is that Philips Lighting will recognize assets and liabilities for its operating leases of real estate, while further assessment is ongoing for other operating leases. In this respect, Philips Lighting identified EUR 358 million of off-balance operating lease obligations per December 31, 2016 (refer to note 27, Contractual obligations). In addition, the nature of expenses related to those leases will now change as IFRS 16 replaces the straight-line operating lease expense with a depreciation charge for right-of-use assets and interest expense on lease liabilities. No significant impact is expected for Philips Lighting's finance leases.

Philips Lighting has not yet determined whether to early adopt or not and which transition approach to apply, and has not yet decided whether it will use any of the optional exemptions.

[3] Information by segment and main country

The operating segments are Lamps, LED, Professional and Home. The segments are organized based on the nature of the products and services. 'Other' represents amounts not allocated to the operating segments and mainly comprise of certain costs of group enabling functions and certain costs of the activities of Philips Lighting Innovation.

Starting in 2016, Philips Lighting revised its approach of allocating overhead costs to its businesses. The tables below present the results by segment for the comparative periods consistent with the revised approach.

The following is an overview of Philips Lighting revenues and results by segment:

Philips Lighting
Information on income statement by segment in mEUR unless otherwise stated
2015-2016

	Sales	Sales including intersegment	Depreciation and amortization [1]	EBITA [2]	EBITA as a % of sales
2016					
Lamps	2,333	2,364	(70)	435	18.6%
LED	1,518	1,631	(17)	140	9.2%
Professional	2,683	2,691	(50)	93	3.5%
Home	559	561	(11)	(46)	(8.2%)
Others [3]	22	40	(35)	(143)	
Intersegment elimination		(172)			
Philips Lighting	**7,115**	**7,115**	**(183)**	**479**	**6.7%**
Amortization [4]				(110)	
Income from operations				**369**	
2015					
Lamps	2,850	2,899	(87)	405	14.2%
LED	1,334	1,427	(16)	70	5.2%
Professional	2,757	2,775	(56)	114	4.1%
Home	515	519	(12)	(72)	(14.0%)
Others [3]	9	9	(37)	(79)	
Intersegment elimination		(164)			
Philips Lighting	**7,465**	**7,465**	**(208)**	**438**	**5.9%**
Amortization [4]				(107)	
Income from operations				**331**	

1) Excluding amortization and impairments of acquisition related intangible assets and goodwill
2) Income from operations excluding amortization and impairments of acquisition related intangible assets and goodwill ("EBITA")
3) Considering the nature of Others, EBITA as a % of sales for Others is not meaningful
4) Amortization and impairments of acquisition related intangible assets and goodwill

Sales between the segments mainly relate to the supply of goods. The pricing of such transactions is determined on an 'arm's length basis'.

Philips Lighting has no external customer that represents 10% or more of total sales.

Sales and tangible and intangible assets are reported based on the country of origin as follows:

Philips Lighting
Sales by main countries in mEUR
2015-2016

	2015		2016	
	Sales	Tangible and intangible assets	Sales	Tangible and intangible assets
Netherlands	438	141	529	142
United States	1,795	2,159	1,718	2,152
Germany	469	8	453	12
China	472	116	445	89
India	417	29	406	25
Saudi Arabia	288	248	203	226
Other countries	3,586	633	3,361	587
Total main countries	**7,465**	**3,334**	**7,115**	**3,233**

Goodwill can be specified as follows:

Philips Lighting
Goodwill allocated to the cash-generating unit in mEUR
2015-2016

	Carrying value as of January 1	Reclassification	Purchase price allocation adjustment	Impairments	Divestments, transfers to assets classified as held for sale and others	Translation differences	Carrying value as of December 31
2016							
Lamps	63	-	-	-	-	7	70
LED	28	-	-	-	-	-	28
Professional	1,626	-	-	-	(12)	57	1,671
Home	127	-	-	-	-	3	130
Philips Lighting	**1,844**	**-**	**-**	**-**	**(12)**	**67**	**1,899**
2015							
Lamps	61	-	-	-	(1)	3	63
LED	33	(5)	-	-	-	-	28
Professional	1,470	(5)	8	-	-	153	1,626
Home	112	10	-	-	-	5	127
Philips Lighting	**1,676**	**-**	**8**	**-**	**(1)**	**161**	**1,844**

[4] 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 relate to:
- interests in subsidiaries
- investments in associates.

Interests in subsidiaries

Wholly-owned subsidiaries

The Consolidated financial statements comprise the assets and liabilities of approximately 150 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.

Philips Lighting
Interests in materially wholly-owned subsidiaries
in alphabetical order
2016

Legal entity name	Principal country of business
Genlyte Thomas Group LLC	United States
Philips Electronics (Thailand) Ltd.	Thailand
Philips Indal, S.L.	Spain
Philips Lighting (China) Investment Co., Ltd	China
Philips Lighting B.V.	Netherlands
Philips Lighting GmbH	Germany
Philips Lighting Holding B.V.	Netherlands
Philips Lighting Hong Kong Limited	Hong Kong
Philips Lighting Hungary Kft.	Hungary
Philips Lighting Luminaires (Shanghai) Co., Ltd.	China
Philips Lighting North America Corporation	United States
Philips Lighting Poland Sp. z o.o.	Poland
Philips Luminaires (Chengdu) Co., Ltd.	China

Not wholly-owned subsidiaries

In total, nine consolidated subsidiaries are not wholly-owned by the company. Among these legal entities is Philips Lighting Saudi Arabia created after the acquisition of General Lighting Company (GLC) where the company owns 51% of the voting power and Alliance Holding domiciled in the Kingdom of Saudi Arabia holds the remaining 49%. GLC was acquired on September 2, 2014. The company controls this entity.
The sales of this entity are less than 3% of the combined financial data. The non-controlling interest of 49% represents an amount of EUR 102 million as per December 31, 2016 (2015: EUR 102 million). The non-controlling interest related to GLC at the acquisition date was measured at the holders' proportionate interest in the recognized amount of the identifiable net assets, which means that goodwill recognized by the company in this transaction relates only to the 51% interest acquired.

Also among the consolidated legal entities is Philips Lighting India Limited where the company owns 96% of the voting power. The non-controlling interest of 4% represents an amount of EUR 1 million as per December 31, 2016.

The consolidated group 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 not considered material.

Investments in associates

The company has investments in a number of associates, none of them are regarded as individually material. In aggregate, the carrying amount and the company's share of profit and other comprehensive income of the associates are shown in the Consolidated balance sheets, Consolidated statements of income and Consolidated statements of comprehensive income above.

[5] Income from operations

Sales and costs by nature

Philips Lighting
Sales and costs by nature in mEUR
2015-2016

	2015	2016
Sales	7,465	7,115
Cost of materials used	(3,289)	(3,032)
Employee benefit expenses	(2,165)	(1,993)
Depreciation and amortization	(315)	(291)
Shipping and handling	(261)	(227)
Advertising and promotion	(184)	(170)
Lease expenses	(116)	(81)
Other operational costs	(830)	(997)
Other business income, net	26	45
Income from operations	**331**	**369**

The sales consist primarily of sales of goods (2016: 96%, 2015: 98%).

Cost of materials used represents the inventory recognized in cost of sales.

Shipping and handling costs are included in the cost of sales and selling expenses.

Advertising and promotion costs are included in selling expenses. The costs related to the brand license fee is included in selling expenses.

Lease expense includes EUR 7 million (2015: EUR 8 million) of other costs, such as fuel and electricity, and taxes to be paid and reimbursed to the lessor.

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, third-party workers, warranty, utilities and repair and maintenance for fixed assets. It also includes EUR 2 million of goodwill impairment relating to goodwill allocated to divestments of certain operations which met the IFRS 5 criteria of assets held for sale.

For further information on depreciation and amortization, refer to note 8, Depreciation, amortization and impairments.

For further information on other business income, refer to note 9, Other business income (expenses).

The amounts for sales to Royal Philips companies and associates are provided in note 29, Related Party transactions.

[6] Employee benefit expenses

Employee benefit expenses included in the Consolidated statements of income consist of the following:

Philips Lighting
Employee benefit expenses by nature in mEUR
2015-2016

	2015	2016
Salaries and wages	(1,261)	(1,188)
Social securities	(240)	(209)
Pension	(113)	(90)
Cost of termination plans	(55)	(63)
Temporary personnel	(190)	(107)
Share-based compensation	(24)	(23)
Other	(282)	(313)
Total	**(2,165)**	**(1,993)**

The employee benefit expenses relate to employees of Philips Lighting, with both permanent and temporary contracts. For further

information on post-employment benefit costs, refer to note 22, Post-employment benefits.
For further information on the remuneration of Key Management, refer to note 31, Information on remuneration.

For further information on the share-based compensation, refer to note 30, Share-based compensation.

Other employee benefit expenses mainly relate to travel expenses, incentives and other personnel related costs.

[7] Employees

The average number of employees is summarized as follows:

Philips Lighting
Employees in FTEs
2015-2016

	2015	2016
Employees	34,374	31,272
Third party workers	5,414	3,995
Total [1]	**39,788**	**35,267**

[1] 3,642 FTEs work in the Netherlands; the remaining FTEs work abroad.

Employees of Philips Lighting are expressed on a full-time equivalent (FTE) basis and correspond to the costs that are reflected in the employee benefit expenses table found in note 6, Employee benefit expenses.

[8] Depreciation, amortization and impairments

Depreciation of property, plant and equipment, amortization of intangible assets and impairments of non-financial assets, are as follows:

Philips Lighting
Depreciation, amortization and impairments in mEUR
2015-2016

	2015	2016
Property, plant and equipment	(169)	(148)
Internal-use software	(12)	(7)
Other intangible assets	(107)	(108)
Development costs	(27)	(28)
Total	**(315)**	**(291)**

Depreciation of property, plant and equipment is primarily included in cost of sales. Amortization of the categories of other intangible assets is reported in selling expenses for brand names and customer relationships and is reported in costs of sales for technology-based and other intangible assets. Amortization of development costs is included in research and development expenses.

[9] Other business income (expenses)

Other business income (expenses) consists of the following:

Philips Lighting
Other business income (expenses) in mEUR
2015-2016

	2015	2016
Result on disposal of businesses:		
• Income	3	3
• Expense	(3)	(3)
Result on disposal of fixed assets:		
• Income	35	17
• Expense	(8)	(5)
Result on other remaining businesses:		
• Income	10	40
• Expense	(11)	(7)
Other business income (expenses)	**26**	**45**
Total other business income	48	60
Total other business expense	(22)	(15)

Result on disposal of businesses is due to the divestment of non-strategic businesses.

Result on disposal of fixed assets mainly relate to the sale of real estate assets. In 2016, EUR 8 million gain is the result of a sale in Thailand.
In 2015, EUR 12 million gain is the result of a sale in Singapore and EUR 14 million gain is the result of a sale of a factory facility in Uruguay.

In 2016, the result on other remaining businesses includes a EUR 14 million gain from the sale of trade accounts receivable and inventories to the other shareholder of GLC in Saudi Arabia resulting in a release of related provisions in Professional and a EUR 13 million gain from the release of provisions with Royal Philips in the US originating from the separation.

[10] Income taxes

The income tax expense amounted to EUR 119 million (2015: EUR 83 million).

The components of income before taxes and income tax expense are as follows:

Philips Lighting
Income tax expense in mEUR
2015-2016

	2015	2016
Netherlands	136	(82)
Foreign	187	384
Income before taxes	**323**	**302**
Netherlands:		
• Current tax benefit (expense)	(39)	–
• Deferred tax benefit (expense)	(6)	19
Total tax expense (Netherlands)	**(45)**	**19**
Foreign:		
• Current tax benefit (expense)	(91)	(91)
• Deferred tax benefit (expense)	53	(47)
Total tax expense (foreign)	**(38)**	**(138)**
Income tax expense	**(83)**	**(119)**

The components of income tax expense are as follows:

Philips Lighting
Current tax expense in mEUR
2015-2016

	2015	2016
Current tax expense	(129)	(89)
Prior year benefit (expense)	(1)	(2)
Current tax expense	**(130)**	**(91)**

Philips Lighting
Deferred income tax expense in mEUR
2015-2016

	2015	2016
Origination and reversal of temporary differences	31	33
Change in tax losses, tax credits and temporary differences recognized	17	(61)
Tax rate changes	–	(2)
Prior year benefit (expense)	(1)	2
Deferred income tax benefit (expense)	**47**	**(28)**

Philips Lighting's operations are subject to income taxes in various foreign jurisdictions. The statutory income tax rates vary from 10% to 40%, which results in a difference between the weighted average statutory income tax rate and the Netherlands' statutory income tax rate of 25% (2015: 25%). A reconciliation of the weighted average statutory income tax rate to the effective income tax rate of continuing operations is as follows:

Philips Lighting
Reconciliation of income tax charge in mEUR unless otherwise stated
2015-2016

	2015	%	2016	%
Income before taxes	**323**		**302**	
Weighted average statutory income tax rate	(67)	(21%)	(86)	(28%)
Non-deductible expenses	(27)	(8%)	(16)	(5%)
Tax incentives and exempt income	89	28%	18	6%
Deferred tax expense related to de-recognition of deferred tax assets - net	(70)	(22%)	(14)	(5%)
Changes in the liability for uncertain tax positions	(1)	0%	(6)	(2%)
Prior year tax expense	(2)	(1%)	(11)	(4%)
Other	(5)	(2%)	(4)	(1%)
Income tax expense recognized in Consolidated statement of income	**(83)**	**(26%)**	**(119)**	**(39%)**

The weighted average statutory income tax rate increased in 2016 compared to 2015 by 7%, as a consequence of a significant change in the mix of profits and losses in the various countries, mainly due to one-off transactions in relation to the separation.

The effective income tax rate is higher than the weighted average statutory income tax rate in 2016 and 2015, mainly due to the net deferred tax expense related to derecognition of deferred tax assets.

Recognized deferred tax assets and liabilities
Deferred tax assets and liabilities relate to the following items:

Philips Lighting
Deferred tax assets and liabilities in mEUR
2015-2016

	Assets	Liabili-ties	Net
2016			
Intangible assets	215	(212)	3
Property, plant and equipment	14	(14)	–
Inventories	53	(1)	52
Prepaid pension cost	–	(1)	(1)
Other receivables and assets	77	(4)	73
Provisions for pensions and other post-retirement	151	–	151
Provisions for termination benefits	4	–	4
Other provisions	41	(1)	40
Other liabilities	31	(39)	(8)
Deferred tax assets on tax attributes 1)	123	–	123
Total Allocations	**709**	**(272)**	**437**
Set-off of deferred tax	(237)	237	–
Net deferred tax assets	**472**	**(35)**	**437**

1) Tax loss carryforwards (including tax credit carryforwards).

	Assets	Liabili-ties	Net
2015			
Intangible assets	25	(237)	(212)
Property, plant and equipment	10	(17)	(7)
Inventories	48	(1)	47
Prepaid pension cost	–	(2)	(2)
Other receivables and assets	17	–	17
Provisions for pensions and other post-retirement	5	–	5
Provisions for termination benefits	39	–	39
Other provisions	69	(1)	68
Other liabilities	30	(6)	24
Deferred tax assets on tax attributes 1)	154	–	154
Total allocations	**397**	**(264)**	**133**
Set-off of deferred tax	(138)	138	–
Net deferred tax assets	**259**	**(126)**	**133**

1) Tax loss carryforwards (including tax credit carryforwards).

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 437 million (2015: EUR 133 million) consists of deferred tax assets of EUR 472 million (2015: EUR 259 million) in countries with a net deferred tax asset position and deferred tax liabilities of EUR 35 million (2015: EUR 126 million) in countries with a net deferred tax liability position. An amount of EUR 335 million of deferred tax assets relates to several tax jurisdictions in which Philips Lighting has suffered a tax loss 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.

Movement in deferred tax balances during 2016 are as follows:

Philips Lighting
Movement in deferred tax balances during the year in mEUR
2016

	Balance as of January 1	Recognized in income	Other	Balance as of December 31
Intangible assets	(212)	9	206	3
Property, plant and equipment	(7)	14	(7)	–
Inventories	47	–	5	52
Prepaid pension assets	(2)	1	–	(1)
Other receivables	17	1	55	73
Provisions:				
• Pensions and other post-retirement	5	(15)	161	151
• Termination benefits	39	1	(36)	4
• Other provisions	68	24	(52)	40
Other liabilities	24	1	(33)	(8)
Tax loss carryforwards [1]	154	(64)	33	123
Net deferred tax assets	**133**	**(28)**	**332**	**437**

1) Tax loss carryforwards (including tax credit carryforwards).

Other primarily include the increase to (net) deferred tax assets resulted from the separation from Royal Philips including the recognition of a deferred tax asset of EUR 202 million relating to intangible assets and EUR 106 million in connection with the transfer of pension liabilities (refer to note 22 Post-employment benefit).

At December 31, 2016, there were no recognized deferred tax liabilities for taxes that would be payable on the unremitted earnings of certain Philips Lighting foreign subsidiaries because there is no intention to distribute these earnings in the foreseeable future. The temporary differences associated with the investments in these subsidiaries, for which a deferred tax liability has not been recognized, aggregate to EUR 314 million.

At December 31, 2016, net operating loss carry-forwards expire as follows:

Philips Lighting
Expiry year operating loss carry-forwards in mEUR
2016

	2016
Total	833
2017	8
2018	–
2019	51
2020	117
2021	29
After 2021 but not unlimited	41
Unlimited	587

At December 31, 2016, the amount of operating loss and tax credit carry-forwards for which no deferred tax assets have been recognized in the balance sheet is EUR 417 million (2015: EUR 510 million).

Out of EUR 417 million, an amount of EUR 337 million should not be limited in time, EUR 77 million will expire by 2021 and the remaining EUR 3 million expires after 2021, but carry-forward is limited in time.

At December 31, 2016, the amount of deductible temporary differences for which no deferred tax asset has been recognized in the balance sheet is EUR 148 million (2015: EUR 91 million).

Classification of the income tax payable and receivable is as follows:

Philips Lighting
Income tax receivables and payables in mEUR
2015-2016

	2015	2016
Income tax receivable under current assets	25	50
Income tax receivable under non-current receivables	–	9
Income tax payable	(6)	(57)

Tax risks
Philips Lighting is exposed to tax uncertainties. These uncertainties include, among others, the following:

Transfer pricing uncertainties
Philips Lighting has issued transfer pricing directives, which are in accordance with international guidelines, such as those of the Organization of Economic Co-operation and Development (OECD). 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 Lighting entities. This could lead to discussions with local tax authorities if they do not accept these charges. For that purpose, service contracts such as intra-group service agreements and licensing agreements are signed with Philips Lighting group entities. Tax authorities review these intra-group service and licensing agreements and may reject the implemented intra-group charges.

Tax uncertainties due to permanent establishments

Philips Lighting may encounter tax uncertainties, due to permanent establishments in countries where new operations are started or business models are altered. This is because when operations in a country involve Philips Lighting organization in another country, there is a risk that tax claims will arise in the former country as well as in the latter country

When Philips Lighting has cross-border operations, there is a risk that tax claims will arise in all relevant countries.

With regard to these uncertainties, a liability is recognized if, as a result of a past event, Philips Lighting has an obligation that can be estimated reliably and it is probable that an outflow of economic benefits will be required to settle the obligation. Related to these uncertainties a liability is recognized of EUR 42 million as disclosed in note 23, Other non-current liabilities. In addition, related to similar uncertainties, an indemnification liability to Royal Philips of EUR 80 million and an indemnification receivable of EUR 10 million is recorded. The total net liability decreased in 2016 by EUR 19 million mainly due to settlements and expirations.

[11] Financial income and expenses

Financial income and expenses include:

Philips Lighting
Financial income and expenses in mEUR
2015-2016

	2015	2016
Interest income	2	6
Net change in fair value of financial assets at fair value through profit or loss	-	2
Other financial income	1	3
Financial income	**3**	**11**
Interest expense	(5)	(49)
Provision-related accretion and interest	(2)	(5)
Net foreign exchange losses	1	(15)
Impairment loss of financial assets	(4)	(3)
Other financial expenses	(1)	(6)
Financial expense	**(11)**	**(78)**
Financial income and expenses	**(8)**	**(67)**

During the year, interest on external debt amounted to EUR 15 million (please refer to note 25, Short-term and long-term debt, for further details). In addition, interest on loans received from Royal Philips amounted to EUR 15 million and interest on pensions amounted to EUR 19 million (please refer to note 22, Post-employment benefits, for further details).

[12] Earnings per share

Philips Lighting
Earnings per share in mEUR unless otherwise stated
2015-2016

	2015	2016
Net income attributable to shareholders of Philips Lighting N.V.	226	189
Weighted average number of ordinary shares outstanding used for calculation (in thousands):		
• Basic		150,000
• Diluted		150,000
Net income attributable to shareholders per ordinary share in EUR [1]		
• Basic		1.26
• Diluted		1.26

[1] Since Philips Lighting N.V. did not have any issued share capital in the previous reporting period, no earnings per share is calculated

[13] Assets and liabilities classified as held for sale

Philips Lighting
Assets and liabilities classified as held for sale
in mEUR
2015-2016

	2015	2016
Assets classified as held for sale	34	3
Liabilities directly associated with assets held for sale	(6)	(1)

Assets classified as held for sale mainly relate to entities which are anticipated to be sold and their balances largely comprise of property, plant and equipment and production inventories.
The liabilities directly associated with assets held for sale consist mainly of trade creditors.

[14] Property, plant and equipment

The movements in property, plant and equipment are as follows:

Philips Lighting
Property, plant and equipment movement schedule in mEUR
2015-2016

	Land and buildings	Machinery and installations	Other equipment	Prepayments and construction in progress	Total
Balance as of January 1, 2015					
Cost	717	1,651	416	56	2,840
Accumulated depreciation	(399)	(1,384)	(335)	–	(2,118)
Book value	**318**	**267**	**81**	**56**	**722**
Change in book value:					
Capital expenditure	4	7	9	78	98
Asset available for use	9	52	20	(81)	–
Acquisition	–	3	2	–	5
Sales and disposals	(11)	(7)	(2)	–	(20)
Transfer to assets classified as held for sale	(10)	(9)	(1)	(1)	(21)
Depreciation	(35)	(77)	(44)	–	(156)
Impairments	(6)	(7)	–	–	(13)
Translation differences and other movements	9	9	10	(9)	19
Total changes	**(40)**	**(29)**	**(6)**	**(13)**	**(88)**
Balance as of December 31, 2015					
Cost	643	1,543	391	43	2,620
Accumulated depreciation	(365)	(1,305)	(316)	–	(1,986)
Book value	**278**	**238**	**75**	**43**	**634**
Change in book value:					
Capital expenditure	3	4	20	62	89
Asset available for use	11	38	21	(70)	–
Acquisition	–	–	–	–	–
Sales and disposals	(3)	(1)	(4)	–	(8)
Divestments and transfers to assets classified as held for sale	(8)	(3)	–	(1)	(12)
Depreciation	(26)	(64)	(35)	–	(125)
Impairments	–	(21)	(1)	–	(22)
Translation differences and other movements	6	2	(2)	4	10
Total changes	**(17)**	**(45)**	**(1)**	**(5)**	**(68)**
Balance as of December 31, 2016					
Cost	596	1,492	396	38	2,522
Accumulated depreciation	(335)	(1,299)	(322)	–	(1,956)
Book value	**261**	**193**	**74**	**38**	**566**

Land with a book value of EUR 18 million is not depreciated (2015: EUR 23 million). Divestments and transfer to assets classified as held for sale mainly relates to divested business of Lamps. The impairment losses were mainly driven by manufacturing footprint rationalization.

Property, plant and equipment includes financial lease assets with a book value of EUR 20 million at December 31, 2016 (2015: EUR 13 million).

The expected useful lives of property, plant and equipment are as follows:

Philips Lighting
Useful lives property, plant and equipment in years
2015-2016

Building	from 5 to 50
Machinery and installations	from 3 to 20
Other equipment	from 1 to 10

[15] Goodwill

The movements in goodwill are as follows:

Philips Lighting
Goodwill movement schedule in mEUR
2015-2016

	2015	2016
Balance as of January 1		
Cost	2,356	2,566
Amortization and impairments	(680)	(722)
Book value	**1,676**	**1,844**
Change in book value:		
Divestments, transfers to assets classified as held for sale and other changes	(1)	(12)
Purchase price allocation adjustment	8	
Impairment	-	-
Translation differences	161	67
Total changes	**168**	**55**
Balance as of December 31		
Cost	**2,566**	**2,638**
Amortization and impairments	**(722)**	**(739)**
Book value	**1,844**	**1,899**

The increase of EUR 67 million in translation differences was mainly due to the change in the USD/EUR rate which impacted the goodwill denominated in USD.

For impairment testing, goodwill is allocated to cash-generating units, which represent the lowest level at which the goodwill is monitored internally for management purposes. From 2015 onwards the cash-generating units correspond to the operating segments.

Goodwill allocated to the cash-generating unit Professional is considered to be significant in comparison to the total book value of goodwill of Philips Lighting at December 31, 2015 and December 31, 2016. The amounts associated as of December 31, 2015 and December 31, 2016, are presented below.

Philips Lighting
Goodwill allocated to the cash-generating unit
in mEUR
2015-2016

	2015	2016
Professional	1,626	1,671
Other	218	228
Book value	**1,844**	**1,899**

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 fourth quarter of 2016 the estimated recoverable amount of the cash-generating unit tested approximated or exceeded the carrying value of the unit. Therefore, no impairment loss was recognized.

Key assumptions used in the impairment tests for the units were sales growth rates, EBITA 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 2017 to 2019 that matches the period used for our strategic process. 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 EBITA used to estimate cash flows are based on past performance, external market growth assumptions and industry long-term growth averages. EBITA in all mentioned units is expected to increase over the projection period as a result of volume growth and cost efficiencies.

Cash flow projections of Professional for 2016 and 2015 were based on the key assumptions included in the table below:

Philips Lighting
Key assumptions in %
2015-2016

	Compound sales growth rate 1)			
	Initial forecast period	Extra-polation period 2)	Used to calculate terminal value 3)	Pre-tax discount rates
Professional				
2016	5.0	4.3	2.7	13.9
Professional				
2015	5.0	5.1	2.7	15.1

1) Compound sales growth rate is the annualized steady growth rate over the forecast period
2) Also referred to later in the text as compound long-term sales growth rate
3) The historical long-term growth rate is only applied to the first year after the 5 year extrapolation period, after which no further growth is assumed for the terminal value calculation

Based on the test performed in the fourth quarter, the headroom of Professional was estimated at EUR 50 million. The following changes could, individually, cause the value in use to fall to the level of the carrying value:

Philips Lighting
Sensitivity analysis
2016

	Increase in pre-tax discount rate, basis points	Decrease in compound long-term sales growth rate, basis points	Decrease in terminal value amount, %
Professional			
2016	20	60	2.6

[16] Intangible assets excluding goodwill

The movements in the intangible assets other than goodwill are as follows:

Philips Lighting
Intangible assets movements schedule in mEUR
2015-2016

	Product development	Technology based	Customer relationships	Brand names	Software	Other	Total
Balance as of January 1, 2015							
Cost	201	321	1,172	333	69	24	2,120
Amortization/ impairments	(158)	(200)	(598)	(197)	(37)	(24)	(1,214)
Book value	**43**	**121**	**574**	**136**	**32**	**–**	**906**
Change in book value:							
Additions	22	13	–	–	–	2	37
Amortization	(23)	(17)	(76)	(13)	(13)	–	(142)
Acquisitions	–	–	(13)	3	–	–	(10)
Impairment	(4)	–	–	–	–	–	(4)
Translation differences and other movements	3	6	49	11	(1)	1	69
Total changes	**(2)**	**2**	**(40)**	**1**	**(14)**	**3**	**(50)**
Balance as of December 31, 2015							
Cost	180	358	1,245	357	24	28	2,192
Amortization/ impairments	(139)	(235)	(711)	(220)	(6)	(25)	(1,336)
Book value	**41**	**123**	**534**	**137**	**18**	**3**	**856**
Change in book value:							
Additions	17	–	–	–	8	5	30
Amortization	(21)	(18)	(76)	(14)	(5)	–	(134)
Acquisitions	–	–	–	–	–	2	2
Impairment	(7)	–	–	–	(2)	–	(9)
Translation differences and other movements	2	3	15	4	–	(1)	23
Total changes	**(9)**	**(15)**	**(61)**	**(10)**	**1**	**6**	**(88)**
Balance as of December 31, 2016							
Cost	179	367	1,280	362	35	15	2,238
Amortization/ impairments	(147)	(259)	(807)	(235)	(16)	(6)	(1,470)
Book value	**32**	**108**	**473**	**127**	**19**	**9**	**768**

Intangible assets other than goodwill mainly relate to balances identified and recorded as part of acquisitions in earlier years in Professional, consisting of brand names, technology and customer relationships.

The additions for 2016 contain internally generated assets of EUR 17 million for product development, and EUR 7 million for software.

The capitalized product development costs and software, for which amortization has not yet commenced, amounted to EUR 13 million as of December 31, 2016 (2015: 17 million).

The amortization of intangible assets is specified in note 8, Depreciation, amortization and impairments.

The estimated amortization expense for other intangible assets for each of the next five years is:

Philips Lighting
Estimated amortization expense for other intangible assets in mEUR

2017	126
2018	108
2019	106
2020	97
2021	95

The expected useful lives of intangible assets other than goodwill are as follows:

Philips Lighting
Expected useful lives of intangible assets excluding goodwill in years

Product development	2-5
Software	1-10
Technology	3-20
Customer relations	2-25
Brand names	2-20
Other	1-8

At December 31, 2016 the carrying amount of the customer relationships originating from the Genlyte acquisition was EUR 261 million (USD 275 million) with a remaining amortization period of 5.9 years (2015: EUR 296 million, USD 324 million; 6.9 years).

[17] Receivables

Philips Lighting
Account receivables-net in mEUR
2015-2016

	2015	2016
Trade receivables (net)	1,519	1,489
Accounts receivable - net	**1,519**	**1,489**

The aging of trade receivables, representing current and overdue but not impaired receivables, is as follows:

Philips Lighting
Aging analysis in mEUR
2015-2016

	2015	2016
Current	1,341	1,312
Overdue 1-30 days	49	45
Overdue 31-180 days	80	94
Overdue > 180 days	49	38
Accounts receivable - net	**1,519**	**1,489**

The changes in the allowance for doubtful accounts receivable are as follows:

Philips Lighting
Allowance for doubtful accounts movement in mEUR
As of December 31
2015-2016

	2015	2016
Balance as of January 1	**(73)**	**(110)**
Additions charged to expense	(33)	(31)
Reclassification	-	27
Utilizations	(4)	4
Releases	-	21
Balance as of December 31	**(110)**	**(89)**

The allowance for doubtful accounts has been primarily established for receivables that are past due. The maximum exposure to credit risk at the reporting date is the carrying value of each class of receivables mentioned above.
The reclassification relates to balances that were fully provided for, which were transferred to indemnification positions with Royal Philips.

Included in the above balances as per December 31, 2016 are allowances for individually impaired receivables of EUR 85 million (2015: EUR 103 million).

Bad debt expenses are recorded as part of selling expenses. For more information on credit risk management please refer to note 32, Details of treasury/other financial risks.

[18] Inventories

Inventories are summarized as follows:

Philips Lighting
Inventories in mEUR
2015-2016

	2015	2016
Raw materials	294	276
Work in progress	27	26
Finished goods	667	584
Total	**988**	**886**

For the year ended December 31, 2016 a reversal of impairment of inventories to realizable value amounted to EUR 5 million was recorded.
The write-down of inventories to realizable value amounted to EUR 10 million for the year ended December 31, 2016 (2015: EUR 36 million).
The write-down and reversal are included in cost of sales.

[19] Other current assets

Philips Lighting
Other current assets in mEUR
2015-2016

	2015	2016
Prepayments and accrued income excluding prepaid pension assets	46	52
Other current assets	**46**	**52**

[20] Cash and cash equivalents

Philips Lighting
Cash and cash equivalents in mEUR
2015-2016

	2015	2016
Cash at banks and in hand	71	434
Short-term deposits	4	578
Other cash equivalents	8	28
Cash and cash equivalents	**83**	**1,040**

Philips Lighting pools cash from subsidiaries to the extent that is legally and economically feasible; cash not pooled remains available for local operational or investment needs.

[21] Provisions

Philips Lighting
Provisions in mEUR
2015-2016

	2015		2016	
	Long-term	Short-term	Long-term	Short-term
Provision for defined benefits	43	–	602	–
Restructuring related provisions	53	125	16	116
Environmental provisions	120	43	101	52
Product warranty	19	41	19	38
Other provisions	115	54	143	38
Total	**350**	**263**	**881**	**244**

Provisions can be analyzed as follows:

Restructuring-related provisions

Philips Lighting
Restructuring-related provisions in mEUR
2015-2016

	2015	2016
Balance as of January 1	**235**	**178**
Additions	88	95
Utilizations	(120)	(118)
Releases	(25)	(27)
Translation differences and other movements	–	4
Balance as of December 31	**178**	**132**

In 2016 the most significant restructuring projects were related to the manufacturing footprint rationalization in Lamps and simplification of the business structure in Professional.
The restructuring projects mainly took place in France and Belgium. The release of the provision mainly originates from lower as expected severance payments from manufacturing footprint rationalization projects. Philips Lighting expects the provision will be utilized mostly within the next year.

Environmental provisions

The movement in environmental provisions during the years presented is as follows:

Philips Lighting
Environmental provisions in mEUR
2015-2016

	2015	2016
Balance as of January 1	**170**	**163**
Additions	10	4
Utilizations	(14)	(15)
Reclassifications	(1)	–
Releases	(13)	(5)
Change in discount rate	(3)	(2)
Accretion	6	2
Translation differences and other movements	8	6
Balance as of December 31	**163**	**153**

The environmental provisions include accrued costs recorded with respect to environmental remediation in various countries.

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 judgements and discount rates. Also refer to note 28, Contingent liabilities.

The environmental provision is expected to be utilized mainly within the next five years.

Product warranty

Philips Lighting
Provisions for product warranty in mEUR
2015-2016

	2015	2016
Balance as of January 1	**66**	**60**
Additions	37	35
Utilizations	(45)	(36)
Reclassifications	–	–
Translation differences and other movements	2	(2)
Balance as of December 31	**60**	**57**

The provision for product warranty reflects the estimated costs of replacement and free-of-charge services that will be incurred by Philips Lighting with respect to products sold. Philips Lighting expects the provision will be utilized mainly within the next year.

Other provisions

Philips Lighting
Other provisions in mEUR
2015-2016

	2015	2016
Balance as of January 1	**190**	**169**
Additions	40	68
Utilizations	(61)	(43)
Reclassifications	4	6
Releases	(7)	(18)
Accretion	-	1
Translation differences and other movements	3	(2)
Balance as of December 31	**169**	**181**

Other provisions mainly comprise of provisions for legal claims, self-insurance, decommissioning, onerous contract provisions and provision for employee jubilee funds. Provisions for legal claims mainly relate to the labor related litigation referred to in note 28, Contingent liabilities.

The provision for employee jubilee funds is expected to be utilized mainly after five years. The provisions for self-insurance, decommissioning, onerous contract, are expected to be used mainly within the next three years. Less than half of the provision for legal claims is expected to be used within the next year.

[22] Post-employment benefits

Employee post-employment plans have been established in many countries in accordance with the legal requirements, customs and 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 typically cover part of the healthcare insurance costs after retirement.

On February 1, 2016 Philips Lighting assumed economic ownership of the pension obligations spun off from Royal Philips to Philips Lighting. The corresponding additional net pension liabilities amounted to EUR 607 million.

The largest defined benefit pension plans are in the US and Germany.

At the start of 2016 these plans accounted for close to 90% of the net liability.

United States

The US-defined benefit plan covers certain hourly workers and salaried workers hired before January 1, 2005. The plan is closed for new entrants and also for further benefit accruals. The company pays the administration cost and contributions to cover the funding deficit.
The assets of the US plan are in a Trust which is governed by Trustees. Plan assets and liabilities were spun off from the Royal Philips plan effectively as at August 1, 2016. The actual values were lower than expected at the beginning of the financial year due to the fact that less active participants moved from Royal Philips to Philips Lighting. The impact on the plan assets and liabilities was a reduction of respectively EUR 26 million and EUR 25 million which have been accounted for as respectively a financial assumptions loss and an experience gain through the Other comprehensive income.

The earlier announced 2016 de-risking contribution to the US pension plan of EUR 45 million which was paid to the plan in March 2016, has been adjusted downwards by EUR 3 million due to the correction in the allocation of plan assets and liabilities. In September 2016, the company made a further contribution of EUR 4 million to the US pension plan to improve the funding level.

Germany

Employees with a salary above a certain threshold participate in the open defined benefit pension plan. Effective February 1, 2016 this plan was continued as an internally funded plan which triggered a EUR 4 million past service cost gain. Employees in Germany can join the Philips Pensionskasse, which is a multi-employer defined contribution plan. As part of the separation from Royal Philips a liability of EUR 245 million of the unfunded retiree related provisions was transferred to Philips Lighting.

The Netherlands

For the pension plan in the Netherlands the company has no other financial obligation than to contribute an agreed fixed percentage of the pensionable salary for the annual accrual for active members. Defined contribution accounting applies for these plans and the contribution paid in 2016 by the company was EUR 55 million.

Risks related to defined-benefit plans

The defined benefit plans expose the company to various demographic and economic risks, such as longevity, investment, currency and interest rate risks 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.

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. These boards and trustees are responsible for and have full discretion over the investment strategy of the plan assets, in general they 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.

Balance sheet positions

The company now presents all net defined benefit post-employment obligations on one line under non-current provisions, instead of split between provisions and other liabilities. In the IPO prospectus (Q1 2016) this was still presented as accrued pension cost, provision for defined benefits and provision for other post-employment benefits.

The measurement date for all defined-benefit plans is December 31.

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.

Philips Lighting
Summary of pre-tax costs for post-employment benefits in mEUR
2015-2016

	2015	2016
Defined benefit plans		
• Included in operating cost	38	7
• Included in financial expense	1	19
Defined contribution plans including multi-employer plans		
• Included in operating cost	74	83

Defined benefit plans:

Movements in the defined benefit obligation, plan assets and net liability for defined benefit plans:

Philips Lighting
Development of the net liability in mEUR
2015-2016

	Obligation	Plan assets	Net liability
Opening balance as of January 1, 2015	**40**	**-**	**40**
Miscellaneous	3		3
Balance as of December 31, 2015	**43**		**43**
Transfer from Royal Philips	1,153	(546)	607
Service cost	10		10
Interest cost / income	47	(28)	19
Admin expenses paid		1	1
Employee contributions	1	(1)	-
Employer contributions		(55)	(55)
Actuarial gains / (losses)			
• demographic assumptions	(12)		(12)
• financial assumptions	47	(1)	46
• experience adjustment	(28)		(28)
(Negative) past service cost	(4)		(4)
Settlements	(2)	2	-
Reclassification	(3)		(3)
Benefits paid	(98)	62	(36)
Exchange rate differences	49	(37)	12
Miscellaneous	40	(38)	2
Balance as of December 31, 2016	**1,243**	**(641)**	**602**

The pension plan in Brazil had a surplus of EUR 19 million at the beginning of the year which was transferred as part of transfer from Royal Philips and reduced to EUR 18 million as of December 31, 2016. The surplus will not bring future economic benefits to the company (asset ceiling restrictions), as the regulatory framework in Brazil prohibits refunds to the employer, the net balance is therefore shown exclusive of this unrecognized asset. The interest income, the exchange rate difference and the remeasurements on the unrecognized assets were EUR 3 million, EUR 4 million and EUR (8) million, respectively.

On February 1, 2016 Philips Lighting assumed additional net pension liabilities of EUR 607 million as part of the separation. The table above provides the net movements of the pensions including the corresponding extra amounts of the assumed legal and economical net pension obligations for the periods prior to separation date. The amounts represent the net defined benefit liability determined under IAS 19.

Due to changes in the Belgian pension situation, the risk has increased that insured returns on pension contributions will not be sufficient to cover minimum guaranteed returns. Actuarial calculations are showing that the defined benefit obligation exceed the plan assets by EUR 2 million as of January 1, 2016. This is reflected in the line item miscellaneous and has been recognized in Other comprehensive income.

Plan assets allocation

The asset allocation in the company's pension plans at December 31, 2016 was as follows:

Philips Lighting
Plan assets allocation in mEUR
2016

	2016
Debt securities	393
Equity securities	162
Other	104
Total assets	**659**

The assets shown in the table above are inclusive of the EUR 18 million of the unrecognized assets because of the asset ceiling restriction.
The assets in 2016 contain 56% unquoted assets. Plan assets in 2016 do not include property occupied by or financial instruments issued by the company.

Some 70% of the total plan assets of the Philips Lighting pension plan are in the US and 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. A further 18% of the total plan assets are of the Brazilian pension plan and are for 96% invested in Brazilian government bonds. The remaining 12% of the total plan assets is mainly the market value of insured pension benefits.

Assumptions

The mortality tables used for the company's major schemes are:

- US: Base table RP-2014, projected with mortality improvements from the base year of the table, 2014, with MP-2016.
- Germany: Richttafeln 2005G K. Heubeck.

A new mortality table has been adopted for the US to reflect the results of a study by the Society of Actuaries on longevity improvements which was released on October 20, 2016. The new table shows a lower degree of longevity improvement than reflected in the mortality table which was used in the previous year.

The weighted averages of the assumptions used to calculate the defined benefit obligation as of December 31 were as follows:

Philips Lighting
Assumptions used for defined benefit obligation in %
2016

	2016
Discount rate	3.9
Inflation (wage and healthcare cost trend rates)	2.7
Rate of compensation increase	1

The average duration of the defined benefit obligation of the pension plans is 10 years.

Sensitivity analysis

The table below illustrates the approximate impact on the defined benefit obligation if the company were to change key assumptions.
The defined benefit obligation was recalculated using a change in the assumptions of 1% which overall is considered a reasonably possible change. The impact on the defined benefit obligation because of changes in discount rate is normally accompanied by offsetting movements in plan assets, especially when using matching strategies.

Philips Lighting
Defined benefit obligation of post-employment benefit provision in mEUR
2016

	2016
Increase	
Discount rate (1% movement)	(121)
Wage change (1% movement)	4
Inflation change (1% movement)	26
Longevity (see explanation)	40
Medical benefit level (1% price increase)	9
Decrease	
Discount rate (1% movement)	142
Wage change (1% movement)	(3)
Inflation change (1% movement)	(24)

Longevity also impacts post-employment defined benefit obligation. The above sensitivity table illustrates the impact on the defined benefit obligation of a further 10% decrease in the assumed rates of mortality for the company's major schemes. A 10% decrease in assumed mortality rates equals improvement of life expectancy by six months to a year.

Cash flows in 2017

The company expects in 2017 cash outflows in relation to post-employment benefits which are estimated to amount EUR 129 million consisting of:

- EUR 10 million employer contributions to defined benefit plans;
- EUR 34 million employer expected cash outflows in relation to unfunded defined benefit plans;
- EUR 85 million employer contributions to defined contribution plans.

For the funding of the deficit of the US plan the company adheres to the minimum funding requirements of the US Pension Protection Act.

The service and administration cost for 2017 is expected to amount to EUR 12 million.
The interest expense for 2017 is expected to amount to EUR 18 million. The cost for defined contribution pension plans in 2017 is expected to amount to EUR 56 million in the Netherlands and EUR 29 million in other countries.

[23] Other non-current liabilities

Other non-current liabilities are summarized as follows:

Philips Lighting
Other non-current liabilities in mEUR
2015-2016

	2015	2016
Deferred income	22	23
Other tax liabilities	131	42
Other liabilities	6	85
Other non-current liabilities	**159**	**150**

The increase of other liabilities is mainly related to indemnification balances, for additional information, please refer to note 29, Related Party transactions. For further details on tax related liabilities refer to note 10, Income taxes.

[24] Other current and accrued liabilities

Other current and accrued liabilities are summarized as follows:

Philips Lighting
Other payables and accrued liabilities in mEUR
2015-2016

	2015	2016
Other current liabilities		
Accrued customer rebates that cannot be offset with accounts receivables for those customers	189	201
Advances received from customers on orders not covered by work in process	31	34
Other taxes including social security premiums	50	74
Other liabilities	42	37
Total	**312**	**346**
Accrued liabilities		
Personnel related costs:		
• Salaries and wages	130	153
• Accrued holiday entitlements	46	48
• Other personnel related costs	21	23
Fixed asset related costs:		
• Gas, water, electricity, rent and other	17	17
Communication and IT costs	13	24
Distribution costs	45	53
Sales related costs:		
• Commissions payable	11	13
• Advertising and marketing related costs	19	23
• Other sales related costs	13	9
Material related costs	23	28
Deferred Income	47	55
Other accrued liabilities	74	56
Total	**459**	**502**

The increase in accrued Communication and IT costs is mainly due to the increase of third party contracts as consequence of the decrease of Transational Service Level Agreements with Royal Philips.

[25] Short-term and long-term debt

Short-term and long-term debt relates to financing by local banks and financial institutions.

Philips Lighting
Short-term and long-term debt in mEUR
2015-2016

	2015	2016
Facility (EUR)	-	735
Facility (USD)	-	473
Finance lease	-	17
Other debt	88	156
Total	**88**	**1,381**
Of which:		
Short-term debt	86	157
Long-term debt	2	1,224
Total	**88**	**1,381**

In May 2016, Philips Lighting entered into a five-year term loan facility agreement. The amounts of the term facility are EUR 740 million and USD 500 million and have been used to replace intra-group financing from Royal Philips. The term facility is repayable in five years; however, the company can repay the term facility at the end of any interest period without penalty.

The Term Loan Facility bears interest at a variable rate based on the relevant applicable EURIBOR and LIBOR respectively with zero floor plus a margin. The margin was 0.75% as of December 31, 2016 and is subject to adjustment based on the level of the Net Leverage Ratio. The Net Leverage Ratio is the ratio of consolidated total net debt as of the test date to consolidated adjusted EBITDA for the preceding 12 months.

In addition, Philips Lighting entered into a five-year committed Revolving Credit Facility of EUR 500 million in May 2016. As of December 31, 2016 Philips Lighting did not have any amounts outstanding under this facility.

Debt issuance costs of EUR 8 million were paid upon signing the facility. These costs are being amortized over the term of the facility as part of financial expenses.

The Term and Revolving Credit Facilities Agreement contains customary undertakings. The undertakings include, among others, a negative pledge that provides that (subject to certain exceptions) no member of Philips Lighting may grant security over its assets without the consent of the lenders, and a restriction on subsidiaries of the company (other than the obligors) incurring additional financial indebtedness. There are also restrictions (subject to certain exceptions and thresholds) on engaging in acquisitions, disposals and reorganizations. The Term and Revolving Credit Facilities Agreement also includes a financial covenant providing that Philips Lighting must maintain a Net Leverage Ratio not greater than 3.00:1.00.

As of December 31, 2016 this ratio was 0.50 which is compliant with the conditions of the covenant.

The facilities are guaranteed by the company and certain subsidiaries of the company incorporated in Belgium, France, Germany, Hungary, Netherlands, People's Republic of China, Poland, Spain, United Kingdom and United States.

Other debt includes various local (bank) loans. The main other debt position are a loans of Philips Lighting in Saudi Arabia amounting to EUR 80 million (December 31, 2015: EUR 77 million) with nominal average interest rate of 3.84% and which are denominated in SAR.

Philips Lighting
Movement schedule of short and long term debt
in mEUR
2016

	Long term debt	Short term debt	Total
Balance as of January 1	**2**	**86**	**88**
New borrowings	1,181	62	1,243
Repayments	(6)	-	(6)
Translation differences and other movements	47	9	56
Balance as of December 31	**1,224**	**157**	**1,381**

[26] Equity

In 2016, Royal Philips completed the Separation of the Philips Lighting business into a separate company. As part of the Separation it made capital contributions to Philips Lighting of EUR 692 million.

In addition, certain assets and liabilities were settled based on their fair values to meet corporate income tax requirements in various countries. Assets and liabilities continue to be recorded at their book values. The excess between the fair value and the recorded carrying value of the net assets transferred, net of tax, is reflected as an equity transaction with Royal Philips of EUR 555 million, a transaction under common control.

Prior to the formation of Philips Lighting, funding by Royal Philips was reflected through the movement in owner's net investment, which includes the finalization of subsidiary share and asset transfers and settlement of inter-group positions with Royal Philips. This resulted in a total distribution to Royal Philips of EUR 1,229 million in the second quarter. In addition, EUR 36 million was contributed in the second half of the year mostly related to post separation tax adjustments.

Upon the completion of the Separation, Royal Philips had transferred the ownership of the respective Lighting businesses to Philips Lighting. As part of the formation of Philips Lighting the Company issued ordinary shares to Royal Philips, resulting in share capital of EUR 1.5 million and share premium of EUR 2,369 million. This included EUR 43 million of net income prior to its formation.

On May 31, 2016 Royal Philips completed an offering of 37,500,000 ordinary shares in the share capital of the Company on the Euronext Stock Exchange in Amsterdam.

The Company has an authorized share capital of EUR 6 million, divided into 300,000,000 ordinary shares with a nominal value of EUR 0.01 per share and 300,000,000 preference shares with a nominal value of EUR 0.01 per share.

As of December 31, 2016, 71.23 % of the issued share capital is held by Royal Philips and 28.78% is publically traded at the Euronext Stock Exchange in Amsterdam. On February 8, 2017, Royal Philips sold 26 million Philips Lighting shares, reducing its stake in the issued and outstanding share capital to 55.18%. As a result, the free float increased to 44.82%.

Ordinary shares
As of December 31, 2016, the issued and fully paid share capital consists of 150,000,000 ordinary shares with a nominal value of EUR 0.01 per share.

On February 8, 2017, Philips Lighting repurchased 3.5 million of its shares from Royal Philips. Philips Lighting intends to cancel these shares.

Preference shares
Stichting Continuïteit Philips Lighting, a foundation organized under the laws of the Netherlands, has been granted the right to acquire preference shares in the Company. As a means to protect the Company and its stakeholders against an unsolicited attempt to acquire (de facto) control of the Company, the Company's articles of association allow the Board of Management and the Supervisory Board to issue (rights to acquire) preference shares to a third-party. As of December 31, 2016, this right has not been exercised therefore no preference shares have been issued.

Dividend distribution
A proposal will be submitted to the 2017 Annual General Meeting of Shareholders to pay a dividend of EUR 1.10 per ordinary share, in cash, from the 2016 net income and free distributable reserves of the Company.

Limitations in the distribution of shareholders' equity
As at December 31, 2016, pursuant to Dutch law, certain limitations exist relating to the distribution of shareholders' equity of EUR 392 million. Such limitations relate to ordinary shares of EUR 1.5 million, as well as to legal reserves required by Dutch law included within share premium of EUR 196 million, unrealized currency translation gains of EUR 190 million and unrealized gains related to cash flow hedges of EUR 4 million.

The legal reserve required by Dutch law of EUR 196 million 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.

Non-controlling interests
For information on Non-controlling interests, refer to note 4, Interest in Entities.

Objectives, policies and processes for managing capital
The company manages capital based upon the following measures; net operating capital (NOC), net debt and cash flows before financing activities. These measures are used by the company to evaluate the capital efficiency of it businesses, 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. Cash flows before financing activities consist of cash flows from operating activities and cash flows from investing activities.

Philips Lighting
Net operating capital composition in mEUR
2015-2016

	2015	2016
Intangible assets	2,700	2,667
Property, plant and equipment	634	566
Remaining assets	2,702	2,670
Provisions	(613)	(1,125)
Other liabilities	(1,994)	(2,105)
Net operating capital	**3,429**	**2,673**

Philips Lighting
Composition of net debt to total equity in mEUR unless otherwise stated
2015-2016

	2015	2016
Long-term debt	2	1,224
Short-term debt	86	155
Short-term loans payable to Royal Philips	–	2
Total debt	**88**	**1,381**
Cash and cash equivalents	83	1,040
Net debt (cash) [1]	**5**	**341**
Shareholders' equity	3,513	2,704
Non-controlling interests	103	104
Total equity	**3,616**	**2,808**
Net debt and total equity	3,621	3,149
Net debt divided by net debt and total equity (in %)	0%	11%
Total equity divided by net debt and total equity (in %)	100%	89%

[1] Total debt less cash and cash equivalents.

Philips Lighting
Composition of cash flows in mEUR
2015-2016

	2015	2016
Cash flows from operating activities	717	505
Cash flows from investing activities	(65)	(62)
Cash flows before financing activities	**652**	**443**

In 2016, total net debt increased by EUR 336 million. Repayments amounted to EUR 6 million. Other changes resulting from consolidation and currency effects led to an increase of EUR 117 million.

[27] Contractual obligations

The following table presents the contractual cash obligations of Philips Lighting as of December 31, 2016.

Off-balance sheet commitments relate to purchase obligations and operating lease obligations.

Philips Lighting
Contractual cash obligations in mEUR
2016

		Payments due by period 1)			
	Total	2017	2018-2019	2020-2021	After 2021
Long-term debt 2)	1,257	46	1	1,209	1
Finance lease liabilities 3)	18	5	8	5	-
Short-term debt	107	107	-	-	-
Operating lease obligations	358	83	117	83	75
Derivative liabilities	20	20	-	-	-
Interest on debt	65	20	27	18	-
Purchase obligations 4)	39	21	10	6	2
Trade payables	1,024	1,024	-	-	-
Contractual cash obligations	**2,888**	**1,326**	**163**	**1,321**	**78**

1) Obligations in this table are undiscounted.
2) Long-term debt includes short-term portion of debt.
3) Including sale finance lease back payments of EUR 15m
4) Philips Lighting 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 Lighting
Operating lease - minimum payments under sale-and-leaseback arrangements in mEUR
2016

2017	5
2018	5
2019	5
2020	5
2021	4
Thereafter	2

Philips Lighting
Finance lease liabilities in mEUR
2016

	Future minimum lease payments	Interest	Present value of minimum lease payments
2017	5	1	4
2018-2021	13	-	13
After 2021	-	-	-
Finance lease total	**18**	**1**	**17**

Certain Philips Lighting suppliers factor their trade receivables from Philips Lighting with third parties through supplier finance arrangements. As of December 31, 2016, approximately EUR 79 million of the Philips Lighting accounts payable were known to have been sold onward under such arrangements whereby Philips Lighting confirms invoices. Philips Lighting continues to recognize these liabilities as trade payables and will settle the liabilities in line with the original payment terms of the related invoices.

[28] Contingent liabilities

Guarantees

Philips Lighting's policy is to provide guarantees and other letters of support only in writing. Philips Lighting does not stand by other forms of support. As of December 31, 2016, the total fair value of guarantees recognized on the Consolidated balance sheet amounted to EUR nil million (2015: EUR nil million). Remaining off-balance-sheet business and credit-related guarantees provided on behalf of third-parties and associates as per December 31, 2016 amounted EUR 8 million (2015: EUR 8 million).

Indemnifications

By way of surety for the fulfilment of the Philips Lighting's obligations under the Separation Agreement, including the indemnifications granted to Royal Philips, certain major subsidiaries of Philips Lighting have provided guarantees to Royal Philips. Conversely, certain major subsidiaries of Royal Philips have provided guarantees to Philips Lighting. Refer to note 29, Related party transactions.

Environmental remediation

Philips Lighting is subject to environmental laws and regulations. Under these laws and regulations, Philips Lighting may be required to remediate the effects of certain chemicals on the environment.

Legal proceedings

Philips Lighting is involved as a party in legal proceedings, regulatory and other governmental proceedings, including discussions on potential remedial actions, relating to , commercial transactions, product liability, participations, environmental pollution and our General Business Principles.

While it is not feasible to predict or determine the ultimate outcome of all pending or threatened legal proceedings, regulatory and governmental proceedings, Philips Lighting is of the opinion that the proceedings may have a significant impact on Philips Lighting's Consolidated balance sheet, results of operations and Consolidated statements of cash flows.

In respect of labor related litigation, Philips Lighting is involved in several proceedings relating to former employees. These proceedings consist of individual claims in various jurisdictions and a collective claim before a federal public prosecutor in South America. The collective action was settled in April 2015 and Philips Lighting is currently involved in the final assessment of potential beneficiaries of the settlement, which is expected in 2017. The remaining individual claims are assessed on a case by case basis and are in various phases of litigation. Please also refer to note 21, Provisions.

[29] Related party transactions

These Consolidated financial statements include transactions with Royal Philips and its group companies that are outside of Philips Lighting. Royal Philips is a related party as it controlled Philips Lighting during the periods presented.

In the normal course of business, Philips Lighting purchases and sells goods and services from/to various parties in which Royal Philips typically holds a 50% or less equity interest and has significant influence. These transactions are generally conducted with terms comparable to transactions with third parties.

Furthermore, transactions during the year relate to the separation from Royal Philips, as well as the Transitional Service Level Agreement, based on which Royal Philips provides Philips Lighting with certain services such as IT, real estate, human resources among others.

An overview of the significant related party transactions and balances is as follows:

Philips Lighting
Related party transactions in mEUR
2015-2016

	2015	2016
Sales to Royal Philips	32	25
Purchases from Royal Philips	(214)	(66)
Movement in funding from (to) Royal Philips	(284)	(1,193)
Capital contribution		692
Brand license fee costs		36
Transfer settlement transactions as part of separation		(555)
Transfer of pension obligations as part of separation		(607)
Transitional Service Level Agreement costs charged by Royal Philips		122

Philips Lighting
Related party balances in mEUR
2015-2016

	2015	2016
Accounts receivable from related parties - Royal Philips	83	7
Accounts payable to related parties - Royal Philips	(111)	(44)
Indemnification receivable from Royal Philips		34
Indemnification payable to Royal Philips		(95)
Funding from Royal Philips (through owners net investment)	(3,158)	
Short-term loans payable to Royal Philips		(2)

Indemnification receivable from (payable to) Royal Philips relate to the indemnification for tax assets (liabilities) arising after Separation which are attributable to Philips Lighting.

Philips Lighting uses the Philips brand name. As part of the Separation, a Trademark License Agreement was signed between Philips Lighting and Royal Philips.

Philips Lighting considers the Board of Management and the Supervisory Board to be the key management personnel as defined in IAS 24 'Related parties'.

For remuneration details of Key Management, see note 31, Information on remuneration.

[30] Share-based compensation

The share-based compensation plans for Philips Lighting employees have been granted by Royal Philips and settled with equity instruments of Royal Philips, as historically Philips Lighting did not have its own share capital. The purpose of the share-based compensation plans is to align the interests of management with those of shareholders by providing incentives to improve

Royal Philips performance on a long-term basis, thereby increasing shareholder value.

As of December 31, 2016, Philips Lighting has not granted any share-based compensation to employees to be settled with the company's own equity and has not issued any (restricted) shares to employees.

Royal Philips has the following plans:
- Performance shares - rights to receive common shares in the future based on performance and service conditions.
- Restricted shares - rights to receive common shares in the future based on a service condition.
- Options on its common shares, including the 2012 and 2013 Accelerate! grant.

Since 2013, executives, including members of Key Management of Philips Lighting, as well as certain selected employees are granted performance shares. Restricted shares are granted only to new employees or certain selected employees of Philips Lighting.

Furthermore, as part of the Accelerate! program, Royal Philips granted options (Accelerate! options) to a group of approximately 500 key employees below the level of Board of Management in January 2012 and to the Board of Management in January 2013.

Under the terms of employee stock purchase plans established by Royal Philips in various countries, employees are eligible to purchase a limited number of Royal Philips shares at discounted prices through payroll withholdings.

Philips Lighting's share-based compensation costs were EUR 23 million (2015: EUR 24 million). The amount recognized as an expense is adjusted for forfeiture. The expense equals the recharge from Royal Philips to Philips Lighting. Philips Lighting is not charged for any additional costs upon delivery of shares or exercising of options. No new grants are made by Royal Philips to employees of Philips Lighting after the separation of Philips Lighting from Royal Philips.

USD-denominated performance shares, restricted shares and options are granted to employees in the US only.

For further information on remuneration, including that of Key Management, refer to note 31, Information on remuneration.

Performance shares

The performance is measured over a three-year performance period. The performance shares have two performance conditions, relative Total Shareholders' Return of Royal Philips compared to a peer group of 21 companies and adjusted EPS growth of Royal Philips. The performance shares vest three years after the grant date. The number of performance shares that will vest is dependent on achieving the two performance conditions, which are equally weighted, and provided that the grantee is still employed with Royal Philips, which for this purpose includes Philips Lighting, on the respective delivery dates.

The amount recognized as an expense is adjusted for actual performance of adjusted EPS growth since this is a non-market performance condition. It is not adjusted for non-vesting or extra vesting of performance shares due to a relative Total Shareholders' Return performance that differs from the performance anticipated at the grant date, since this is a market-based performance condition.

The fair value of the performance shares is measured based on Monte Carlo simulation, which takes into account dividend payments between the grant date and the vesting date by including reinvested dividends, the market conditions expected to impact relative Total Shareholders' Return performance in relation to selected peers, and the following weighted-average assumptions:

Philips Lighting
Assumptions used in Monte-Carlo simulation for valuation in %
2016

	2016
EUR-denominated	
Risk-free interest rate	(0.45%)
Expected dividend yield	3.4%
Expected share price volatility	26%
USD-denominated	
Risk-free interest rate	(0.45%)
Expected dividend yield	3.4%
Expected share price volatility	29%

The assumptions were used for these calculations only and do not necessarily represent an indication of Royal Philips management's expectation of future developments for other purposes. Volatility assumptions were based on historical experience measured over a ten-year period.

A summary of the status of Royal Philips performance share plans applicable to Philips Lighting employees as of December 31, 2016 and changes during the year are presented below.

On December 31, 2016, an estimated total of EUR 26 million of unrecognized compensation costs relate to non-vested performance shares allocated to employees of Philips Lighting. These costs are expected to be recognized over a weighted-average period of 1.8 years.

Philips Lighting
Performance share plans
2016

	EUR-denominated		USD-denominated	
	Shares	Weighted average grant-date fair value	Shares	Weighted average grant-date fair value
Outstanding as of December 31, 2015 [1]	**2,170,590**	**24.53**	**576,670**	**30.64**
Granted	701,739	24.78	196,575	28.32
Vested	547,220	23.61	146,332	31.56
Forfeited	229,445	25.06	76,972	31.49
Outstanding as of December 31, 2016	**2,095,664**	**24.79**	**549,941**	**29.44**

1) Opening balances were revised to reflect only positions for employees active in Philips Lighting during the year.

Restricted shares

The fair value of restricted shares is equal to the share price at grant date less the present value, using the risk-free interest rate, of estimated future dividends which will not be received up to the vesting date.

Royal Philips issues restricted shares that, in general, vest in equal annual installments over a three-year period, starting one year after the date of grant. For grants up to and including January 2013 Royal Philips granted 20% additional (premium) shares, provided the grantee still holds the shares after three years from the delivery date and the grantee is still with Royal Philips, which for this purpose includes Philips Lighting, on the respective delivery dates.

A summary of the status of Royal Philips restricted shares granted to Philips Lighting employees as of December 31, 2016 and changes during the year are presented below:

Philips Lighting
Restricted shares
2016

	EUR-denominated		USD-denominated	
	Shares	Weighted average grant-date fair value	Shares	Weighted average grant-date fair value
Outstanding as of December 31, 2015 [1]	**292,412**	**25.05**	**42,024**	**27.69**
Granted	325,108	23.71	103,397	27.27
Vested	139,505	24.99	21,073	27.57
Forfeited	4,196	25.32	-	-
Outstanding as of December 31, 2016	**473,819**	**24.14**	**124,348**	**27.36**

1) Opening balances were revised to reflect only positions for employees active in Philips Lighting during the year.

On December 31, 2016, an estimated total of EUR 7 million of unrecognized compensation costs relate to non-vested restricted shares allocated to employees of Philips Lighting. These costs are expected to be recognized over a weighted-average period of 1.7 years.

Option plans

Royal Philips granted options that expire after 10 years. These options vest after three years, provided that the grantee is still employed with Royal Philips, which includes Philips Lighting.

The following tables summarize information about options held by employees of Philips Lighting as of December 31, 2016 and changes during the year:

Philips Lighting
Options
2016

	EUR-denominated		USD-denominated	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding as of December 31, 2015 [1]	**1,919,785**	**21.65**	**658,968**	**30.46**
Exercised	464,399	18.23	35,650	19.56
Forfeited	5,844	22.46	-	-
Expired [2]	145,440	28.80	46,260	35.26
Outstanding as of December 31, 2016	**1,304,102**	**22.06**	**577,058**	**30.74**
Exercisable as of December 31, 2016	**1,304,102**	**22.06**	**577,058**	**30.74**

1) Opening balances were revised to reflect only positions for employees active in Philips Lighting during the year.
2) Expired line item includes movements where employees are no longer active Philips Lighting employees.

The exercise prices for EUR denominated options range from EUR 12.63 to EUR 32.04. The weighted average remaining contractual term for options outstanding and options exercisable held by employees of Philips Lighting on December 31, 2016, was for both 3.1 years. The aggregate intrinsic value of the options outstanding and options exercisable held by employees of Philips Lighting as of December 31, 2016, was EUR 10 million for both.

The total intrinsic value of options exercised by employees of Philips Lighting during 2016 was EUR 4 million.

The exercise prices for USD-denominated options range from USD 16.76 to USD 44.15. The weighted average remaining contractual term for options outstanding and options exercisable held by employees of Philips Lighting on December 31, 2016, was for both 2.9 years. The aggregate intrinsic value of the options outstanding and options exercisable held by employees of Philips Lighting as of December 31, 2016, was USD 2 million for both.

The total intrinsic value of options exercised by employees of Philips Lighting during 2016 was USD 0.3 million.

On December 31, 2016 there were no unrecognized compensation costs related to outstanding options.

The aggregate intrinsic value in the text above represents the total pre-tax intrinsic value (the difference between the Royal Philips closing share price on the last trading day of 2016 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option-holders if the options had been exercised on December 31, 2016.

The following table summarizes information about Accelerate! options held by employees of Philips Lighting as of December 31, 2016 and changes during the year:

Philips Lighting
Accelerate! options
2016

	EUR-denominated		USD-denominated	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding as of December 31, 2015 [1]	**173,500**	**15.24**	**30,000**	**20.02**
Exercised	81,000	15.24	–	–
Forfeited/ expired	10,000	15.24	–	–
Outstanding as of December 31, 2016	**102,500**	**15.24**	**30,000**	**20.02**
Exercisable as of December 31, 2016	**102,500**	**15.24**	**30,000**	**20.02**

1) Opening balances were revised to reflect only positions for employees active in Philips Lighting during the year.

The exercise price of the Accelerate! options is EUR 15.24 for EUR-denominated options and is USD 20.02 for USD-denominated options.
The weighted average remaining contractual term for EUR-denominated Accelerate! options outstanding and exercisable held by employees of Philips Lighting on December 31, 2016 is 6.1 years for both. The weighted average remaining contractual term for USD-Accelerate! options outstanding and exercisable held by employees of Philips Lighting on December 31, 2016 is 5.1 years for both. The aggregate intrinsic value of the EUR-denominated Accelerate! options outstanding and exercisable on December 31, 2016, was EUR 1.4 million for both. The aggregate intrinsic value of the USD-denominated Accelerate! options outstanding and exercisable on December 31, 2016, was USD 0.3 million for both.

The total intrinsic value of Accelerate! options exercised during 2016 by employees of Philips Lighting was EUR 1 million for EUR-denominated options.

[31] Information on remuneration

Philips Lighting
Remuneration costs of Key Management in EUR
2015-2016

	2015 [2,3]	2016 [1]
Board of Management	4,146,408	5,058,193
Supervisory Board [4]	–	221,979
Total	**4,146,408**	**5,280,172**

1) Remuneration costs shown for the full year.
2) The 2015 comparatives were revised to reflect the definition of Key Management as applied from 2016 onwards.
3) The 2015 comparatives present the remuneration costs for all individuals functioning as CEO and CFO in 2015. In the 2015 Combined financial statements, the key management personnel comprised the CEO, CFO and Business Groups leaders, with a total compensation of EUR 7 million.
4) Supervisory Board only in place since the IPO in 2016.

Remuneration of the Board of Management

In 2016, the total remuneration costs relating to the members of the Board of Management amounted to EUR 3,800,152.

At December 31, 2016, the members of the Board of Management held no options on Philips Lighting shares. Members of the Board of Management held 152,568 stock options related to shares in Royal Philips at a weighted average exercise price of EUR 19.83.

Philips Lighting
Remuneration costs of Key Management - the Board of Management in EUR
2015-2016

	2015 2)	2016 1)
Salary/base compensation	1,465,488	1,510,726
Annual incentive 3)	628,379	1,641,621
Long Term Incentives 4)	1,305,356	1,225,281
Pension allowances	512,247	521,418
Pension scheme costs	72,978	57,956
Other compensation 5)	161,960	101,191
	4,146,408	**5,058,193**

1) Remuneration costs shown for the full year.
2) The 2015 comparatives present the remuneration costs for all persons functioning as CEO or CFO during 2015.
3) The annual incentives are related to the performance in the year reported which are paid out in the subsequent year.
4) Costs relate to Royal Philips shares only. As of December 31, 2016 Philips Lighting has not granted any share-based compensation to employees to be settled with the company's own equity and has not issued any (restricted) shares to employees. Costs of performance shares, stock options and restricted share rights are based on accounting standards (IFRS) and do not reflect the value of stock options at the end of the lock up period and the value of performance shares and restricted share rights at the vesting/release date.
5) The stated amounts mainly concern (share of) allowances to directors that can be considered as remuneration. In a situation where such a share of an allowance can be considered as (indirect) remuneration (for example, private use of the company car), then the share is both valued and accounted for here. The method employed by the fiscal authorities in the Netherlands is the starting point for the value stated.

Philips Lighting
Remuneration costs of individual members of the Board of Management 1) in EUR
2016

	Base compen-sation/ salary	Annual incentive 2)	Perfor-mance shares 3)	Stock options 3)	Restricted share rights 3)	Pension allowances	Pension scheme costs	Other compen-sation 4)	Total costs
E.H.E. Rondolat	499,053	973,844	441,067	–	4,772	185,901	14,489	26,712	2,145,838
C.L. van Schooten	308,239	523,691	265,428	–	2,068	113,964	14,489	15,557	1,243,436
S.L.A. Rougeot 5)	183,333	144,086	–	–	–	37,373	8,280	37,806	410,878
	990,625	**1,641,621**	**706,495**	**–**	**6,840**	**337,238**	**37,258**	**80,075**	**3,800,152**

1) Remuneration costs of individual members of the Board of Management are disclosed for the period starting May 31, 2016, representing the time from which the current members of the Board of Management were formally in place.
2) The annual incentives are related to the performance in the year reported which are paid out in the subsequent year. For more details on the annual incentives, see sub-section 9.2.2, Annual Incentive (annual cash bonus), of this Annual Report.
3) Costs relate to Royal Philips shares only. As of December 31, 2016, Philips Lighting has not granted any share-based compensation to employees to be settled with the company's own equity and has not issued any (restricted) shares to employees. Costs of performance shares, stock options and restricted share rights are based on accounting standards (IFRS) and do not reflect the value of stock options at the end of the lock up period and the value of performance shares and restricted share rights at the vesting/release date.
4) The stated amounts mainly concern (share of) allowances to members of the Board of Management that can be considered as remuneration. In a situation where such a share of an allowance can be considered as (indirect) remuneration (for example, private use of the company car), then the share is both valued and accounted for here. The method employed by the fiscal authorities in the Netherlands is the starting point for the value stated.
5) Pending appointment as a member of the Board of Management in AGM 2017.

For further information on remuneration costs, see chapter 9, Remuneration report, of this Annual Report.

The tables below give an overview of the performance share plans, restricted share rights and the stock option plans of Royal Philips, held by the members of the Board of Management of Philips Lighting:

Philips Lighting
Number of performance shares (holdings) in number of shares
2016

	January 1, 2016	Awarded 2016	Awarded dividend shares 2016	Realized 2016	December 31, 2016	Vesting date
E.H.E. Rondolat 1)	34,025	–	–	28,922	–	05.03.2016
	32,017	–	1,107	–	33,124	04.28.2017
	29,142	–	1,007	–	30,149	05.05.2018
	–	36,080	1,247	–	37,327	04.29.2019
C.L. van Schooten 1)	18,322	–	–	15,573	–	05.03.2016
	16,008	–	554	–	16,562	04.28.2017
	10,049	–	347	–	10,396	05.05.2018
	–	15,785	546	–	16,331	04.29.2019
S.L.A. Rougeot	–	–	–	–	–	–
Performance shares (holdings)	**139,563**	**51,865**	**4,808**	**44,495**	**143,889**	

1) Awarded before date of appointment as a member of the Board of Management

Restricted shares all vested prior to January 1, 2016. As at December 31, 2016, awarded premium shares amounted to 3,320 for E.H.E. Rondolat and 620 for C.L. van Schooten.

Philips Lighting
Number of restricted share rights (holdings) in number of shares
2016

	January 1, 2016	Awarded 2016	Released 2016	December 31, 2016	Premium shares
E.H.E. Rondolat [1]	–	–	–	–	3,320
C.L. van Schooten [1]	–	–	–	–	620
S.L.A. Rougeot	–	–	–	–	–
Restricted share rights (holdings)	**–**	**–**	**–**	**–**	**3,940**

1) Awarded before date of appointment as a member of the Board of Management.

Philips Lighting
Stock options (holdings) in number of shares
2016

	January 1, 2016	Granted	Exercised	Expired	December 31, 206	Grant price (in EUR)	Share (closing) price on exercise date	Expiry date
E.H.E. Rondolat [1]	102,000	–	30,000	–	72,000	14.82	23,83	04.23.2022
C.L. van Schooten [1]	10,800	–	–	10,800	–	26.28	–	04.18.2016
	15,840	–	–	–	15,840	30.96	–	04.16.2017
	2,403	–	–	–	2,403	24.18	–	01.21.2018
	16,200	–	–	–	16,200	23.11	–	04.14.2018
	18,000	–	–	–	18,000	24.9	–	04.19.2020
	28,125	–	–	–	28,125	20.9	–	04.18.2021
	22,500	–	22,500	–	–	14.82	27,68	–
S.L.A. Rougeot	–	–	–	–	–	–	–	–
Stock options (holdings)	**215,868**	**–**	**52,500**	**10,800**	**152,568**			

1) Awarded before date of appointment as a member of the Board of Management.

See note 30, Share-based compensation, for further information on performance shares, stock options and restricted share rights as well as chapter 9, Remuneration report, of this Annual Report.

The accumulated annual pension entitlements and the pension costs of individual members of the Board of Management are as follows (in EUR):

Philips Lighting
Accumulated annual pension entitlements and pension related costs in EUR
2016

	Age at December 31, 2016	Accumulated annual pension as of December 31, 2016 [1]	Total pension related costs [2, 3]
E.H.E. Rondolat	50	30,367	200,390
C.L. van Schooten	57	204,344	128,453
S.L.A. Rougeot [4]	48	542	45,653
Pension costs			**374,496**

1) Total of entitlements under applicable pension scheme in Philips Lighting including - if applicable - transferred pension entitlements under pension scheme(s) of previous employer(s).
2) Cost include paid pension allowances as well as pension premium paid by employer to Collective Defined Contribution plan.
3) Costs are disclosed for the period starting May 31, 2016, representing the time from which the current members of the Board of Management were formally in place.
4) Pending appointment as a member of the Board of Management in AGM 2017

When pension rights are granted to members of the Board of Management, necessary payments (if insured) and all necessary provisions are made in accordance with the applicable accounting principles. In 2016, no (additional) pension benefits were granted to former members of the Board of Management.

Remuneration of the Supervisory Board
The remuneration of the members of the Supervisory Board amounted to EUR 221,979.

At December 31, 2016 the members of the Supervisory Board held no stock options.
The individual members of the Supervisory Board received, by virtue of the positions they held, the following remuneration (in EUR):

Philips Lighting
Remuneration of Key Management - the Supervisory Board in EUR
2016

	Membership	Committees	Other compensation [3]	Total
2016 [1, 2]				
A.P.M. van der Poel	64,583	14,678	–	79,261
C.J.A. van Lede	44,034	22,017	–	66,051
R.S. Lane	44,034	7,633	25,000	76,667
F.A. van Houten [4]	–	–	–	–
A. Bhattacharya [4]	–	–	–	–
	152,651	**44,328**	**25,000**	**221,979**

1) Supervisory Board only in place since the IPO in 2016.
2) As of 2013, part of the remuneration of members of the Supervisory Board living in the Netherlands is subject to VAT. The amounts mentioned in this table are excluding VAT.
3) The amounts mentioned under other compensation relate to the fee for intercontinental travel, inter-European travel.
4) Unsalaried

Supervisory Board members' and Board of Management members' interests in Philips Lighting shares.

Philips Lighting
Philips Lighting shares held by board members [1)]
in number of shares
2016

	December 31, 2016
E.H.E. Rondolat	25,000
C.L. van Schooten	12,500
S.L.A. Rougeot	5,000

1) Reference date for board membership is December 31, 2016. At December 31, 2016 the members of the Supervisory Board held no Philips Lighting shares

[32] Details of treasury/other financial risks

Philips Lighting is exposed to several types of financial risks. This note further analyzes these financial risks.

Philips Lighting does enter into derivative financial instruments to hedge part of this risk but does not purchase or hold these instruments for speculative purposes.

Information regarding financial instruments is included in note 33, Fair value of financial assets and liabilities.

Interest rate risk
Interest rate risk is the risk of the fair value or future cash flows of a financial instrument fluctuating because of changes in the market interest rates. As of December 31, 2016, Philips Lighting had outstanding interest-bearing debt of EUR 1,381 million, which creates an inherent interest rate risk. Failure to effectively hedge this risk could negatively impact financial results. There are no major changes in the funding expected for the short term, but this could change due to business developments.

Philips Lighting constantly monitors interest rate coverage, short-term and long-term interest rate developments and has the flexibility to opt for different short-term interest periods for the debt instruments at roll-over dates, or could enter into derivatives financial instruments to fix interest rates for a certain period of time. As of December 31, 2016, Philips Lighting had a ratio of fixed-rate debt to total outstanding debt of approximately 5%.

The sensitivity of changing interest rates for this reporting period is low as the underlying EUR interest rates are negative and most of the interest-bearing debt is exposed to EUR rates.

A sensitivity analysis conducted as of January 2017 shows that if interest rates were to increase instantaneously by 1% from their level of December 31, 2016, with all other variables held constant, the annualized net interest expense would increase by approximately EUR 3 million. This impact was based on the outstanding net floating debt position as of December 31, 2016.

Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities.

Liquidity risk for the company is monitored through the Treasury Risk and Liquidity Committee which tracks the development of the actual cash flow position for the company and uses input from a number of sources in order to forecast the overall liquidity position both on a short term and long-term basis.

Philips Lighting invests surplus cash primarily in money market deposits and with Royal Philips with appropriate maturities to ensure sufficient liquidity is available to meet liabilities when due.

Philips Lighting has various sources to mitigate the liquidity risk for the company. As of December 31, 2016, Philips Lighting had EUR 1,040 million in cash and cash equivalents, within which short-term deposits of EUR 578 million. Philips Lighting pools cash from subsidiaries to the extent legally and economically feasible; cash not pooled remains available for operational or investment needs by the company.

Furthermore, Philips Lighting has a EUR 500 million revolving credit facility that can be used for general purposes. The EUR 500 million facility is maturing in May 2021. As of December 31, 2016 Philips Lighting did not have any amounts outstanding under this facility.

On December 30, 2016, a financial institution erroneously transferred EUR 150 million of cash to the company's bank account. On January 2, 2017 the transfer was reversed by all parties involved for the full amount with retrospective effect to December 30, 2016. As the transaction lacks economic substance and Philips Lighting never had any exposure or benefit, the transaction has not been accounted for in these financial statements.

Currency risk

Currency risk is the risk that reported financial performance or the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. Philips Lighting operates in many countries and currencies and therefore currency fluctuations may inevitably impact its financial results.
The company is exposed to currency risk in the following areas:

- Transaction exposures, related to anticipated sales and purchases and on-balance-sheet receivables/payables resulting from such transactions.
- Transaction exposure of foreign currency intercompany and external debt and deposits.
- Translation exposure of net income in foreign entities.
- Translation exposure of foreign currency denominated equity invested in consolidated companies.
- Translation exposure to equity interests in non-functional-currency investments in associates and available-for-sale financial assets.

It is Philips Lighting's policy to reduce the potential year-on-year volatility caused by foreign currency movements on its net earnings by hedging the anticipated net exposure of foreign currencies resulting from foreign-currency sales and purchases. In general, net anticipated exposures are hedged during a period of 15 months in layers of 20% up to a maximum hedge of 80%, using forwards and currency options. Philips Lighting's policy requires significant committed foreign currency exposures to be fully hedged, generally using forwards. However, not every foreign currency can or shall be hedged as there may be regulatory barriers or prohibitive hedging cost preventing Philips Lighting from effectively and/or efficiently hedging its currency exposures. As a result, hedging activities cannot and will not eliminate all currency risks for anticipated and committed transaction exposures.

The following table outlines the estimated nominal value in millions of EUR for transaction exposure and related hedges for Philips Lighting's most significant currency exposures:

Philips Lighting
Estimated transaction exposure and related hedges
in mEUR
2016

	Receivables		Payables	
	Exposure	Hedges	Exposure	Hedges
Balance as of December 31				
Exposure currency				
CNY	25	(25)	(737)	517
USD	35	(35)	(350)	206
EUR [1]	247	(164)	(52)	46
GBP	93	(52)	–	–
RON	38	(22)	–	–
SEK	35	(18)		
CHF	32	(16)		
AUD	30	(18)		
CZK	23	(12)		
NOK	17	(9)		
MXN	15	(11)		
PLN	10	(10)	(23)	23
NZD	10	(6)		
JPY	8	(4)		
AED	4	(4)		
Others	24	(17)	(1)	–
Total 2016	**646**	**(423)**	**(1,163)**	**792**
Total 2015	**615**	**(418)**	**(667)**	**399**

1) EUR exposures in non EUR denominated functional currencies

The derivatives related to transactions are, for hedge accounting purposes, split into hedges of on-balance-sheet accounts receivable/payable and forecasted sales and purchases. Changes in the value of on-balance-sheet foreign currency accounts receivable/payable, as well as the changes in the fair value of the hedges related to these exposures, are reported within cost of goods sold in the Consolidated statements of income. Hedges related to forecasted transactions, where hedge accounting is applied, are accounted for as cash flow hedges.
The results from such hedges are deferred in other comprehensive income within equity, to the extent that the hedge is effective.

As of December 31, 2016, a gain of EUR 4 million (2015: EUR 2 million) was deferred in equity as a result of these hedges. The result deferred in equity will be released to earnings mostly during 2017 at the time when the related hedged transaction affects the Consolidated statements of income. During 2016, a net loss of EUR 1 million (2015: a net loss of less than EUR 1 million) was recorded within cost of goods sold in the Consolidated statements of income as a result of ineffectiveness on certain anticipated cash flow hedges.

The total net fair value of hedges related to transaction exposure as of December 31, 2016 was an unrealized asset of EUR 3 million (2015: EUR 3 million). An instantaneous 10% increase in the value of the euro against all currencies would lead to an increase of EUR less than 1 million in the value of the derivatives.

The total net fair value of hedges related to transaction exposure as of December 31, 2015 was an unrealized asset of EUR 3 million.
An instantaneous 10% increase in the value of the euro against all currencies would lead to an increase of EUR 9 million in the value of the derivatives; including a EUR 4 million increase related to foreign exchange transactions of the Polish Zloty against the euro and a EUR 4 million increase related to foreign exchange transactions of the Pound Sterling against euro, partially offset by a EUR 8 million decrease related to foreign exchange transactions of the euro against the US dollar.

Foreign exchange exposure also arises as a result of intercompany loans and deposits. Where Philips Lighting enters into such arrangements the financing is generally provided in the functional currency of the subsidiary entity.
The currency of Philips Lighting external funding and liquid assets is matched with the required financing of subsidiaries either directly through external foreign currency loans and deposits or synthetically by using foreign exchange derivatives, including foreign exchange forward contracts. In certain cases, where group companies may also have external foreign currency debt or liquid assets, these exposures are also hedged through the use of foreign exchange derivatives. Changes in the fair value of hedges related to this exposure are recognized within financial income and expenses in the Consolidated statements of income.

Philips Lighting does not currently hedge the foreign exchange exposure arising from equity interests in non-functional currency investments in associates and available-for-sale financial assets.

Commodity price risk
Commodity price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in commodity prices.

Philips Lighting is a purchaser of certain base metals, precious metals and energy. Philips Lighting hedges certain commodity price risks using derivative instruments to minimize significant, unanticipated earnings fluctuations caused by commodity price volatility.
The commodity price derivatives that Philips Lighting enters into, is accounted for as cash flow hedges, to offset forecasted purchases. As of December 31, 2016 Philips Lighting does not have any outstanding commodity derivatives.

As of December 31, 2015 a loss of EUR 0.1 million was deferred in equity as a result of these hedges. A 10% increase in the market price of all commodities as of December 31, 2015 would increase the fair value of the derivatives by less than EUR 0.1 million.

Credit risk
Credit risk represents the loss that would be recognized at the reporting date, if counterparties failed completely to perform their payment obligations as contracted. Credit risk is present within Philips Lighting trade receivables. To have better insights into the credit exposures, Philips Lighting performs ongoing evaluations of the financial and non-financial condition of its customers and adjusts credit limits when appropriate. In instances where the creditworthiness of a customer is determined not to be sufficient to grant the credit limit required, there are a number of mitigation tools that can be utilized to close the gap, including reducing payment terms, cash on delivery, pre-payments and pledges on assets.

Philips Lighting invests available cash and cash equivalents with various financial institutions and is exposed to credit risk with these counterparties. Philips Lighting is also exposed to credit risks in the event of non-performance by financial institutions with respect to financial derivative instruments. Philips Lighting actively manages concentration risk and on a daily basis measures the potential loss under certain stress scenarios, should a financial institution default. These worst-case scenario losses are monitored and limited by the company.

Philips Lighting does not enter into any financial derivative instruments to protect against default by financial institutions. However, where possible, Philips Lighting requires all financial institutions with whom it deals in derivative transactions to complete legally enforceable netting agreements under an International Swap Dealers Association master agreement or otherwise prior to trading, and whenever possible, to have a strong credit rating from Standard & Poor's and Moody's Investor Services. Philips Lighting also regularly monitors the development of the credit risk of its financial counterparties. Wherever possible, cash is invested and financial transactions are concluded with financial institutions with strong credit ratings or with governments or government-backed institutions.

The below table shows the credit ratings of the financial institutions with which Philips Lighting had short-term deposits above EUR 25 million as of December 31, 2016. For an overview of the overall maximum credit exposure of the group's financial assets, please refer to note 33, Fair value of financial assets and liabilities, for details of carrying amounts and fair value.

Philips Lighting
Credit rating
2016

	EUR 25 - 100 million	EUR 100 - 500 million
A-rated bank counter-parties	3	4

Rating based on Standard & Poor's

Country risk
Country risk is the risk that political, legal, or economic developments in a single country could adversely impact our performance. The country risk is defined as the sum of the equity of all subsidiaries and associated companies in country cross-border transactions, such as intercompany loans, accounts receivable from third parties and intercompany accounts receivable. The country risk is monitored on a regular basis. Country risk is monitored and developments such as Brexit and the US elections are followed.

As of December 31, 2016 Philips Lighting had country risk exposure of EUR 1.8 billion in the United States and EUR 1.1 billion in the Netherlands. Other countries' exposures higher than EUR 200 million are Belgium (EUR 501 million), Poland (EUR 489 million), Saudi Arabia (269 million), China (including Hong Kong, EUR 207 million) and Spain (EUR 205 million). Countries where the risk exceeded EUR 50 million but was less than EUR 200 million are Canada, Mexico, Indonesia, France, India and Australia. The degree of country risk is taken into account when new investments are considered. Philips Lighting does not, however, use financial derivative instruments to hedge country risk.

Other insurable risk
Philips Lighting is covered for a broad range of losses by global insurance policies in the areas of property damage/business interruption, general and product liability, transport, directors' and officers' liability, employment practice liability, crime and cybersecurity. The counterparty risk related to the insurance companies participating in the above mentioned global insurance policies is actively managed. As a rule, Philips Lighting only selects insurance companies with a Standard & Poor's credit rating of at least 'A'. Throughout the year the counterparty risk is monitored on a regular basis.

To lower exposures and to avoid potential losses, Philips Lighting has a global Risk Engineering program in place. The main focus of this program is on property damage and business interruption risks including company interdependencies. Regular on-site assessments take place at Philips Lighting locations and business critical suppliers by risk engineers of the insurer in order to provide an accurate assessment of the potential loss and its impact. The results of these assessments are shared across Philips Lighting's stakeholders. On-site assessments are carried out against the predefined Risk Engineering standards which are agreed between Philips Lighting and the insurers.

Recommendations are made in a Risk Improvement report and are monitored centrally. This is the basis for decision-making by the local management of the business as to which recommendations will be implemented.

For all policies, deductibles are in place, which vary from EUR 250,000 to EUR 1.5 million per occurrence and this variance is designed to differentiate between the existing risk categories within Philips Lighting. Above this first layer of working deductibles, Philips Lighting operates as per May 27, 2016, its own re-insurance captive, which during 2016 retained EUR 1.5 million per occurrence and EUR 3 million in the aggregate per year for property damage and business interruption losses. For general and product liability claims, the captive retained was EUR 1.5 million per claim and EUR 1.75 million in the aggregate. New contracts were signed on

December 31, 2016, for the coming year. For 2017 the captive retentions are EUR 1.5 million per occurrence for property damage and business interruption losses and EUR 3 million in the aggregate per year and for general and product liability claims, EUR 1.5 million per claim and EUR 3 million in the annual aggregate.

[33] Fair value of financial assets and liabilities

The estimated fair value of financial instruments has been determined by Philips Lighting using available market information and appropriate valuation methods. The estimates presented are not necessarily indicative of the amounts that will ultimately be realized by Philips Lighting upon maturity or disposal. The use of market assumptions and/ or estimation methods may have a material effect on the estimated fair value amounts.

For cash and cash equivalents, held-to-maturity investments, current and non-current accounts receivable, non-current loans receivable, accounts and notes payable, interest accrual, short-term and long-term debts, indemnification receivable and payable from and to Royal Philips the carrying amounts are reasonable approximation of fair value. Therefore, the fair value disclosure in tabular format for these items was removed compared to the previous periods.

At December 31, 2016 long-term loans and receivables included in other non-current financial assets in the Consolidated balance sheet amounted to EUR 7 million (2015: EUR 3 million) and held to maturity investments amounted to EUR 1 million (2015: EUR nil million).

The following hierarchy is applied to classify the financial assets and liabilities:

Level 1
Instruments included in Level 1 are comprised primarily of listed equity investments classified as available-for-sale financial assets, investees and financial assets designated at fair value through profit and loss. The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Level 2
The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) are determined by using valuation techniques. These valuation techniques maximize the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are based on observable market data, the instrument is included in Level 2.

The fair value of derivatives is calculated as the present value of the estimated future cash flows based on observable interest yield curves, basis spread and foreign exchange rates.

Level 3
If one or more of the significant inputs are not based on observable market data, the instrument is included in Level 3.

Philips Lighting
Fair value hierarchy in mEUR
2015-2016

	Level 1	Level 2	Level 3	Total
Balance as of December 31, 2016				
Derivative financial instruments - assets	-	29	-	29
Fair value through profit and loss - non-current	-	-	2	2
Available-for-sale financial assets	-	-	1	1
Total	**-**	**29**	**3**	**32**
Derivative financial instruments - liabilities	-	(26)	-	(26)
Total	**-**	**(26)**	**-**	**(26)**
Balance as of December 31, 2015				
Derivative financial instruments - assets	-	9	-	9
Available-for-sale financial assets	-	-	5	5
Total	**-**	**9**	**5**	**14**
Derivative financial instruments - liabilities	-	(7)	-	(7)
Total	**-**	**(7)**	**-**	**(7)**

During 2016 under Level 3, an impairment loss on available-for-sale financial assets of EUR 3 million was recognized in the Consolidated statements of income, EUR 1 million has been transferred to other captions of the Consolidated balance sheets and EUR 2 million fair value gain has been recognized in relation to financial assets at fair value through profit or loss.

Philips Lighting has the following balances related to its derivative activities. These transactions are subject to master netting and set-off agreements with financial counterparties. In case of certain termination events, under the terms of these Master Agreements, Philips Lighting can terminate the outstanding transactions and aggregate their positive and negative values to arrive at a single net termination sum (or close-out amount). This contractual right is subject to the following:

- the right may be limited by local law if the counterparty is subject to bankruptcy proceedings
- the right applies on a bilateral basis.

Philips Lighting
Financial assets subject to offsetting, enforceable master netting arrangements with financial counterparties or similar agreements
in mEUR
2016

	2016
Derivatives	
Gross amounts of recognized financial assets	29
Gross amounts of recognized financial liabilities offset in the statement of financial position	-
Net amounts of financial assets presented in the statement of financial position	29
Related amounts not offset in the statement of financial position	
Financial instruments	(12)
Cash collateral received	-
Net amount	**17**

Philips Lighting
Financial liabilities subject to offsetting, enforceable master netting arrangements with financial counterparties or similar agreements
in mEUR
2016

	2016
Derivatives	
Gross amounts of recognized financial liabilities	(26)
Gross amounts of recognized financial assets offset in the statement of financial position	-
Net amounts of financial liabilities presented in the statement of financial position	(26)
Related amounts not offset in the statement of financial position	
Financial instruments	12
Cash collateral received	-
Net amount	**(14)**

[34] Events after the balance sheet date

On February 8, 2017, Philips Lighting repurchased 3.5 million of its shares for an aggregate amount of EUR 81.9 million. The repurchase was part of an accelerated bookbuilt offering by Royal Philips to institutional investors of 26 million shares in Philips Lighting at a price of EUR 23.40 per share.

The repurchase is financed by the company's own funds and is in line with its previous announcement that it will return up to EUR 300 million to its shareholders over the period 2017-2018, by participating in share disposals by its main shareholder, Royal Philips. Philips Lighting intends to cancel these shares.

This transaction reduced Royal Philips' stake in the issued and outstanding share capital of Philips Lighting from 71.23% to 55.18%, and resulted in a free float of Philips Lighting shares of 44.82%.

15. Philips Lighting N.V. financial statements

Introduction

Statutory financial statements
The sections Consolidated financial statements and Philips Lighting N.V. financial statements contain the statutory financial statements of Philips Lighting N.V. (the 'Company').

The Company, incorporated as a private limited liability company on February 1, 2016, was converted into a public company with limited liability on May 31, 2016.

As the Lighting business was transferred by Royal Philips to Philips Lighting N.V. as at May 31, 2016, the income statement of the Company only includes the Lighting business results as from this date.

A description of the activities of the Company, its subsidiaries and company structure is included in the Consolidated financial statements.
The corporate seat of the Company is in Eindhoven, The Netherlands, and its registered office is at High Tech Campus 45, 5656 AE Eindhoven. Philips Lighting N.V. is registered in the Commercial Register of the Chamber of Commerce under number 65220692.

A list of all Philips Lighting N.V. 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 statutory financial statements and is deposited at the Chamber of Commerce in Eindhoven, Netherlands.

Accounting policies applied
The financial statements of the Company included in this section are prepared in accordance with Part 9 of Book 2 of the Dutch Civil Code. Section 362 (8), Book 2, Dutch Civil Code, allows companies that apply IFRS as endorsed by the European Union in their consolidated financial statements to use the same measurement principles in their company financial statements. The Company has prepared these Company financial statements using this provision.

The accounting policies are described in note 2, Significant accounting policies. Investments in subsidiaries are accounted for using the equity method.

The balance sheet as included in these Company financial statements has been prepared before the appropriation of result. As the Company was incorporated on February 1, 2016 no comparative information is included.

15.1 Balance sheet before appropriation of results

Philips Lighting N.V.
Balance sheet before appropriation of results in mEUR
As of December 31

		2016	
	Non-current assets		
[C]	Financial fixed assets		3,448
	Total non-current assets		**3,448**
	Total assets		**3,448**
[D]	**Shareholders' equity**		
	Shareholders' equity		
	Preference shares, nominal value EUR 0.01 per share:		
	Authorized: 300,000,000 shares		
	Issued: none		
	Ordinary shares, nominal value EUR 0.01 per share:		
	Authorized: 300,000,000 shares		
	Issued and fully paid: 150,000,000 shares	2	
	Share premium	2,173	
	Retained earnings	(7)	
	Net income	146	
	Legal reserve: Currency translation differences	190	
	Legal reserve: Cash flow hedges	4	
	Legal reserve: Affiliated companies	196	
	Total shareholders' equity		**2,704**
	Current liabilities		
[E]	Short-term debt		743
	Accrued liabilities		1
	Total current liabilities		**744**
	Total liabilities and shareholders' equity		**3,448**

15.2 Statement of income

Philips Lighting N.V.
Statement of income in mEUR
For the period February 1 - December 31

		2016
	Other expenses	(1)
	Financial expenses	(3)
	Share in results of subsidiaries	150
[A]	**Net income**	**146**

15.3 Statement of changes in equity

Philips Lighting N.V.
Statement of changes in equity in mEUR
As of December 31

	Share capital	Share premium	Retained earnings	Net income	Legal reserves: Currency translation differences	Legal reserves: Cash flow hedges	Legal reserves: Affiliated companies	Total share-holders' equity
Balance as of February 1, 2016	–	–	–	–	–	–	–	–
Shares issuance and formation of the Company	2	2,169			84	(3)	200	2,452
Net income				146				146
Other comprehensive income			(7)		106	7		106
Total comprehensive income	**–**	**–**	**(7)**	**146**	**106**	**7**	**–**	**252**
Legal reserves reclassifications		4					(4)	–
Balance as of December 31, 2016	**2**	**2,173**	**(7)**	**146**	**190**	**4**	**196**	**2,704**

15.4 Notes to the Company financial statements

[A] Income statement

Share in results of subsidiaries represents the share of the Company in the results of these affiliated companies. Other expenses mainly relates to remuneration of the directors of the Company and the supervisory board. These costs are partly recharged to the subsidiaries of the Company. Financial expenses relates to the interest paid on the intercompany loan with Philips Lighting Holding B.V.

[B] Audit fees

A summary of Audit fees from Ernst & Young Accountants LLP is shown below.

Philips Lighting N.V.
Fees Ernst & Young Accountants LLP in mEUR
2016

	2016
Audit fees [1]	5.6
• consolidated financial statements	3.6
• statutory financial statements	2.0
Audit-related fees	0.3
• acquisitions and divestments	–
• sustainability assurance	0.3
Tax fees	–
• tax compliance services	–
Other fees	–
• other fees	–
Fees E&Y in millions of EUR [2]	**5.9**

1) The audit fees included represent the fees in relation to the audit of the 2016 financial statements.
2) Fees charged by the Dutch organization of EY were EUR 2.8 million

[C] Financial fixed assets

The Company has one directly owned subsidiary, Philips Lighting Holding B.V. This investment is presented as a financial fixed asset in the balance sheet using the equity method. Goodwill paid upon acquisition of investments in subsidiaries is included in the net equity value of the investment and is not shown separately on the face of the balance sheet. The acquisitions/additions line relates to the acquisition of Philips Lighting Holding B.V. in May 2016 as part of the formation of the Company.

Philips Lighting N.V.
Financial fixed assets in mEUR
2016

	Investments in Subsidiaries
Balance as of February 1	–
Changes:	
Acquisitions/additions	3,192
Share in results of subsidiaries	150
Translation differences	106
Balance as of December 31	**3,448**

[D] Shareholders’ equity

Upon the completion of the separation, Royal Philips had transferred the ownership of the respective Lighting businesses to Philips Lighting. As part of the formation of Philips Lighting, the Company issued ordinary shares to Royal Philips, resulting in share capital of EUR 1.5 million and share premium of EUR 2,169 million.

Subsequently, on May 31, 2016 Royal Philips completed an initial public offering of 37,500,000 ordinary shares in the share capital of the Company on the Euronext Stock Exchange in Amsterdam.

The Company has an authorized share capital of EUR 6 million, divided into 300,000,000 ordinary shares with a nominal value of EUR 0.01 per share and 300,000,000 preference shares with a nominal value of EUR 0.01 per share.

As of December 31, 2016, 71.23 % of the issued share capital is held by Royal Philips and 28.78% is publically traded at the Euronext Stock Exchange in Amsterdam. On February 8, 2017, Royal Philips sold 26 million Philips Lighting shares, reducing its stake in the issued and outstanding share capital to 55.18%. As a result, the free float increased to 44.82%.

Ordinary shares

As of December 31, 2016, the issued and fully paid share capital consists of 150,000,000 ordinary shares with a nominal value of EUR 0.01 per share.

On February 8, 2017, Philips Lighting repurchased 3.5 million of its shares from Royal Philips. Philips Lighting intends to cancel these shares.

Preference shares

Stichting Continuïteit Philips Lighting, a foundation organized under the laws of the Netherlands, has been granted the right to acquire preference shares in the Company. As a means to protect the Company and its stakeholders against an unsolicited attempt to acquire (de facto) control of the Company, the Company's articles of association allow the Board of Management and the Supervisory Board to issue (rights to acquire) preference shares to a third-party. As of December 31, 2016, this right has not been exercised therefore no preference shares have been issued.

Dividend distribution

A proposal will be submitted to the 2017 Annual General Meeting of Shareholders to pay a dividend of EUR 1.10 per ordinary share, in cash, from the 2016 net income and free distributable reserves of the Company.

Legal reserves

As of December 31, 2016, legal reserves relate to 'affiliated companies' reserve of EUR 196 million, unrealized currency translation gains of EUR 190 million, unrealized gains related to cash flow hedges of EUR 4 million.

The item 'affiliated companies' relates to the 'wettelijke reserve deelnemingen', which is required by Dutch law. This reserve 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.

Limitations in the distribution of shareholders' equity

Pursuant to Dutch law, limitations exist relating to the distribution of shareholders' equity of EUR 392 million as at December 31, 2016. Such limitations relate to ordinary shares of EUR 1.5 million, 'affiliated companies' reserve of EUR 196 million , unrealized currency translation gains of EUR 190 million as well as to unrealized gains related to cash flow hedges of EUR 4 million.

[E] Short term debt

Short term debt includes an intercompany loan of EUR 740 million with an interest rate equal to the higher of 6 months EURIBOR or 0% plus 0.75% with a maturity date of December 31, 2017 and other debt to subsidiaries of EUR 3 million.

[F] Employees

The number of persons employed by the Company at year-end 2016 was 3. For the remuneration of past and present members of both the Board of Management and the Supervisory Board, please refer to note 31, Information on remuneration, which is deemed incorporated and repeated herein by reference.

[G] Contingent liabilities not appearing in the balance sheet

General guarantees as referred to in Section 403, Book 2, of the Dutch Civil Code, have been given by the Company on behalf of other group companies in the Netherlands. The liabilities of these companies to third parties amounted to EUR 1,115 million as of December 31, 2016.

There has been no other general guarantees or credit guarantees given on behalf of unconsolidated companies and third-parties.

For corporate income tax purposes, the Company is the parent of a fiscal unity that contains the most significant Dutch wholly-owned group companies. The Company is therefore jointly and severally liable for the corporate income tax liabilities of the tax unity as a whole.
For additional information, please refer to note 28, Contingent liabilities, which is deemed incorporated and repeated herein by reference.

[H] Events after the balance sheet date

For the disclosure of events after the balance sheet date, reference is made to note 34, Events after the balance sheet date.

On February 21, 2017, the Board of Management authorized the statutory financial statements for issue. The statutory financial statements as presented in this report are subject to the adoption by the Annual General Meeting of Shareholders, to be held on May 9, 2017.

February 21, 2017

Board of Management
Eric Rondolat
René van Schooten

Supervisory Board
Arthur van der Poel
Frans van Houten
Rita Lane
Kees van Lede
Abhijit Bhattacharya

15.5 Independent auditor's report

To: the Annual General Meeting of Shareholders and Supervisory Board of Philips Lighting N.V.

Report on the audit of the financial statements 2016

Our opinion

We have audited the financial statements 2016 of Philips Lighting N.V., based in Eindhoven, the Netherlands. The financial statements include the consolidated financial statements and the company financial statements.

In our opinion:
- the accompanying consolidated financial statements give a true and fair view of the financial position of Philips Lighting N.V. as at December 31, 2016, and of its result and its cash flows for 2016 in accordance with International Financial Reporting Standards as adopted by the European Union (EU-IFRS) and with Part 9 of Book 2 of the Dutch Civil Code.
- the accompanying company financial statements give a true and fair view of the financial position of Philips Lighting N.V. as at December 31, 2016, and of its result for 2016 in accordance with Part 9 of Book 2 of the Dutch Civil Code.

The consolidated financial statements comprise:
- the consolidated balance sheet as at December 31, 2016;
- the following statements for 2016: the consolidated statement of income, comprehensive income, cash flows and changes in equity; and
- the notes comprising a summary of the significant accounting policies and other explanatory information.

The company financial statements comprise:
- the company balance sheet as at December 31, 2016;
- the company statements of income and changes in equity for 2016; and
- the notes comprising a summary of the accounting policies and other explanatory information.

Basis for our opinion

We conducted our audit in accordance with Dutch law, including the Dutch Standards on Auditing. Our responsibilities under those standards are further described in the "Our responsibilities for the audit of the financial statements" section of our report.

We are independent of Philips Lighting N.V. in accordance with the 'Verordening inzake de onafhankelijkheid van accountants bij assurance-opdrachten" (ViO, Code of Ethics for Professional Accountants, a regulation with respect to independence) and other relevant independence regulations in the Netherlands. Furthermore, we have complied with the "Verordening gedrags- en beroepsregels accountants" (VGBA, Dutch Code of Ethics).

We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Materiality

Materiality	€ 17 million
Benchmark applied	5% of income before taxes adjusted for certain pre-tax items
Explanation	Based on our professional judgment we consider earnings-based measures as the most appropriate basis to determine materiality.

We have also taken misstatements into account and/or possible misstatements that, in our opinion, are material for the users of the financial statements for qualitative reasons.

We agreed with the Supervisory Board that misstatements in excess of € 900 thousand, which are identified during the audit, as well as smaller misstatements that, in our view, should be reported on qualitative grounds would be reported to them.

Scope of the group audit

Philips Lighting N.V. is at the head of a group of entities. The consolidated financial statements of Philips Lighting N.V. represent the financial information of this group.

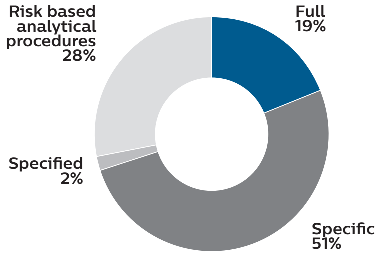
Following our assessment of the risk of material misstatement to Philips Lighting N.V.'s consolidated financial statements, we have selected 4 components which required an audit of the complete financial information (Full Scope Components) and 26 components requiring audit procedures on specific account balances that we considered to have the potential for the greatest impact on the significant accounts in the financial statements either because of the size of these accounts or their risk profile (Specific Scope Components). We performed audit procedures on those accounting areas managed centrally such as goodwill, legal claims and treasury.

Where this did not give adequate quantitative coverage of significant account balances, we used our judgment to scope additional procedures on account balances or requested the component auditors to perform additional specified procedures (Specified Procedures). As a result of our scoping of the complete financial information, specific account balances, and the performance of audit procedures at different levels in the organization, our actual coverage varies per account balance. In addition, the depth of our audit procedures per account balance varies depending on our risk assessment.

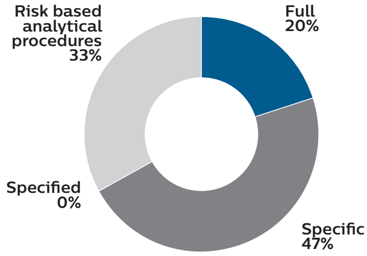
Of the remaining components, we performed risk based analytical procedures to respond to any potential risks of material misstatements to the financial statements.

Accordingly, our audit coverage of the group's sales, total assets, and gross revenues can be summarized as follows:

Assets



Sales



Involvement with component teams
Component materiality was determined by our judgment, based on the relative size of the component and our risk assessment. Component materiality did not exceed € 9 million and the majority of our component auditors applied a component materiality that is significantly less than this threshold.

We sent detailed instructions to all component auditors, covering the significant areas that should be covered and set out the information required to be reported to us. Based on our risk assessment, we visited component locations in the United States, China, Indonesia, France, Poland and Saudi Arabia. These visits involved co-developing the significant risk area audit approach, reviewing key local working papers and conclusions, meeting with local and regional leadership teams, obtaining an understanding of key control processes including centralised entity level control processes, and attending closing meetings. Where appropriate during various stages of the audit, we interacted regularly with the component teams. We attended closing meetings in person or via conference call, reviewed key working papers and were responsible for the scope and direction of the audit process.

By performing the procedures mentioned above at group entities, together with additional procedures at group level, we have been able to obtain sufficient and appropriate audit evidence about the group's financial information to provide an opinion on the consolidated financial statements.

Our key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements. We have communicated the key audit matters to the Supervisory Board. The key audit matters are not a comprehensive reflection of all matters discussed.

Key audit matters were addressed in the context of our audit of the financial statements as a whole and, in forming our opinion thereon, we do not provide a separate opinion on these matters.

Organizational changes including separation

Key audit matter	In 2016, the organization of the company changed significantly due to the separation from Royal Philips and then to the Initial Public Offering of the company's shares in May 2016. We assess that, as a result of the organizational changes, there is an increased risk in relation to execution of internal controls and the proper accounting of the separation. This includes the impact of potential local tax consequences and the completeness and measurement of transaction costs, such as expenses and potential settlements or disputes with Royal Philips based upon indemnifications and guarantees. In addition, the technological transition of the lighting industry from conventional lighting technologies to LED lighting technologies impacts the structure of the company and the valuation of assets and liabilities involved. We recognize that, due to the wind-down of the organization in respect to conventional lighting technologies, there is a risk that related charges for restructuring and impairment of assets are not recognized properly or timely. Further reference is made to notes 1 and 21 to the consolidated financial statements.
Our audit approach	Our audit procedures included, amongst others, discussions with management to understand the separation process, the separation principles applied, and the separation's impact on the company's assets, liabilities and equity. Furthermore, we tested the relevant internal controls of the company and assessed the appropriateness of the accounting of the separation and the related transaction costs using supporting documentation such as the Master Separation Agreement and the underlying level service agreements. We have evaluated the indemnifications and guarantees based on the agreement with Royal Philips. With regard to the business transformation, we have inquired of key management to obtain a better understanding of the impact involved. We have assessed the relevant restructuring provisions, reviewed board minutes and the underlying business plans, and assessed whether the restructuring provisions are in accordance with IAS 37.

Valuation of goodwill

Key audit matter	At December 31, 2016, the total carrying value of goodwill amounted to € 1,899 million, representing 25% of total assets. Goodwill is allocated to Cash Generating Units (CGUs). For those CGUs, management is required to test the carrying value of goodwill annually, or more frequently if there is a triggering event for testing, for impairment. We focused on this area given the significant judgement and complexity of valuation methodologies used to determine the appropriateness of the carrying value of goodwill. This includes the determination of the CGUs used to assess goodwill for impairment, the allocation of goodwill to CGUs, and the assumptions used in the valuation model to support the recoverable amount of goodwill as disclosed in note 15.
Our audit approach	As part of our audit, we assessed and tested the assumptions, methodologies, and data used by the company in their valuation model, by comparing them to external data such as expected inflation rates, discount rates and implied growth. Additionally, we validated that the cash flow projections used in the valuation are consistent with the approved strategic plans and have evaluated the historical accuracy of management's estimates that drive the assessment, such as expected growth rates. We performed sensitivity analyses by stress testing key assumptions in the model to determine the degree to which these assumptions would need to change before an impairment charge is triggered. We included in our team a valuation expert to assist us in these audit activities. Our main focus was on the CGU Professional as this represented the majority of the goodwill balance of the group as of December 31, 2016. In addition and as disclosed in note 15, the headroom, being the difference between the carrying amount and the recoverable amount, for the CGU Professional is EUR 50 million (2%). We have also tested the effectiveness of the company's internal controls around the valuation of goodwill. We assessed the adequacy of the company's disclosure around goodwill as included in note 15 to the consolidated financial statements as well as the company's policies that are more critical in nature as included in note 2 to the consolidated financial statements.

Taxes - Valuation of deferred tax assets and liabilities for uncertain tax positions

Key audit matter	The accounting for deferred tax assets and tax risk liabilities were significant to our audit since the company has extensive international operations, makes judgements and estimates in relation to the realization of deferred tax assets, and has tax risks resulting in the recognition of other tax liabilities. In addition to the assessment of the realization of deferred tax assets and recognition of tax liabilities in the normal course of business, the recognition and valuation of the deferred tax assets and liabilities is also impacted by the separation. At December 31, 2016, the net deferred tax assets are valued at € 472 million and the other tax liability related to tax uncertainties is valued at € 112 million. Further reference is made to note 10 to the consolidated financial statements.
Our audit approach	With the involvement of our tax experts we evaluated the tax accounting in various jurisdictions in which the company operates, taking into account the impact of the local tax jurisdiction and including effects resulting from the separation. With regard to deferred tax assets, we tested management's assumptions used to determine the probability that deferred tax assets recognized in the balance sheet will be recovered. This is based upon forecasted taxable income in the countries where the deferred tax assets originated and the periods when the deferred tax assets can be utilized. These forecasts were evaluated by us and we assessed the historical accuracy of management's assumptions. We evaluated and challenged the company's judgements in respect to estimates of tax exposures in consideration of ongoing local tax authority audits, legislative developments, and relevant historical and recent judgements. We tested the company's internal controls around the recording and continuous re-assessment of the deferred tax assets and tax risk liabilities. Where possible, we compared information provided by management to corroborative or contradictory information. We also assessed the adequacy of the company's disclosure included in note 10 in respect to deferred tax assets and other tax liabilities related to tax uncertainties.

Improper revenue recognition and risk of management override

Key audit matter	Sales are recognized when the risks and rewards of products have been transferred to the customer or when services have been rendered. Management focuses on sales as a key performance measure which could create an incentive for sales to be recognized before the risks and rewards have been transferred due to the pressure management may feel to achieve planned results. Further reference is made to note 2 to the consolidated financial statements.
Our audit approach	Our audit procedures included the assessment of the appropriateness of the company's revenue recognition accounting policies and the compliance with EU-IFRS. We tested the effectiveness of the company's controls over revenue recognition and the correct timing thereof. We assessed whether there is a risk that sales may be overstated as a result of management override, particularly in relation to contracts with specific terms. We assessed sales transactions taking place before and after year-end to ensure the existence of revenue and that it is recognized in the correct period. We also assessed the adequacy of the sales disclosures contained in note 3, information by sector and main country, and note 5, Income from operations.

Initial audit engagement

Key audit matter	There are additional considerations involved in performing initial audit engagements. Additional planning activities and considerations are required to establish an appropriate audit strategy and audit plan.
Our audit approach	After being appointed as the company's auditor effective 2016, we developed a comprehensive transition plan, which included specific planning activities, to ensure an effective transition from the predecessor auditor. The specific planning activities included, but were not limited to, obtaining an initial understanding of the Company and its business, including background information, strategy, business risks, IT landscape, and its financial reporting and internal controls framework, to assist us in performing our risk assessment procedures. We assessed the opening balances and the selection and consistent application of accounting policies by discussing the audit with the predecessor auditor and reviewing the predecessor auditor's file. Furthermore, in January 2016, we attended closing meetings related to the 2015 audit. The foregoing has been used as a basis for our 2016 audit plan. We discussed and agreed our 2016 audit plan with the Audit Committee and the Board of Management of Philips Lighting N.V. in July 2016 and have provided status updates, progress reports, and key findings from our audit process on a regular basis.

Report on other information included in the annual report

In addition to the financial statements and our auditor's report thereon, the annual report contains other information that consists of:

- The management board's report
- Other information pursuant to Part 9 of Book 2 of the Dutch Civil Code
- Sustainability statements
- Corporate Governance report

Based on the following procedures performed, we conclude that the other information:

- is consistent with the financial statements and does not contain material misstatements
- contains the information as required by Part 9 of Book 2 of the Dutch Civil Code

We have read the other information. Based on our knowledge and understanding obtained through our audit of the financial statements or otherwise, we have considered whether the other information contains material misstatements. By performing these procedures, we comply with the requirements of Part 9 of Book 2 of the Dutch Civil Code and the Dutch Standard 720. The scope of the procedures performed is less than the scope of those performed in our audit of the financial statements.

Management is responsible for the preparation of the other information, including the management board's report in accordance with Part 9 of Book 2 of the Dutch Civil Code and other information pursuant to Part 9 of Book 2 of the Dutch Civil Code.

Report on other legal and regulatory requirements

Engagement

We were appointed as the auditor of the majority shareholder by the general meeting of shareholders in May 2015 as of the audit for the year 2016. We were engaged by the Supervisory Board as the auditor of Philips Lighting N.V. on July 15, 2016 for the audit of 2016 and have operated as statutory auditor since that date.

Description of responsibilities for the financial statements

Responsibilities of the Board of Management and the Supervisory Board for the financial statements

The Board of Management is responsible for the preparation and fair presentation of the financial statements in accordance with EU-IFRS and Part 9 of Book 2 of the Dutch Civil Code. Furthermore, the Board of Management is responsible for such internal control as the Board of Management determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

As part of the preparation of the financial statements, the Board of Management is responsible for assessing the company's ability to continue as a going concern. Based on the financial reporting frameworks mentioned, the Board of Management should prepare the financial statements using the going concern basis of accounting unless the Board of Management either intends to liquidate the company or to cease operations, or has no realistic alternative but to do so. The Board of Management should disclose events and circumstances that may cast significant doubt on the company's ability to continue as a going concern in the financial statements.

The Supervisory Board is responsible for overseeing the company's financial reporting process.

Our responsibilities for the audit of the financial statements

Our objective is to plan and perform the audit assignment in a manner that allows us to obtain sufficient and appropriate audit evidence for our opinion.

Our audit has been performed with a high, but not absolute, level of assurance, which means we may not have detected all material errors and fraud.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements. The materiality affects the nature, timing and extent of our audit procedures and the evaluation of the effect of identified misstatements on our opinion.

We have exercised professional judgment and have maintained professional skepticism throughout the audit, in accordance with Dutch Standards on Auditing, ethical requirements and independence requirements. Our audit included:

- Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, designing and performing audit procedures responsive to those risks, and obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;

- Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control;
- Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management;
- Concluding on the appropriateness of management's use of the going concern basis of accounting, and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause a company to cease to continue as a going concern;
- Evaluating the overall presentation, structure and content of the financial statements, including the disclosures;
- Evaluating whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Because we are ultimately responsible for the opinion, we are also responsible for directing, supervising and performing the group audit. In this respect we have determined the nature and extent of the audit procedures to be carried out for group entities. Depending on the size and/or the risk profile, the organisation of the group and the effectiveness of group-wide controls, changes in the business environment, and other relevant factors, we selected group entities for which an audit or review had to be carried out on the complete set of financial information or specific items.

We communicate with the Supervisory Board regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant findings in internal control that we identify during our audit.

We provide the Supervisory Board with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Supervisory Board, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, not communicating the matter is in the public interest.

Amsterdam, The Netherlands
February 21, 2017

Ernst & Young Accountants LLP

O.E.D. Jonker

16. Sustainability statements

16.1 Approach to sustainability reporting

Sustainability is central to our company vision, strategy and purpose. This integrated financial, social and environmental report marks our first year of reporting as Philips Lighting, building on eight years of integrated reporting as an operating company within Royal Philips.

As part of our continuing commitment to the United Nations Sustainable Development Goals (SDGs), we report on our progress towards the following SDGs: 7 - Affordable and clean energy; 11 – Sustainable cities and communities; 12 – Responsible consumption and production; and 13 – Climate action. These SDGs link directly to our vision to create brighter lives and a better world.

Our external auditor Ernst & Young Accountants LLP (EY) has not only audited our financial information but has also provided reasonable (highest level) assurance on our sustainability performance and sustainability statements in this Integrated Annual Report. EY's independent assurance report can be found in section 16.4, Independent Assurance Report, of this Annual Report. With this, Philips Lighting is a frontrunner in this field.

16.1.1 Stakeholder engagement

Through dialogue with key stakeholders, we have gained significant insights into how to create value and anticipate risks. Accordingly, we are better equipped to understand society's needs and translate them into our company strategy and goals. Working closely with key stakeholders strengthens our ability to address their needs and concerns within the context of our organization.

Stakeholders considered most relevant to our success include customers, employees, suppliers, investors, governments, and society. In addition to our strategic conversations with these stakeholders, we hold memberships and are active in many organizations including the Carbon Disclosure Project (CDP), the Ellen MacArthur Foundation, the World Economic Forum (WEF), the Electronic Industry Citizenship Coalition (EICC), the World Business Council for Sustainable Development (WBCSD), and the European Partnership for Responsible Minerals (EPRM). For more information on the work we perform with stakeholders, refer to sub-section 16.2.9 Working with stakeholders, of this Annual Report.

Philips Lighting
Stakeholder overview (non-exhaustive)

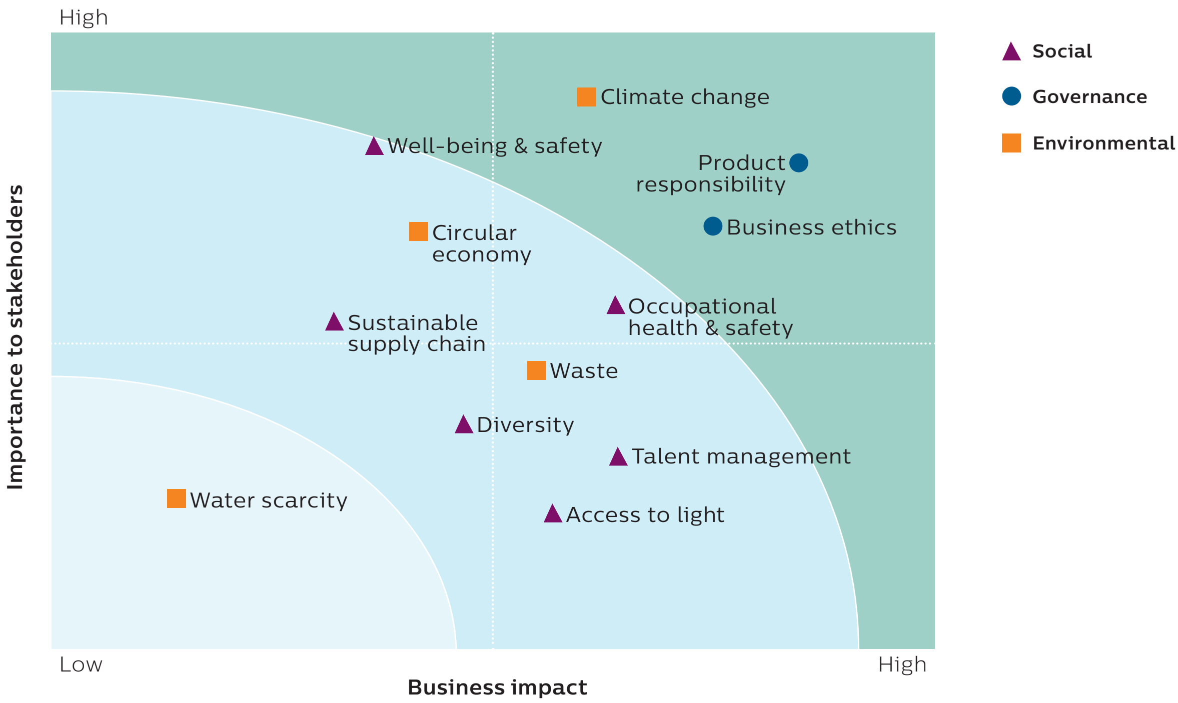
Stakeholder group	Processes through which we engage with our stakeholders	Exemplary topics discussed
Customers	Joint (research) projects, business development, lean value chain projects, consumer panels, net promoter scores, training centers, social media, customer surveys, key account management (several times per week)	(Sustainable) revenues- and innovation Satisfaction rates ESG performance
Employees	Regular meetings, quarterly My Accelerate! surveys, bi-annual employee development process, quarterly update webinars	Strategic alignment sessions Training & development Engagement
Investors	Roadshows, investor conferences, Capital Markets Day, investor relations email address, investor surveys	Strategic alignment sessions ESG performance
Suppliers	Supplier development and quality activities (including topical training sessions) (4 times per week), supplier forums, industry working groups like EPRM and EICC (4 times per year), and the commodity management, supplier quality and procurement engineering functions	Sustainability performance Peer learning
Governments, municipalities	Issues meetings, annual innovation experience, research projects, policy and legislative developments, business development	Sustainable cities Sustainable innovation
Civil society	Partnerships with NGOs (several times per week), cross-sector (multi-stakeholder) projects, our social investment program, and the Philips Foundation	Access to light Sustainable operations Sustainable revenues

16.1.2 Material topics and our focus

Through various channels and stakeholder interactions, we identify the environmental, social and governance (ESG) topics most relevant to our business. We use a materiality assessment to take informed decisions. We define materiality along two axes. The horizontal axis captures the significance of each topic in terms of its business impact on our company, both positive and negative. The vertical axis captures the importance of each topic for external stakeholders and how these topics may influence their opinions and decision-making. Assessing both aspects enables us to prioritize and focus on the most relevant issues.

The materiality assessment process uses many sources of information. These include media-search, trend analyses, and structured and unstructured stakeholder dialogues. For example, in 2016, Philips Lighting asked a diverse group of external stakeholders to rank a comprehensive list of topics relevant to them and our organization. After compiling their responses, we organized workshops where the results were shared with stakeholders to foster ongoing discussion. The results are reflected on the vertical axis of the materiality matrix. The scores on the horizontal axis are based on Philips Lighting's own assessment, for which a large group of diverse internal stakeholders were consulted and interviewed. Our materiality assessment was conducted in line with the GRI Standards Reporting Framework.

Materiality matrix



Philips Lighting
Key material topics

	Reference	Boundary
Environmental		
Climate change	section 3.2 Sustainability, sub-section 16.3.1 Sustainable revenues, sub-section 16.3.2 Sustainable innovation, sub-section 16.3.3 Carbon footprint and energy, sub-section 16.2.7 Supply chain sustainability, of this Annual Report	Supply chain, own operations, use phase
Circular economy	sub-section 16.3.1 Sustainable revenues, sub-section 16.3.2 Sustainable innovation, of this Annual Report	Own operations, use phase
Waste	sub-section 16.3.4 Waste, of this Annual Report	Supply chain, own operations
Water scarcity	sub-section 16.3.6 Water, of this Annual Report	Supply chain, own operations

	Reference	Boundary
Social		
Access to light	sub-section 16.2.8 Access to Light, of this Annual Report	Use phase
Diversity	sub-section 16.2.3 Diversity & inclusion, of this Annual Report	Own operations
Health & Safety	sub-section 16.2.5 Safe and healthy workplace, sub-section 16.2.7 Supply chain sustainability, of this Annual Report	Supply chain, own operations
Well-being & Safety	sub-section 16.2.5 Safe and healthy workplace, sub-section 16.3.1 Sustainable revenues, sub-section 16.3.2 Sustainable innovation, of this Annual Report	Use phase
Talent management	sub-section 16.2.2 Employee engagement, sub-section 16.2.4 Leadership & development, of this Annual Report	Own operations
Sustainable supply chain	sub-section 16.2.7 Supply chain sustainability, of this Annual Report	Supply chain

	Reference	Boundary
Governance		
Product responsibility	sub-section 16.3.1 Sustainable revenues, of this Annual Report	Use phase
Business ethics	section 12.1 Our approach to risk management and business control, sub-section 16.2.6 General Business Principles, of this Annual Report	Own operations

This materiality analysis shows how our world is changing. Key global megatrends, such as population growth, increasing urbanization, resource challenges, climate change and digitalization lead to many interrelated material topics that we prioritize in our strategy and business. We work to address these topics and move towards a more sustainable future by taking a leading role in creating brighter lives and a better world. In the sections that follow we explain how we manage these social and environmental material topics in our operations, supply chain and products.

16.1.3 Sustainability governance

The Sustainability function, including Environment, Health & Safety, headed by Nicola Kimm, consists of global, regional and local sustainability professionals and falls under the responsibility of the Chief Strategy & Marketing Officer, Bill Bien. Progress is reviewed on a quarterly basis by senior management and the Board of Management. During these meetings progress on strategic programs is reviewed and corrective actions taken when necessary. Progress is also reviewed with the Supervisory Board on an annual basis. In addition, the results of our Sustainability programs are communicated on a quarterly basis to all Philips Lighting employees.

Sustainability programs are embedded in the Philips Lighting organization and ways of working. Examples of departments that include sustainability programs are innovation, manufacturing, sourcing, and logistics. Targets on sustainability are set both at a corporate level and at a Business Groups level.

16.1.4 Program targets

Our sustainability commitments are grouped under our sustainability program ‘Brighter Lives, Better World’, launched in September 2016. Targets of this program have been set for a five-year period, ending in 2020. Change regarding targets, policies, definitions or scope are specified annually. As this is the first time that Philips Lighting has set sustainability targets as a standalone company, there are no changes in targets, policies, definitions or scope to be reported in 2016.

Philips Lighting
Program targets
2016

Program	Baseline	Target 2020
Sustainable revenues	N/A	80% of revenues
LED lamps	2015	>2 billion LED lamps delivered cumulatively
Operational carbon footprint	N/A	Net 0 kt CO_2 emissions
Electricity	N/A	100% of electricity from renewable sources
Waste to landfill	N/A	100% of our manufacturing sites report zero waste to landfill
Health & Safety	2015	50% reduction in total recordable injury rate
Sustainable Supply Chain	N/A	100% of risk suppliers audited, minimum performance rate of 90%

16.1.5 Reporting standards

For this report, we have applied the Global Reporting Initiative (GRI) Standards.
The sustainability information in this report is presented in accordance with the GRI Standards comprehensive option. A detailed overview of the GRI Comprehensive Indicators can be found in the GRI content index on our Sustainability webpage http://www.lighting.philips.com/main/company/about/sustainability/downloads.html.

As part of Royal Philips, Philips Lighting committed to the United Nations Global Compact in March 2007 to advance 10 universal principles in the areas of human rights, labor, the environment, and anti-corruption efforts. This report also serves as our annual Communication on Progress (COP) towards abiding by these principles.

16.1.6 Data definitions, boundaries, and scope

Two billion LED lamps

The societal costs of avoided carbon emissions from using our LED lamps and the resulting reduced electricity consumption is based on market intelligence, expert opinion and statistical data. The emission factors set for consumed electricity are based on the IEA 2015 publication. The societal cost for an avoided tonne of CO_2 is estimated at EUR 100 across regions. The figures reported are Philips Lighting's best estimate. There is an inherent uncertainty in our calculations due to the estimations. As our insight increases, we may enhance the calculation methodology in the future.

Employee data

Social data covers all employees, including temporary employees, but excludes interns, and employees on long-term sick leave. The Net Promoter Score (NPS) is calculated through a weighted average.

Environmental data

Environmental data from manufacturing operations are reported quarterly or half-yearly, according to defined company guidelines that include definitions, procedures and calculation methods. A robust system of internal controls has been implemented to ensure consistent data quality. The results are tracked and internally reported to measure progress against our program targets.

Data on operational energy usage includes energy use from manufacturing sites and non-industrial sites and excludes transmission losses to the grid.

Health & Safety

Health & Safety data is reported by sites with more than 50 FTEs (full-time equivalents) and is voluntary for sites with fewer employees. Health & Safety data are reported and validated on a monthly basis. The focus of reporting is on work-related injuries and illnesses that predominantly occur in manufacturing operations and lead to a recordable injury case. Recordable cases include all injuries and illnesses sustained at work that result in medical treatment, restricted work, lost work days, or fatality. Fatalities are reported for staff, contractors and visitors.

General Business Principles

Alleged General Business Principles' violations are registered via our intranet-based reporting and validation tool. Our ethics hotline is available to all employees and outside parties, allowing complaints to be registered by telephone or through an online web form. In addition, local compliance officers are available globally, to register complaints on behalf of employees.

Operational carbon footprint

Philips Lighting reports in line with the Greenhouse Gas Protocol (GHGP). The GHGP distinguishes three scopes of carbon emissions. The market-based method of reporting is used as a reference for calculating our total operational carbon footprint.

- Scope 1 – direct CO_2 emissions – is reported with direct emissions from our industrial and non-industrial sites in full.

- Scope 2 – indirect CO_2 emissions – is reported with indirect emissions from our industrial and non-industrial sites in full.
- Scope 3 – other CO_2 emissions related to activities not owned or controlled by Philips Lighting is reported for business travel and distribution activities.

The operational carbon footprint (scope 1, 2 and 3) is calculated internally on a quarterly basis and includes emissions from:
- industrial sites – manufacturing and assembly sites
- non-industrial sites – offices, warehouses, IT centers and R&D facilities
- business travel – lease and rental cars and airplane travel
- logistics – air, ocean and road transport.

Sustainable supply chain
Supplier audits focus on risk suppliers, based on identified risk countries
- Based on the Verisk Maplecroft Human Rights Risk Index, risk countries for supply chain management in 2016 were: China, India, Philippines, Indonesia, Mexico, Brazil, Russia and Belarus. This year, as in previous years, the majority of the audits were implemented in China.
- Suppliers of new ventures are included to the extent that the integration process of these ventures has been finalized. Normative integration period is two years following closure of the new venture.

The CDP supply chain results are based on self-reporting from suppliers. This causes an inherent uncertainty of the accuracy of impacts from their emission reduction activities.

Sustainable innovation
Sustainable innovation comprises all R&D activities contributing to sustainable products, systems or services. This means all products, systems, or services that demonstrate a measurable positive impact in energy efficiency (10% or greater), and preferably also in one or more sustainable focal areas: Circularity, Weight & Materials, Packaging, Substances, Human Centric Lighting, Basic Needs or Access to Light. Sustainable innovation is calculated by multiplying the total R&D spend with percentages for sustainable innovation per Business Group. These percentages are assessed through the contribution of R&D projects to sustainable innovation and are calculated based on innovation budget. For this assessment, all innovation in LED related products and systems are considered as sustainable innovation due to the energy efficiency of this lighting technology.

Sustainable revenues
Sustainable revenues are measured per product category and tracked for each Business Group. Sustainable products, systems or services must demonstrate a measurable positive impact in energy efficiency (10% or greater), and preferably in one or more sustainable focal areas: Circularity, Weight & Materials, Packaging, Substances, Human Centric Lighting, Basic Needs or Access to Light. Sustainable products outperform reference products (predecessor product in the particular product family), or product-specific eco-requirements, or by being awarded with a recognized eco-performance label. The lifecycle approach is used to determine the environmental impact and improvement of our products over their total life cycle (from raw materials, manufacturing, packaging, transportation, product use, through to disposal).

Zero waste to landfill
To determine if a manufacturing site qualifies for the 'zero waste to landfill' status, only regular operational non-hazardous waste is considered. Zero waste to landfill is reported in two consecutive periods before a site reaches zero waste to landfill status. When more than 99.5% of the total operational waste generated at that site is diverted from landfill, a site is considered to qualify as 'zero waste to landfill'.

16.2 Social statements

Gordana Landen, CHRO Philips Lighting: "As a standalone company we have the remarkable opportunity to define our culture and embed our new purpose and values so we can continue to be the leader in our industry. In Philips Lighting we want to develop the industry's best talent and leaders by creating a continuous learning organization and an inclusive environment where we value diversity and reward performance. I am proud to be part of a company with such strong values aimed at responsible growth. This is how we will continue to lead in a competitive and evolving industry."

At Philips Lighting, we provide an empowering workplace where people are passionate about taking light beyond illumination. The separation of our company and new standalone status provides an opportunity to define who we are as an organization. By defining our company purpose and values we provide our people with a common direction about why we exist, what we value, and how we work. We determined our values by engaging people from across our organization. We also used input from customers and other stakeholders to gain further insight and jointly define our purpose and values.

At Philips Lighting, we put the Customer First. We will always be Greater Together by collaborating across teams to build on our strengths and diversity, and work towards our shared goal. We want to be a Game Changer, by innovating to set ourselves apart and continue to lead in the market. And we have Passion For Results by working smarter and faster to deliver excellence.

16.2.1 Employment

The total number of Philips Lighting employees was 34,256 at the end of 2016, compared to 37,399 at the end of 2015. Approximately 66% of our employees were employed by one of our four segments, focusing on manufacturing and research & development: 14,349 of those are allocated to direct labor; 22% are employed in one of our markets, focusing on sales & marketing. The remaining 12% work in corporate functions. Compared to 2015, the number of employees decreased by 3,143. This reduction is primarily related to our industrial footprint.

Philips Lighting
Employees
2014-2016

	2014	2015	2016
Philips Lighting total	41,635	37,399	34,256

In 2017, the number of employees is expected to be below the levels of 2016. In 2016, employee turnover amounted to 20% (of which 13% was voluntary) which is similar to 2015.

Philips Lighting
Employee turn-over %
in 2016

	Staff	Professional	Management	Executives	Total
Involuntary turnover	9%	5%	4%	2%	7%
Voluntary turnover	18%	7%	6%	4%	13%
Of which regretted	1%	3%	2%	1%	1%

Top sources of talent

Our approach to talent is to build and develop employees' skills continuously, while attracting new talent where critical capabilities need to be strengthened for us to achieve our strategic objectives. In 2016, our global Talent Acquisition team recruited talent internally and externally, which involved more than 4,000 people. As in previous years, around one-third of those vacancies were filled with internal candidates, and the remainder filled with qualified external talent.

A strong global employer brand with local relevance in the digital age

At Philips Lighting we know it is crucial to attract the best talent in order to deliver on our strategic goals. In 2016, we strengthened our global employer brand by developing and launching a new Employee Value Proposition. We focused our strategic recruitment marketing investments on the most critical talent segments, to drive our transformation and growth. For example, we launched a digital employer brand campaign that raised awareness and generated preference for us as an employer among innovation, marketing, and sales & services professionals. The campaign is running across key social and digital media channels globally.

As part of our global talent acquisition strategy, we seek to attract talent from proven high-quality sources. In 2016, the top sources of hire were:

- **Employee referral** – Historical data has shown that our top-performing hires are those referred by our own employees. We encourage our employees to share their network through a formal employee referral program, which generates close to 30% of our total hires each year.
- **Internal hire** - We fill more than 30% our vacancies with internal top performers each year.
- **Proactively sourced by recruiter** – Our dedicated in-house sourcing function focuses solely on building talent pipelines and requires all recruitment professionals to contribute to the proactive identification of passive industry talent.
- **Digital career channel (employee review sites, social media sites, online community groups, etc.)** – Channel-specific indicators included an increase of 9% in the Philips Talent Brand Index on LinkedIn, almost doubling the number of followers.
- **Philips Lighting careers website** – Our career website attracts talent by emphasizing our Employer Value Proposition through targeted information sharing and storytelling from

our employees and leadership teams.
The Philips global career website can be found at www.lighting.philips.com/main/careers.

16.2.2 Employee engagement

Employee engagement is key to our competitive performance and is at the heart of our vision, promoting the best place to work for people who share our passion. Engaged employees are emotionally committed to our company. They help us meet our business goals, and contribute to a dynamic, high performance workplace.
We can only offer an environment in which all our people thrive by maintaining dialogue with our employees in order 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 Lighting to grow, but help us to understand our employees' needs in depth and respond to these in turn.

Given that employee feedback and input is so critical, we actively track it via quarterly surveys with a set of targeted questions. In 2012 we implemented a team-focused quarterly survey called My Accelerate! Survey (MAS) with the 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 continue to run MAS on a quarterly basis to monitor engagement.

In 2016, we showed strong results in the area of communication. We undertook a series of surveys with our employees and came back with the following results: 84% of our employees responded favorably to the statement: "Communication in my team is open and honest". 84% were favorable to the statement: "In my team, discussions and decision-making are focused on issues that matter".

We also maintained a strong score on diversity and inclusion. 83% responded favorably to the statement: "In my team we encourage and promote diversity of backgrounds, talents and perspectives", while 84% responded favorably to the statement: "In my team good ideas are adopted regardless of who suggests them or where they come from". We have noted that we need to improve in effectiveness and recognition. Improvement initiatives to address these are driven at a team level via our Team Performance Dialogues, and we continue to drive progress on these questions during our Quarterly Performance Reviews.

To measure employee satisfaction, the NPS methodology was adopted with the introduction of MAS. Employees were asked to rank how likely it is that they would recommend our company as a great place to work. The scoring for this answer is based on a 0 to 10 scale. Those who respond with a score of 9 to 10 are called Promoters, and are considered likely to exhibit value-creating behaviors. Those who respond with a score of 0 to 6 are labeled Detractors, and they are believed to be less likely to exhibit the value-creating behaviors. Responses of 7 and 8 are labeled Passives, and their behavior falls in the middle of Promoters and Detractors. The NPS is calculated by subtracting the percentage of employees who are Detractors from the percentage of employees who are Promoters. The NPS can be as low as –100 (everybody is a detractor) or as high as +100 (everybody is a promoter). An NPS that is positive (i.e. higher than zero) is felt to be good, and an NPS of +50 is excellent. In 2016, MAS had an average employee response rate of more than 75% across all four quarters, and we recorded an overall NPS score of 8 across the Philips Lighting population. This exceeded our target by 60% set at the beginning of the year (target: 5).

In 2017 we will launch the Team Survey that will replace MAS. The Team Survey will follow the same quarterly frequency with continued focus on the team performance dialogue. The survey will also enable us to track the adoption of our new values and will contain an adjusted set of questions.

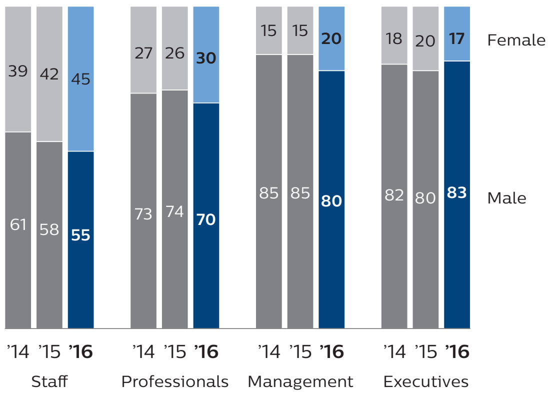
16.2.3 Diversity & Inclusion

At Philips Lighting we believe in building a diverse and inclusive workplace. This means we celebrate and foster an environment in which all 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 Lighting's success.

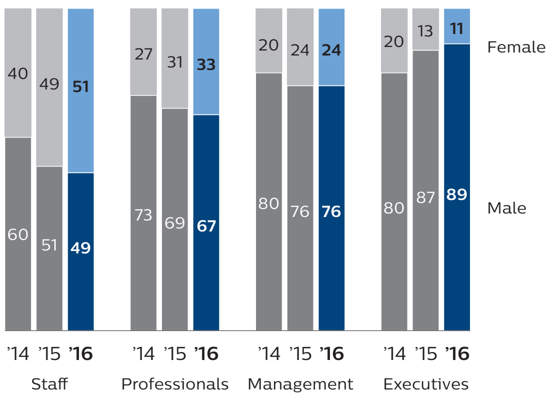
Philips Lighting is a global company, embracing a global mindset and actively promoting and building capability in this area. Our executives originate from more than 20 countries, reflecting our global focus and footprint.

We continually monitor our gender diversity numbers and have maintained a healthy balance of 18-20% females in our executive population over the past three years. In 2016, 17.4% of executives across the company were female.
We maintain a healthy pipeline of female talent at approximately 35% of our overall employee population. Overall, 38% of Philips Lighting employees in 2016 were female.

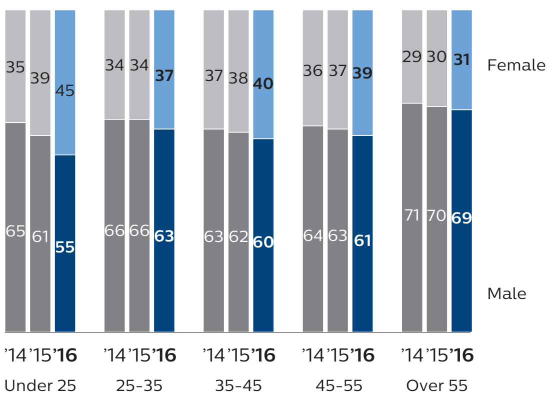
Philips Lighting
Gender diversity in %
2014 - 2016



Philips Lighting
New hire diversity in %
2014 - 2016



Philips Lighting
Employees per age category in %
2014 - 2016



Our approach to succession planning for executives and other key positions ensures we drive rigorous development and career planning for all identified successors and other top talent. We aim to build an inclusive work environment and to continuously improve our capabilities for the future success of Philips Lighting.

Equal remuneration
Philips Lighting pursues an active equal opportunity policy throughout the organization. Our General Business Principles explicitly condemn all forms of discrimination based on race, color, age, gender, gender identity or expression, sexual orientation, language, religion, political or other opinions, disability, national or social origin or birth. The principle of equal pay for work of equal value is applied in all countries in which Philips Lighting operates.

16.2.4 Leadership & Development

We consider continuous development as key in the lives and careers of our employees – whether within their current jobs or as preparation for their next step. By nurturing a learning culture, we enable employees to embrace change and unlock their potential. Twice a year, we pay special attention to our progress as we reflect on our performance and think about our careers. In 2016, the Philips Lighting University launched several key learning opportunities for employees to build on these periods of reflection and development planning.

Our development methodology is built on the 70/20/10 philosophy, enabling learning on the job through challenging assignments on the job (70% of the time), providing coaching and mentoring through developmental relationships (20% of the time), and offering formally structured learning methods such as classroom teaching and online courses (10% of the time). To support our leadership & development methodology, the Philips Lighting University was launched in September 2014. It serves as our central Learning Management System through which classroom training and e-learning modules are made available to employees across regions.

Leadership development
In 2016 we launched a new development program, focused on accelerating the development of our first-level leaders in the following areas: understanding customer needs, developing broad relationships, fostering fresh ideas with considered risks, acting with urgency and providing feedback to drive effectiveness; mid-level leaders looked at understanding stakeholders, setting business priorities, building partnerships and entrepreneurial behavior for growth, empowering teams to work more lean and strengthen talent pipelines; while enterprise

leaders worked on building trust-based relationships, influencing across networks, agility for change and growth, fostering a culture of accountability and role model effective leadership.

Trainings and courses
To ensure our workforce is well equipped to perform and meet business requirements, each functional area has identified ‘fit for future’ competency on which the respective area will focus. Through the award-winning Harvard Manage Mentor leadership suite, employees also have access to 39 individual modules on personal development, business and management skills. In 2016, more than 2,000 training courses were offered through the Philips Lighting University. In addition, our employees have access to GetAbstract, one of the largest libraries of business book summaries, as well as summaries of talks and economic reports. Through this extensive database of compressed knowledge, employees are able to download the latest business literature to their laptops, smartphones or tablets.

Our dedication to always acting with integrity is supported through our training and development programs and all employees are required to complete a mandatory course to ensure awareness of and compliance with the content of our General Business Principles.

We continued to partner with online e-learning providers to complement the curriculum of critical programs. In 2016 more than 93.000 e-learnings were booked through the Lighting University, and more than 28,000 classroom trainings got scheduled.

16.2.5 Safe and healthy workplace

Health & Safety performance
Since our founding in 1891, we have prioritized the health and wellbeing of people involved with our activities, committing ourselves to provide a safe and healthy workplace for all. The Total Recordable Case (TRC) rate is the central lagging indicator through which we measure our overall safety performance. Targets for this indicator are set and managed at an overall company level, for the individual Business Groups and manufacturing sites.

We regret to report two fatalities in 2016. One of our sales officers passed away after a traffic accident in Pakistan. In India a contractor died due to injuries sustained at one of our factories. For both of these fatalities, a thorough investigation and root cause analyses were conducted. Corrective actions were implemented, including reminding our employees of safe driving rules and accelerating our injury prevention program to prevent such occurrences in the future. Before these awful accidents, Philips Lighting had been fatality free since July 2013.

In spite of these tragic events, it was encouraging to see the general improvement in safety performance. During 2016 fewer injuries and severity cases were recorded. Significant progress was also made in the new safety program which was initiated in 2015. The overall Health & Safety performance showed improvement in all regions. We recorded 156 TRC cases, a year-on-year improvement of 34% versus the 235 cases in 2015. The TRC rate decreased to 0.50 per 100 FTEs, compared with 0.66 in 2015. Twelve of our industrial units went through 2016 without any recordable injuries. One of our sites in Brazil has been injury free since mid-2013.

Philips Lighting
Recordable cases
2014-2016

	2014	2015	2016
Total recordable cases rate	0.77	0.66	0.50
Lost workday cases rate	0.37	0.34	0.22
Fatalities	–	–	2

Efforts continued to further reduce injury and illness rates by focusing on preventing injuries. The injury prevention framework was launched in 2015 and has continued its integration into the operational Lean manufacturing framework. 60% of our manufacturing sites have adopted the key elements of this new framework.

Management system
We have implemented a Health & Safety management system in accordance with the OHSAS-18001 standard at all manufacturing sites. In 2016, 66% of our reporting manufacturing sites were certified to OHSAS-18001. The remaining manufacturing sites have procedures in place which assure compliance with local regulations and Philips Lighting policies.

Health and wellbeing initiatives
Apart from our commitment to provide an injury-free workplace, we support our employees with their health and wellbeing. Through diverse initiatives managed by our country offices, our staff are enabled to proactively work on their vitality and personal health. Examples of initiatives which support active health management include:
- periodic health-checks
- discounts to health and sports centers
- free offerings of fresh fruits
- on-site availability of massage therapy and physiotherapy.

In addition, more of our office spaces are using the latest lighting technologies, which enable lumen outputs to follow the human circadian rhythm, enabling our employees to see, feel, and function better. Several of our locations also provide the ability for each employee to adjust the individual light settings in the workspace with their smartphones, ensuring the brightness and tone of our office lighting aligns with their energy patterns and needs.

16.2.6 General Business Principles

The General Business Principles (GBP) serve as our code of conduct, setting 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. For a description of GBP processes and policies, please refer to section 12.1, Our approach to risk management and business control, of this Annual Report.

In 2016, 164 GBP complaints were filed via the Philips Lighting Ethics Line and the GBP Compliance Officers. Compared with 2015 (135 complaints), this is an increase of 21%. This is a continuation of the upward trend reported since 2014, the year in which Royal Philips completely overhauled its GBP and deployed a related communication campaign. We believe this demonstrates that previous efforts to inform our employees via training sessions and encouraging them to speak up have paid off. In addition, we believe the increase in complaints is due to the split from Royal Philips and the consequential increase in corporate activities. Now that we are a standalone company, we are expecting a normalized level of reported concerns going forward.

Most commonly reported concerns

Treatment of employees

As in previous years, the most commonly reported type of concern related to the category 'Treatment of employees'. In 2016 there were 97 reports in this category. This represents 59% of the total number of concerns. Two subcategories, 'Respectful treatment' and 'Equal and fair treatment', make up 69% of the concerns related to 'Treatment of employees'. The 'Respectful treatment' category generally relates to concerns about verbal abuse, (sexual) harassment, and hostile work environments. 'Equal and fair treatment' primarily addresses favoritism, and matters of discrimination and unfair treatment in the workplace.

Business integrity

The second-most reported type of concern relates to Business Integrity, which makes up 29% of the total cases reported. This is slightly less than in 2015, when the percentage was 35%.

Philips Lighting
Breakdown of alleged violations GBP
2014-2016

	2014	2015	2016	% substantiated
Health & Safety	6	1	7	40%
Treatment of employees	61	63	97	23%
• Collective bargaining	-	-	2	-
• Equal and fair treatment	26	12	22	19%
• Employee development	-	-	3	67%
• Employee privacy	-	2	2	50%
• Employee relations	4	-	4	33%
• Respectful treatment	24	28	45	24%
• Remuneration	5	4	6	0%
• Right to organize	-	-	-	-
• Working hours	2	1	6	0%
• HR other	–	16	7	100%
Legal	7	14	5	50%
Business Integrity	37	48	47	59%
Supply management	1	3	3	100%
IT	1	2	2	0%
Other	6	4	3	0%
Total	**119**	**135**	**164**	**34%**

Substantiated/unsubstantiated concerns

Of the 164 cases reported in 2016, 40 are open, in particular those that were filed towards the end of the year, and the business integrity cases of a more complex nature. Of the 124 reports investigated, 42 were ultimately closed having been found to be substantiated, which represents 34% of the closed cases.

Of the reported concerns that were substantiated, i.e. concerns for which there was found to be a breach of our GBP, 26 were followed up with disciplinary measures varying from termination of employment and written warnings to training and coaching. In other cases, corrective action was taken, which varied from strengthening the business processes to increasing awareness of the expected standard of business conduct

16.2.7 Supply chain sustainability

The sustainability challenges that we address often require us to engage beyond our own operations. As Philips Lighting we have a direct business relationship with approximately 5,000 product and component suppliers and more than 10,000 service providers. Managing our supply chain in a responsible way requires a structured and innovative approach due to the wide variety of stakeholders. Insights gained through stakeholder engagement are used to develop our sustainable supply chain strategy. Our programs cover the assessment and development of supplier sustainability performance (audits and training), responsible minerals and carbon disclosure of our supply chain.

Supplier sustainability performance
The core of our supplier sustainability performance program is the Supplier Sustainability Declaration (SSD). This declaration forms an integral part of our supplier contracts. For further information go to www.philips.com/Lighting-SSD.

The SSD is derived from the Electronic Industry Citizenship Coalition (EICC) Code of Conduct and sets out the standards and behaviors we require from our suppliers and their suppliers. It covers labor, health & safety, environment, ethics and management systems. We monitor supplier compliance with the SSD through a system of regular audits. We provide training to support supplier development and capacity building. In the EICC Code of Conduct and in our SSD, special attention is given to the prevention of human slavery as referred to in the United Kingdom (UK) Modern Slavery Act Disclosures, and the California Transparency in Supply Chains Act. The formal statement on these legislations can be found on our website.

Three-year audit cycle
Full audits are performed in a three-year cycle by an independent audit firm. If non-conformities are identified, we require the supplier to draw up a corrective action plan. Our sustainability experts then support the supplier in correcting the non-conformities, for instance by providing training or sharing best practices. We monitor the execution of corrective action plans until the supplier is compliant with our requirements.

Philips Lighting
Summary of 2016 audit program (3 year cycle, 3rd party audit)
2016

	Greater China	Rest of the world	Americas	Europe	Total
Total amount of risk suppliers	**203**	**34**	**13**	**–**	**250**
Total no. of audits	83	12	8	–	103
Initial audits	25	4	3	–	32
Continued conformance audits	58	8	5	–	71
Workers employed at sites audited	59,449	1,547	8,384	–	69,380

In 2016 we audited 103 of our current risk suppliers, including 71 continued conformance audits with suppliers that were previously in the three-year cycle. The majority of the audits were done in China. Through these audits we have reached more than 69,000 workers employed at supplier production sites.

To limit the burden of audit preparation and follow-up at supplier sites, we share our audit results with other EICC members. This reduces the need for multiple audits and enables a stronger focus on corrective actions and follow up.

Implementing corrective actions
When an audit reveals areas of non-conformance, we request that suppliers implement corrective actions. Our sustainability experts and independent third-party auditors monitor the implementation of these actions during resolution audits. If we notice a delay in the implementation of a corrective action plan, we apply a stratified approach for consequence management. In cases where a supplier is unwilling to improve, we end the business relationship. We work with each supplier to resolve the non-conformities within 90 days where possible.

Results three-year audit cycle program
In 2016 the average audit score of our risk suppliers was 63 (2015: 65). Risk suppliers new to the audit program scored 51 (2015: 66). This lower score can be explained through the addition of new suppliers in India, who had not yet received sustainability training. Dedicated follow-up to close the non-conformities was carried out for the lower scoring suppliers. After implementing the corrective action plans, the average overall audit score in 2016 was 91 out of 100.

The supplier sustainability performance rate represents the percentage of risk suppliers with an audit score of at least 90 out of 100 points. In 2016 we achieved a supplier sustainability performance rate of 92% (2015: 90%).

The table shows the supplier sustainability performance and indicates the conformance level in the audits before suppliers have taken corrective actions. Four suppliers showed outstanding performance during the third party audit, without any non-conformities found.

Philips Lighting
Summary of 2016 audit findings, supplier compliance rate per category of SSD including top 10 non-conformities coverage of the Supplier Sustainability Declaration

Labor	Health & Safety	Environment	Ethics	General
Freely chosen employment 80-100%	Occupational safety 40-60%	Environmental permits and reporting 60-80%	Business integrity 60-80%	EICC code 80-100%
Child labor prohibition/ Young worker management 80-100%	Emergency preparedness 20-40%	Pollution prevention and resource reduction 80-100%	No improper advantage 80-100%	
Working hours 40-60%	Occupational injury and illness 60-80%	Chemical storage and waste 40-60%	Disclosure of information 80-100%	
Wages and benefits 40-60%	Industrial hygiene 40-60%	Wastewater and solid waste 80-100%	Protection of intellectual property 80-100%	
Humane treatment 80-100%	Physically demanding work 80-100%	Air and noise emissions 80-100%	Fair business, advertising and competition 80-100%	
Non-discrimination 80-100%	Machine safeguarding 80-100%	Product content restrictions 80-100%	Protection of identity 80-100%	
Freedom of association 80-100%	Food sanitation and housing 60-80%		Responsible sourcing of minerals 80-100%	
			Privacy 80-100%	
			Non-retaliation 80-100%	

The top 10 non-conformities are concentrated in six areas: working hours, wages and benefits, occupational safety, emergency preparedness, industrial hygiene and chemical storage & waste. Analysis shows that the type of top non-conformities is consistent over recent years, but that the overall percentage of top non-conformities is decreasing. Through root cause analysis we found most of the non-conformities are due to a lack of awareness and knowledge with supplier management and workers, emphasizing the importance of our supplier training program.

Additional audit efforts

In addition to the audits with current risk suppliers, we also audited three potential suppliers during the supplier selection process. Potential suppliers need to close any zero-tolerance issues and score at least 80 points before they can work with Philips Lighting.

In the continued conformance audits, we noticed that suppliers typically fall back to a low score again. Our aim is to have suppliers continuously scoring 90 points or more. For this reason, in 2016 we introduced an annual verification for the highest risk suppliers. Depending on the risk category this can either be an on-site audit performed by our sustainability experts or a self-assessment questionnaire. This year we performed 41 annual verifications. Our plan is to continue annual audits to ensure continued scoring at levels Philips Lighting requires from its supply base.

Supplier training and development

We provide classroom training sessions on the EICC Code of Conduct/SSD. Our sustainability experts perform these trainings, supported by training materials provided by the EICC.
To address emerging issues we also provide in-depth capability building programs for our suppliers on specific topics that are covered in the SSD. In 2016, we focused these extra trainings

on Health & Safety issues. We organized 15 training sessions which were attended by 104 suppliers globally, with a total 204 attendees.

Reducing water and air pollution levels in China

Philips Lighting worked with the Institute of Public & Environmental Affairs (IPE), a Chinese NGO, which publishes a map of Chinese factories linked to water and air pollution levels of concern. We periodically match our suppliers on this IPE map. When we discover that one of the mentioned factories is a Philips Lighting supplier, we engage with that company to implement corrective actions immediately. At the same time, we keep a close connection with IPE and invite third-party firms, certified by the IPE, to verify adequate resolution of the issues.

Responsible sourcing of minerals

Our commitment to sustainable development extends to issues further down in our supply chain, to prevent financing of conflict and human rights abuses in the extractives sector. Global supply chains in the lighting industry are long and complex, typically with more than seven tiers between the finished product and the source of raw materials used for manufacturing. However, we believe that through strong multi-stakeholder partnerships we can make a difference. For more information go to http://images.philips.com/is/content/PhilipsConsumer/PDFDownloads/Global/ODLI20160706_001-UPD-en_AA-Philips_Lighting_Position_on_Conflict_Minerals.pdf.

Conflict Minerals program

In the Conflict Minerals program, we implement measures in our supply chain to ensure that our products are not directly or indirectly funding atrocities in the Democratic Republic of Congo (DRC). Philips Lighting works towards the following goals:

- Eliminate all illicit minerals from the market by steering our supply chain towards sourcing from conflict-free validated smelters only, while working with all relevant industries to increase the number of audited smelters.
- Enable legitimate minerals from the region to enter global supply chains, thereby supporting the Congolese economy and the local communities that depend on these exports.

Philips Lighting does not directly source minerals from mines. Our supply chain for these metals consists of many tiers, including mines, traders, exporters, smelters, refiners, alloy producers and component manufacturers, before reaching our direct suppliers. We have committed to not purchase raw materials, sub-assemblies, or supplies which are found to contain conflict minerals. We support and follow the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High Risk Areas. The full description of our due diligence process is available at http://www.lighting.philips.com/main/company/about/suppliers/supplier-sustainability/our-programs/conflict-minerals.html.

Each year we invite our main suppliers, based on purchasing spend and metal usage, to fill in the latest version of the Conflict Minerals Template (CMRT). Our Conflict Minerals Support Center helps suppliers investigate their long and complex supply chains. We request our suppliers to adopt and implement a conflict-free minerals policy, to investigate their supply chain and share all smelter names used in their supply chains to produce the metals. Suppliers are also asked to cascade Philips Lighting's request to only source from smelters validated as conflict free.

We carefully review the information received via the CMRT from each supplier against our Philips Lighting requirements. We developed additional training materials to assist suppliers with improving their due diligence performance. After identifying the smelters in our supply chain, we publish our Philips Lighting Conflict Minerals Declaration, including our smelter list here: http://www.lighting.philips.com/main/company/about/suppliers/supplier-sustainability/our-programs/conflict-minerals.html. Each year we update the Philips Lighting smelter list with new information received from our suppliers.

This year we invited 183 priority suppliers to fill in the CMRT. We had a 100% supplier response and approved 97% of the CMRTs against the Philips Lighting requirements. We had a total amount of 293 smelters in our supply chain, of which 226 (77%) were validated smelters. The results of the Reasonable Country of Origin Inquiry (RCOI) can be found in the table below. The information for the RCOI is provided for by the CFSI (Conflict Free Sourcing Initiative).

Philips Lighting
Results of the RCOI (Reasonable Country of Origin Inquiry)
2016

	Gold	Tantalum	Tin	Tungsten	Total
Smelters known to source from the DRC and/or adjoining countries		29	5	5	39
Smelters known to process only recycled or scrap materials	11	1	3	1	16
Smelters known to source from outside the DRC or adjoining countries	4	12	56	33	105
Smelters that disclosed mineral country of origin to auditors only	66				66
Smelters with unknown minerals origin	39	4	18	6	67

We are an active member of the Conflict-Free Sourcing Initiative (CFSI) which runs the audit program to verify the smelters conflict-free status. For more information visit www.conflictfreesourcing.org. During 2016 significant progress was made in validating additional conflict-free smelters. Since the program's inception, we have actively directed our supply chain towards these smelters.

Philips Lighting is not listed in the United States and thus not bound to the Dodd-Frank Act to report on conflict minerals. Due to our responsible sourcing ambition, however, we disclose the results of our Conflict Minerals program.

European Partnership for Responsible Minerals
We are a partner of the European Partnership for Responsible Minerals (EPRM), a public-private partnership initiative which was launched on May 12, 2016. The EPRM provides a platform for cooperation between European governments, companies and civil society to address the issues occurring in the mining of minerals and to enable responsible sourcing from high risk and conflict regions. Another goal of EPRM is to promote dialogue, cross-sector learning and support for the implementation of due diligence mechanisms along the entire supply chain, with special attention to small- and medium-size enterprises. The EPRM will not only focus on conflict minerals, but also includes activities directed at responsible sourcing of other minerals, such as cobalt and mica.

Improving sustainability performance in our Chinese supply chain

Philips Lighting was invited by the Dutch Consulate in China to partner with seven other Dutch companies (including: Royal Philips, AkzoNobel, Heineken and Royal Dutch Airlines), to form the Shanghai branch of the Dutch Association of Investors for Sustainable Development.

With Jiangsu province as the host of the two-year program, the Dutch companies cooperated with other brands and suppliers helping them to enhance sustainability. Supported by training, the program focuses on hands-on practice to help companies improve their sustainability management systems, as well as business management. In 2015 and 2016, six of our suppliers located in the Jiangsu province joined the training program. They learned about new laws and regulations, shared best practices and discussed the challenges they face.

The purpose of the program is to help Dutch companies in China work on a sustainable business strategy and to develop sustainable management capability, by building a platform for cooperation among Dutch companies and their suppliers. The participants of the program are the Dutch Consulate, the Netherlands Business Support Office, the Jiangsu Federation of Industry and Commerce, the Dutch NGO Solidaridad and the China National Textile and Apparel Council.

Carbon disclosure
We believe that climate change and the growing need for energy consumption require innovative solutions and transformation in the behavior of companies and people. We contribute with energy-efficient products and our carbon neutral commitment for our own operations. In addition, we motivate our supply chain to reduce its carbon footprint. We proactively initiate, develop and support carbon emission reduction activities in the supply chain through our partnership with the CDP Supply Chain program.

This year we developed our stand-alone structure for the CDP Supply Chain program and defined our target for 2020: to have at least 250 strategic suppliers annually reporting on scope 1 & 2 emissions (direct and indirect greenhouse gas emissions), and 200 strategic suppliers annually reporting on emission reduction activities.

For this reporting year we worked with our suppliers to focus on basic disclosures of climate change strategy and policies, and disclosing scope 1 and scope 2 emissions. We supported them with webinar trainings and tools.
In cooperation with CDP we also developed and launched a reporting tool for suppliers to calculate CO_2 emissions. The tool is available in English and Chinese.

In total, our suppliers undertook 181 carbon emission-savings projects in 2016, with a total of 19 million tonnes CO_2 emissions saved, amounting to a monetary saving of EUR 750 million.

Philips Lighting
CDP reporters per region and topics reported
2016

	Greater China	Rest of the world	Europe	Americas	Total
Scope 1	62%	69%	71%	50%	64%
Scope 2	60%	62%	60%	56%	59%
Scope 1 & 2	56%	62%	60%	50%	57%
Have a reduction target	40%	69%	46%	39%	45%
Have on-going reduction activities	50%	77%	54%	56%	55%
Climate change opportunities	80%	85%	74%	72%	78%
Climate change risks	80%	85%	71%	61%	75%
Integrated climate change in business strategy	58%	62%	74%	56%	63%
Integrated climate change in risk management	42%	62%	51%	39%	47%
Total amount of reporters	**50**	**13**	**35**	**18**	**116**

16.2.8 Access to light
As a responsible company, we aim to use our expertise and knowledge of lighting to give back to the communities in which we operate.
The Lighting CSR strategy uses our ability to innovate, and fulfil lighting needs, in the various humanitarian and developmental environments we work in. By enabling access to education, health and sanitation, while at the same time enhancing safety and security, the value we add through our non-commercial activities is proof of our delivery of Light beyond Illumination.

Philips Lighting has identified four strategic pillars to bring focus to its CSR program across all the diverse markets and countries where it offers its services.

Lighting Lives
The Lighting Lives pillar aims to bring light to communities that are not connected to the grid or are underserved by the grid. Currently there are still 1.1 billion people in the world without access to electric light at night. The only light they have after sunset is from smoky fuels, candles, kerosene, wood or coal. All of these are expensive, some are unhealthy, and some are dangerous: each year about 1.5 million people who rely on kerosene lamps die in fires or from respiratory illnesses.

Inadequate access to light is also restricting economic growth and progress in communities and countries. The costs are incalculable, and the impact is felt across the board – socially, economically, and culturally. In short, the overall quality of people’s lives can be enhanced, often significantly, by enabling consistent access to light. Through our portfolio of energy efficient and solar powered LED lighting this pillar focuses on community lighting needs.

Bringing light to the Xinjiang region

The Xinjiang region is in critical need of public lighting, to make it safer and more navigable in the dark. Access to the gird is lacking, particularly in the rural areas of this province. This forces the population to rely on unsafe non-electric lighting, such as kerosene burners.

The local communities primarily consist of farmers and sheep and cattle breeders most of whom live beneath the poverty line. In partnership with CEPF, we installed 120 sets of solar LED street lights. As a result, the people in this area are now able to conduct outdoor activities at night. Local women and children also enjoy more security when they have to go out late at night or early in the morning.

Lighting entrepreneurs
This pillar helps communities build capacity to take ownership of lighting solutions, and offers technical training and support for the development of business skills. Lighting Lives can have a long-term impact only if the communities have the skills to operate and maintain the lighting installation provided. They are then able to take ownership, reducing their dependence on external agencies to manage the lighting installation in the longer term. In order to facilitate this knowledge transfer, Philips Lighting provides technical and business skills trainings and supports local entrepreneurs who may be able to use the excess solar energy generated. The ultimate aim is to providing solar-powered lighting solutions that will build sustainable technical and business capacities that will, in turn, empower communities.

Energy awareness
In the fight against climate change, it is essential to educate the next generation on the real value of energy efficiency, as well as on the risks we create by failing to take action. Advocating for energy efficiency can help foster awareness of the benefits that sustainable solutions such as solar-powered lighting can bring.

Philips Lighting is building grass-roots awareness of energy efficiency and conservation as a solution to climate change. By reaching out to a new generation and creating energy efficiency awareness in school curricula, in a fun and informative way, we seek to inspire the change-makers of the future.

Humanitarian lighting
Philips Lighting also offers material and logistical assistance to communities affected by humanitarian crises, focusing primarily on providing lighting infrastructure and expertise. When disasters strike, infrastructure systems are often severely compromised, meaning that access to crucial resources is limited.

Emergency lighting solutions enable humanitarian efforts to continue after nightfall, allowing those in need to receive supplies and medical care, while enabling the restoration of damaged infrastructure. Temporary solar-powered lighting can also reduce the strain on generators, allowing more energy to flow to other important services.

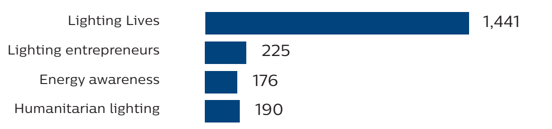
Shining a light on the Mansour Eddahbi secondary school

We teamed up with UNICEF and the Regional Academy for Training and Education, to renovate the Mansour Eddahbi secondary school in Marrakech, Morocco. As part of our ongoing commitment to support access to light across underserved communities, the goal of this project was to improve the learning environment of the students.

By installing LED luminaires and solar-powered LED technology in the school, students were provided with lighting that enhances their learning abilities, effectively extending their days. By reducing electricity consumption, the energy efficient lighting equipment will also mean lower energy bills for the school.

In 2016 more than 15 lighting projects have been approved to be implemented across the world, via local partner NGOs, supported and channeled through the Philips Foundation, established by Royal Philips in 2014.

Philips Lighting
Funding of different pillars in thousands of EUR
2016



16.2.9 Working with stakeholders

In 2016, several important events took place in the areas of sustainable development and climate change. At Philips Lighting we further expanded existing initiatives and partnerships. The events and conferences included the World Economic Forum in Davos, the second UN Environmental Assembly in Nairobi, the seventh Clean Energy Ministerial (CEM7) in San Francisco, Climate Week NYC in New York (CWNYC), UN Habitat III in Quito, and COP22, the UN Climate Change Conference in Marrakech.

Throughout these events we engaged with a variety of stakeholders emphasizing the environmental and socioeconomic benefits of energy efficiency and the potential of connected LED lighting.

At CEM7 we made the commitment to deliver two billion LED lamps and systems by 2020, as part of the Global Lighting Challenge (a global program aimed at supporting market penetration of 10 billion LEDs by 2020). Under new leadership of the UN's Sustainable Energy for All program, which covers Sustainable Development Goal 7 (affordable and clean energy), the Global Energy Efficiency Accelerator Platform was further expanded. The principle of 'Energy Efficiency First' was adopted, with the aim to at least double the rate of global energy efficiency.

At CWNYC we worked on the important subject of energy efficiency of buildings. Together with our partners The Climate Group, the World Green Building Council and Architecture 2030 we made a call for all new buildings to use LED lighting by 2020, and all new and existing buildings to be equipped with LED lighting by 2030.

Closer to the end of the year we participated in COP22 the UN Climate Change Conference in Marrakech. As a partner of the UNFCCC, we had a range of activities on energy efficiency and LED lighting, one of which was an event 'Boosting energy efficiency through smart lighting systems'. For more information go to http://newsroom.unfccc.int/climate-action/boosting-energy-efficiency-through-smart-lighting-systems/. During this event our CEO, Eric Rondolat, demonstrated how smart lighting systems are cutting greenhouse gas emissions and reducing energy costs. This included a live demonstration of how smart energy solutions work and how they make a difference on climate change.

16.3 Environmental statements

Since the 1970s we have focused on minimizing the environmental impact of our operations. This integrated report serves as our 18th annual update of the progress we have made in this area. At Philips Lighting we manage our environmental responsibility by setting ambitious targets, developing and implementing detailed plans and reporting on our progress. We continuously strive for excellence in environmental management. All our environmental policies and management framework are based on the international ISO-14001 standard. In 2016, 88% of our manufacturing sites were certified to ISO-14001.

16.3.1 Sustainable revenues

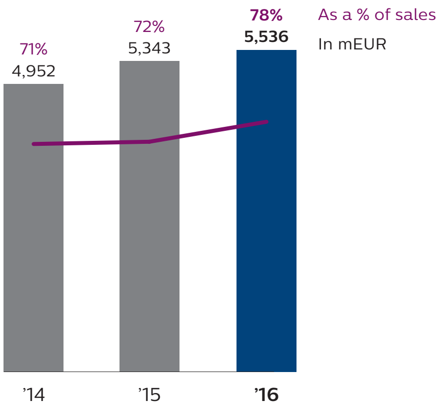
Sustainable revenues come from products, systems, and services that deliver environmental or social benefits by offering a significant improvement in energy efficiency (10% or greater) and an optional benefit in one or more of the following sustainable focal areas:

- packaging
- substances
- weight & materials
- circularity
- access to light
- basic needs
- human centric lighting.

The environmental performance is measured quantitatively through the lifecycle assessment approach.

Our sustainable revenues increased from EUR 5.3 billion (2015) to EUR 5.5 billion in 2016, or 78% of sales (72% in 2015) – a record level for Philips Lighting.

Philips Lighting
Sustainable revenues in mEUR
2014 - 2016



Partnering on LED lamps to create more sustainable cities

Philips Lighting partnered with the Dubai Municipality to create the Dubai Lamp Initiative, a unique research partnership that resulted in the development of the world's most energy-efficient commercially available LED lamp. By replacing conventional lamps with the Dubai Lamp – the first commercially available 200 lumen per watt LED lamp – households and enterprises can reduce electricity used for lighting by up to 90%.

In addition to raising light and energy efficiency to new levels, the Dubai Lamp is extremely durable, with an average lifespan of up to 15 times that of conventional lamps. Dubai is committed to becoming the world's most sustainable city and recognizes Philips Lighting's Dubai Lamp as its 'Best Government-Private Sector Initiative.'

Two billion LED lamps

Approximately 15% of the world's electricity is used for lighting. Through our digital LED technology, Philips Lighting offers light that is up to 80% more energy efficient, compared with conventional technologies, which are still commonly used. For this reason, we have pledged to deliver two billion LED light bulbs by 2020. Reaching this goal is estimated to save an amount of energy equivalent to that generated by 60 medium-sized coal-fired power stations (equivalent to emissions from 24 million cars) by 2020. Considering the environmental impact of avoided carbon emissions, our LED lamps sold thus far have saved 15,651 kilotonnes in CO_2 which equals EUR 1,565 million in societal costs.

Philips Lighting
LED lamps delivered in millions of units
2015-2016

	2015	2016	Total
LED lamps delivered	257	371	628

Product substances

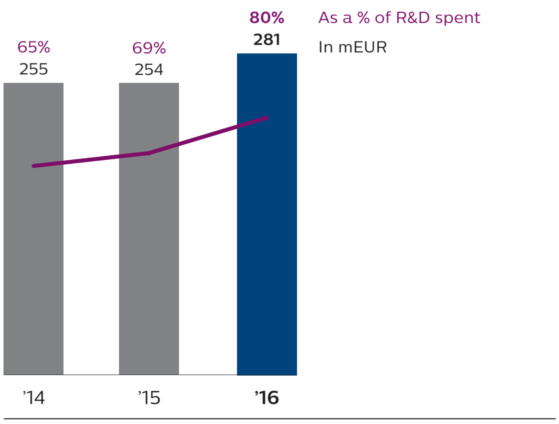
All our products and systems delivered to the EU and in countries where CE marking is required, are compliant with the RoHS Directive (2011/65/EU). Guided by precautionary principles, our philosophy is "prevention is better than cure". In case of threats of serious or irreversible harm to the environment and/or human health, the lack of scientific certainty should not be used as a reason for postponing cost-effective preventive measures. For this reason, we require all our suppliers to communicate all substances in their components and to comply with the stipulations that we have listed in our Regulated Substance List (RSL), which in many cases goes beyond legislation. In 2016, we continued to further roll out the publicly available BOM check tool to our suppliers, in which components and substances can be registered.

16.3.2 Sustainable innovation

Sustainable innovation encompasses our R&D spend related to the development of new generations of sustainable lighting technologies, products, systems and services. In 2016 we invested EUR 281 million in sustainable innovation mainly as a result of investments in LED technology and connected lighting. At Philips Lighting, our mission is to deliver Light Beyond Illumination to improve a customer's business, organization, and life.

With a 2016 investment of EUR 281 million in sustainable innovation, we invested a higher amount compared with 2015 (EUR 254 million). Increasing investments in digital lighting solutions, cloud computing and circular economy designs have led to further improvements in the areas of energy and material resource efficiency.

Philips Lighting
Sustainable innovation in mEUR
2014 - 2016



Circular economy

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

Lighting for a Circular Economy

Bruynzeel Storage Systems and Philips Lighting have entered into a partnership to install circular lighting in the nine-hall production facility in Panningen. The indoor lighting from Philips Lighting has been developed in accordance with the principles of the circular economy, and delivers warmer, more comfortable light, saving up to 73% energy consumption. Philips Lighting remains the owner of the lighting system and Bruynzeel is the user. This means that the products and the business model are based on circular economy principles.

“Over the coming years we will pay a fixed monthly fee for lighting. We do not have to worry about management and maintenance, we’ll benefit from innovations that occur in the meantime, and we will have maximum peace of mind.”

Bart Sijben, Operational Manager at Bruynzeel Storage.

The circular economy program at Philips Lighting ran for the fourth year in 2016 and consists of three strategic pillars:

1. engagement with external and internal stakeholders
2. innovation and the development of proof-points
3. embedding circular economy competences in our Philips Lighting processes.

Philips Lighting has a long-standing global partnership with the Ellen MacArthur Foundation. In addition, we have partnered with Circle Economy Netherlands, Turntoo, World Economic Forum and The Guardian.

In 2016 we stepped up our efforts to embed circular thinking into our business processes. Circular economy principles are deployed via training and circular competencies are built into the areas of design, business models, reversed logistics and collaboration. As the circular economy program touches many different business areas, including strategy, design, business development, marketing, and finance, we have prioritized establishment of the right processes and procedures to facilitate this approach throughout the company. In 2016, through our Philips Lighting Excellence Process Framework, our Sustainable Design process was extended with ‘Design-for-Circular-Economy’ design rules.

16.3.3 Carbon footprint and energy

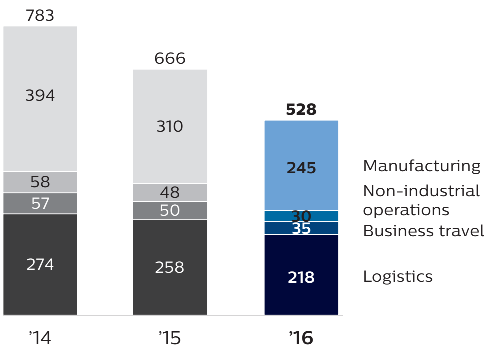
At Philips Lighting we have long focused on increasing the energy efficiency of our products and reducing energy use in our production processes. We acknowledge the findings of the Intergovernmental Panel on Climate Change (IPCC) and believe we have an important role to play in the transformation towards a low-carbon economy. In our Brighter Lives, Better World sustainability program, reduction of CO_2 emissions and energy use are central to our 2020 sustainability commitments. We are committed to becoming 100% carbon neutral in our operations and sourcing only renewable electricity by 2020. Through substantial efforts in various departments, we intend to continue our carbon reduction efforts to make our operational footprint carbon neutral. This consists of manufacturing, non-industrial operations, logistics, and business travel.

In 2016 CO_2 reductions of 21% were achieved year-on-year, resulting in a total of 528 kilotonnes in CO_2 emissions. In addition, through our partnership with the South Pole Group, we initiated several strategic projects that target forest conservation and increased availability of renewable electricity through small-scale hydro plants in China and bio-gas recovery in Thailand. With these projects, we reduced CO_2 emissions to the atmosphere by 122 kilotonnes, thereby offsetting 23% of our own emissions, resulting in a net carbon footprint of 406 kilotonnes.

Reducing carbon emissions through forest conservation

The forest conservation project provides sustainable livelihood opportunities for poor communities in Northern Zimbabwe, a region suffering heavily from deforestation, poverty and drought. With this project, we were able to reduce deforestation and forest degradation through a range of activities, such as conservation farming. For more information on this project, as well as the other projects we work on with South Pole Group, go to www.thesouthpolegroup.com/philipslighting

Philips Lighting
Operational carbon footprint in kilotonnes CO_2-equivalent
2014 - 2016



Manufacturing

Accounting for 46% of our operational carbon footprint, CO_2 emissions from manufacturing decreased 21%. This was achieved mainly due to operational changes as well as efficiency improvements, for instance, relating to waste-heat recovery. In addition, further optimization of our glass furnaces improved the efficiency of our most energy-intense operations, resulting in decreased energy use.

Non-industrial operations

CO_2 emissions from non-industrial operations (offices, warehouses) represent 6% of our total emissions. By further optimizing the office utilization rate, we were able to reduce the overall floor space in our non-industrial real estate portfolio. Combined with increased renewable electricity usage, our emissions decreased by 38% year-on-year.

Logistics

Overall CO_2 emissions from logistics, representing 41% of our total, showed a decrease of 16% compared to 2015. One way that we have reduced carbon emissions this year is by innovating the packaging of our products, enabling a further optimization of transportation loads. In addition, we enhanced our logistics modality mix, prioritizing the use of less carbon-intense transportation methods.

Philips Lighting
Operational carbon footprint for logistics
in kilotonnes CO_2-equivalent
2014-2016

	2014	2015	2016
Air transport	102	121	77
Road transport	72	53	50
Ocean transport	100	84	91
Total Philips Lighting	**274**	**258**	**218**

Business travel

Our CO_2 emissions relating to business travel account for 7% of our operational carbon footprint. The CO_2/km ratio of our car fleet improved again year-on-year and we successfully extended the implementation of video conferencing in our offices, decreasing the use of air travel. This resulted in a decrease of 30% year-on-year.

Philips Lighting
Operational carbon footprint by GHG
In kilotonnes CO_2-equivalent
2014-2016

	2014	2015	2016
Scope 1	279	221	187
Scope 2 (market based)	173	137	88
Scope 3	331	308	253
Total Philips Lighting	**783**	**666**	**528**
Scope 2 (location based)	336	284	236

Energy use in operations

Total energy usage amounted to 4,460 terajoules in 2016. This is a decrease of 14% year-on-year. The decrease in energy use was driven by a reduction of activities in energy-intensive operations as well as energy efficiency improvements in our factories.

Electricity

In 2015, we became an active member of the RE100 group as part of our commitment to use electricity from renewable sources by 2020. One of the ways that we are achieving this milestone is through power purchase agreements. With the Los Mirasoles windfarm in Texas, all our operations in North America are fully powered through renewable sources since December 2016.

In 2016, we procured 67% of our electricity from renewable sources. Approximately 62% of our renewable electricity is contracted via our energy providers. The remaining 38% was mainly sourced through procurement of renewable energy certificates.

Philips Lighting
Ratios relating to carbon emissions and energy use
2014-2016

	2014	2015	2016
Operational CO_2 emissions in kilotonnes CO_2-equivalent	783	666	528
Operational CO_2 efficiency in tonnes CO_2-equivalent per million euro sales	112	89	74
Operational energy use in terajoules	6,536	5,213	4,460
Operational energy efficiency in terajoules per million euro sales	0.94	0.70	0.63

16.3.4 Waste

Philips Lighting aims to use and manage the planet's limited resources in a sustainable way. For our products, we incorporated circular economy design rules. These design rules optimize products for easy recycling, spare parts harvesting, refurbishment and technical and economic lifetime extension. In our operations, we develop solutions to effectively reduce, recycle and re-use the waste in our sites, as much as possible.

Zero waste to landfill program

In mid-2016, as part of the Brighter Lives, Better World program, we launched a five-year program that targets all of our manufacturing sites to send zero waste to landfill by 2020. In 2016, 26% of our manufacturing sites sent zero waste to landfill, ensuring that the waste from daily operations is recycled, re-used or incinerated.

In 2016, we continued to reduce waste to landfill through our waste recycling program.
The recycling programs address waste arising from manufacturing activities and offices, such as glass or canteen waste, but also from suppliers, such as packaging materials.

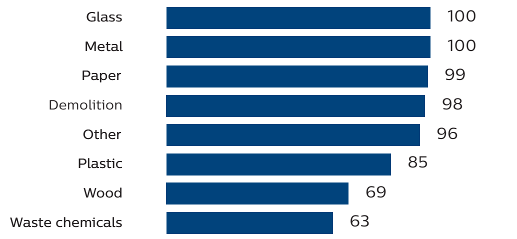
In 2016, total waste amounted to 39.9 kilotonnes. This is a decrease of 12% compared to 2015.
The decrease is mainly due to operational changes, lower production volumes and efficiency improvements.

Philips Lighting
Total waste
2014-2016

	2014	2015	2016
Kilotonnes	54	45	40
% recycled	80%	85%	85%

Total waste consists of waste that is delivered for landfill, incineration or recycling. 85% of total waste was recycled, which is the same as the results in 2015 (85%). Of the remaining waste, 7% was offered for incineration (2015: 3%).

Philips Lighting
Industrial waste categories delivered for recycling in %
2016



16.3.5 Chemical substances in production processes

We prioritize the safe management of chemical substances to ensure that we manage the risks of these substances related to the environment, society and our employees in their daily work.
If there are threats of serious harm to the environment or human safety, we proactively search for effective alternatives.

We have a robust approach to identifying and managing regulated and hazardous substances in our production processes. Based on our continuous monitoring of chemicals usage in manufacturing sites, in 2010 we developed a program to start the phase-out of several substances of very high concern, sorted under category 1 and category 2 substances.

- *Category 1 substances:* Mercury and mercury compounds.
- *Category 2 substances:* Lead and lead compounds, Styrene, Toluene, and Xylene.

Category 1 substances

Emissions from Mercury and Mercury compounds totaled 6 kilograms in 2016. The target to achieve emissions as low as reasonably possible was met in 2015. Philips Lighting continues to closely monitor usage, emissions and exposure, to determine if further improvement opportunities are possible. Since 2012 we have been able to drastically decrease the emissions stemming from mercury by changing our production processes and through the use of liquid mercury versus solid state mercury. Since then, the emissions have remained stable.

Philips Lighting
Category 1 substances in kilograms
2014-2016

	2014	2015	2016
Mercury and Mercury Compounds	8	7	6

Category 2 substances
Due to improvements in operations relating to the coating of products, the application of Xylene and Toluene (as carriers for lacquers) was extensively reduced, now limited to hand-sprayed batches, of small quantities. Philips Lighting continues to phase out styrene in resins, used for impregnation. Lead has been completely removed for all sites but one, which reported in 2016 an amount of three kilograms.

Emissions of hazardous substances totaled 1916 kilograms in 2016. This is a decrease of 29% compared to 2015. As described above, reduction targets have been set on a selected number of hazardous substances.

Philips Lighting
Category 2 substances in kilograms
2014-2016

	2014	2015	2016
Lead and lead compounds	7	6	3
Styrene	2,155	1,231	1,119
Toluene	87	132	99
Xylene	1,348	1,339	695
Emissions from category 2 substances	**3,597**	**2,708**	**1,916**

16.3.6 Water
As we expand our portfolio with LED products, systems and services, the water intensity of our operations continues to decrease. In 2016, we partnered with Trucost to analyze our exposure to water risk. The study considers the possible premiums on water pricing and takes into account and internalizes the societal costs of using this natural capital. Despite activities in several regions facing a current or foreseeable future risk of water scarcity, the Trucost pricing for our water use is forecasted to remain at non-material and stable amounts in the coming three to ten years. Despite these encouraging outcomes, our motivation to transition to technologies and business models with a lower dependency on water remains strong. We will continue to monitor and search for ways to improve our efficiency and reduce our dependency on water in the future.

Total water intake in 2016 was 1,451 million m^3. Compared to 2015 this is a reduction of 17%. This decrease was due mainly to lower production volumes in those sites where water is used for cooling purposes. In addition, a decrease in usage was realized through operational changes and water-saving actions at several of our Philips Lighting sites.

Philips Lighting
Water intake in thousands of m^3
2014-2016

	2014	2015	2016
Total water	2,052	1,751	1,451

In 2016 52% of our water was purchased and 48% was extracted from groundwater wells.

16.3.7 Environmental incidents
In 2016, Philips Lighting experienced no significant environmental incidents. However, four instances of non-compliance were reported. One resulted in a non-material fine for a manufacturing site exceeding the use of its emergency generator.

16.4 Independent assurance report

Assurance report of the independent auditor

To: the shareholders and supervisory board of Philips Lighting N.V.

Our Opinion
We have audited the Sustainability Information in the Annual Report of Philips Lighting N.V. (further referred: Philips Lighting), Eindhoven, the Netherlands for the year ended December 31, 2016. The scope of our audit engagement is described in Section "Our Scope". An audit engagement is aimed at obtaining reasonable assurance.

In our opinion, the Sustainability Information in the Annual Report 2016 presents, in all material respects, a reliable and adequate view of:
- the policy and business operations with regard to sustainability; and
- the thereto related events and achievements for the year ended December 31, 2016

in accordance with the GRI Standards of Global Reporting Initiative (GRI) (option Comprehensive) and the supplemental internally applied reporting criteria as disclosed in section 16.1, "Approach to sustainability reporting" in the chapter 16, "Sustainability statements", of the Annual Report 2016.

Basis for our opinion
We have performed our audit on the Sustainability Information in accordance with Dutch law, including Dutch Standard 3810N "Assurance engagements relating to sustainability reports". Dutch Standard 3810N is a subject specific standard under the International Standard on Assurance Engagements (ISAE) 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information". Our responsibilities under this standard are further described in the Section "Our responsibilities for the audit of the Sustainability Information".

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our Independence
We are independent of Philips Lighting in accordance with the "Verordening inzake de onafhankelijkheid van accountants bij assurance-opdrachten" (ViO) (ViO is a regulation with respect to independence) and other relevant independence regulations in the Netherlands. This includes that we do not perform any activities that could result in a conflict of interest with our independent assurance engagement. Furthermore, we have complied with the "Verordening gedrags- en beroepsregels accountants" (VGBA) (VGBA is the Dutch Code of Ethics).

Our Scope
The Sustainability Information comprises chapter "16 Sustainability statements" and sections "3.2 Sustainability" and "4.2 Sustainability performance" of the Annual Report 2016 and provides a representation of Philips Lighting's policy, the related business operations, events and achievements relating to sustainability during 2016.

The Sustainability Information includes prospective information such as ambitions, strategy, plans, expectations and estimates. Inherent to this information is that the actual results may differ in the future and are therefore uncertain. We do not provide any assurance on the achievability and feasibility of this prospective information.

The references, excluding to the "GRI content index", in the Sustainability Information (www.lighting.philips.com, external websites, interviews and other documents) are outside the scope of our assurance engagement.

Furthermore, we do not provide assurance on the corresponding figures and disclosures related to the period 2013-2015.

We have read the information on sustainability in the rest of the Annual Report 2016 and to the extent we can identify this information is consistent with the Sustainability Information in scope of our audit.

Responsibilities of management for the Sustainability Information
Management of Philips Lighting is responsible for the preparation of the Sustainability Information in accordance with the GRI Standards (option Comprehensive) and the supplemental internally applied reporting criteria as disclosed in section "Approach to sustainability reporting" in the chapter "Sustainability statements" of the Annual Report 2016. This responsibility includes the identification of stakeholders and the determination of material aspects. The choices made by management regarding the scope of the Sustainability Information and the reporting policy of Philips Lighting is summarized in section "Approach to sustainability reporting".

Furthermore, management is responsible for such internal control as it determines is necessary to enable the preparation of the Sustainability Information that is free from material misstatement, whether due to fraud or errors.

Our responsibilities for the audit of the Sustainability Information

Our responsibility is to plan and perform the audit engagement in a manner that allows us to obtain sufficient and appropriate audit evidence for our opinion.

Reasonable assurance is a high, but not absolute level of assurance, which means we may not have detected all material errors and fraud. Misstatements can arise from fraud or errors and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the Sustainability Information. The materiality affects the nature, timing and extent of our audit procedures and the evaluation of the effect of identified misstatements on our opinion.

We apply the "Nadere voorschriften accountantskantoren ter zake van assurance opdrachten (RA/AA)" and accordingly maintain a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

We have exercised professional judgement and have maintained professional skepticism throughout the audit, in accordance with the Dutch Standard 3810N, ethical requirements and independence requirements.

Our audit included amongst others:

- Evaluating the appropriateness of the reporting policy, its consistent application, including the evaluation of the results of the stakeholders' dialogue, the reasonableness of management's estimates and the related disclosures made by management.
- Performing an external environment analysis and obtaining insight into relevant social themes and issues and the characteristics of the organization.
- Identifying and assessing the risks of material misstatement of the Sustainability Information, whether due to errors or fraud, designing and performing audit procedures responsive to those risks, and obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from errors, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Interviewing management and relevant staff responsible for the sustainability's strategy, policy and achievements.
- Interviewing relevant staff at corporate level responsible for providing the information in the Sustainability Information, carrying out internal control procedures on the data and consolidating the data in the Sustainability Information.
- Evaluating the design and implementation and testing the operating effectiveness of the reporting systems and processes related to the Sustainability Information.
- Evaluating the underlying transactions and events.
- Visits to production sites to evaluate the source data and to evaluate the design and implementation of control, including validation procedures, at local level.
- Testing relevant data and internal and external documentation, on a sample basis, to determine the reliability of the Sustainability Information.
- An analytical review of the data and trends submitted for consolidation at corporate level.
- Evaluating the overall presentation, structure and content of the Sustainability Information.

Amsterdam, The Netherlands
February 21, 2017

Ernst & Young Accountants LLP

Subject matter expert Sustainability	Independent auditor
J. Niewold	**O.E.D. Jonker**

17. Reconciliation of non-IFRS financial measures

Explanation of Non-IFRS financial measures

Certain parts of this Annual Report contain financial measures that are not measures of financial performance or liquidity under IFRS. These are commonly referred to as non-IFRS financial measures and include such items as comparable sales growth, adjusted gross margin, EBITA, adjusted EBITA and free cash flow, and other related ratios.

Although the non-IFRS financial measures presented are not measures of financial performance or liquidity under IFRS, the company uses these measures to monitor the underlying performance of its business and operations. These measures have not been audited or reviewed by the company's external auditor. Further, these measures may not be indicative of the company's historical operating results, nor are such measures meant to be predictive of the company's future results. These measures are presented in this Annual Report because the company considers them an important supplemental measure of its performance and believes that these and similar measures are widely used in the industry in which the company operates as a means of evaluating a company's operating performance and liquidity.

Comparable sales growth

The company discloses comparable sales growth as a supplemental non-IFRS financial measure, as the company believes that the presentation of comparable sales growth is a meaningful measure for investors to evaluate the performance of the company's business activities over time.
The company determines comparable sales growth by deducting the percentage figures for changes from the nominal change of sales. Interaction effects between currency movements and changes in consolidation (second order effects) are not taken into account. The company presents comparable sales growth on both a Business Group and Market Group basis. Comparable sales growth is also used by the company as key financial measures to assess the operating performance of the Business Groups and Market Groups.

Philips Lighting
Sales growth composition per business in %
2016

	Comparable growth	Currency effects	Consolidation changes	Nominal growth
Lamps	(15.8)	(1.9)	(0.4)	(18.1)
LED	16.1	(2.3)	–	13.8
Professional	(0.5)	(2.0)	(0.2)	(2.7)
Home	11.0	(2.1)	(0.2)	8.7
Total	**(2.4)**	**(2.0)**	**(0.3)**	**(4.7)**

Philips Lighting
Sales growth composition per market in %
2016

	Comparable growth	Currency effects	Consolidation changes	Nominal growth
Americas	(1.9)	(2.6)	(0.1)	(4.6)
Europe	(2.0)	(1.1)	(0.5)	(3.6)
Rest of the world	(3.2)	(2.9)	(0.1)	(6.2)
Global businesses	(2.2)	(0.1)	(1.0)	(3.3)
Total	**(2.4)**	**(2.0)**	**(0.3)**	**(4.7)**

EBITA and adjusted EBITA

The company discloses EBITA, adjusted EBITA and adjusted EBITA ratio as supplemental non-IFRS financial measures, as the company believes they are meaningful measures to evaluate the performance of the company's business activities over time. The company understands that these measures are used by analysts, rating agencies and investors in assessing the company's performance. The company presents EBITA, adjusted EBITA and adjusted EBITA ratio on a Business Group basis. The company also believes that the presentation of EBITA, adjusted EBITA and adjusted EBITA ratio provide useful information to investors on the development of the company's business and, in the case of EBITA, adjusted EBITA and adjusted EBITA ratio, enhances the ability of investors to compare profitability across the Business Groups. In the case of EBITA, the company believes that EBITA makes the underlying performance of its businesses more transparent by factoring out the amortization related to acquisition-related intangible assets, which arises when acquisitions are consolidated by the company. In the case of adjusted EBITA and adjusted EBITA ratio, the company believes that adjusted EBITA and adjusted EBITA ratio make the underlying performance of its businesses more transparent by factoring out restructuring costs, acquisition-related charges and incidental charges which are not directly related to the operational performance of a Business Group. EBITA, adjusted EBITA and adjusted EBITA ratio are also used by the company as key financial measures to assess the operating performance of the Business Groups.

Philips Lighting
EBITA to income from operations (or EBIT) in mEUR
2015-2016

	Philips Lighting	Lamps	LED	Profes-sional	Home	Others
2016						
Adjusted EBITA	645	472	142	145	(20)	(94)
Restructuring	(115)	(37)	(2)	(49)	(26)	(1)
Acquisition-related charges	(3)	–	–	(3)	–	–
Incidental items	(48)	–	–	–	–	(48)
EBITA	**479**	**435**	**140**	**93**	**(46)**	**(143)**
Amortization [3]	(110)	(2)	(4)	(102)	(2)	–
Income from operations (or EBIT)	**369**	**433**	**136**	**(9)**	**(48)**	**(143)**
2015						
Adjusted EBITA	547	463	74	150	(57)	(83)
Restructuring	(90)	(52)	(2)	(26)	(14)	4
Acquisition-related charges	(5)	–	–	(5)	–	–
Incidental items	(14)	(6)	(2)	(5)	(1)	–
EBITA	**438**	**405**	**70**	**114**	**(72)**	**(79)**
Amortization [3]	(107)	(2)	(4)	(100)	(1)	–
Income from operations (or EBIT)	**331**	**403**	**66**	**14**	**(73)**	**(79)**

3) Amortization and impairments of acquisition related intangible assets and goodwill.

Adjusted gross margin

The company discloses adjusted gross margin ratio as a supplemental non-IFRS financial measure, as the company believes it is a meaningful measure to evaluate the company's gross margin on a comparable basis over time without the effects of variations in sales and by factoring out restructuring costs, acquisition-related charges and incidental charges which are not directly related to the operational performance the company. Adjusted gross margin ratio is also used by the company as key financial measures to assess the operating performance of the company.

Philips Lighting
Adjusted gross margin in mEUR unless otherwise stated
2015-2016

	2015	2016
Sales	7,465	7,115
Cost of sales	(4,810)	(4,438)
Gross margin	**2,655**	**2,677**
Restructuring	62	85
Acquisition-related charges	–	–
Incidental items	14	1
Adjusted gross margin	**2,731**	**2,763**
Adjusted gross margin %	36.6%	38.8%

Adjusted indirect costs: adjusted SG&A costs and adjusted R&D costs

The company discloses adjusted gross SG&A costs and adjusted R&D costs as a supplemental non-IFRS financial measure, as the company believes it is a meaningful measure to evaluate the company's SG&A costs and R&D costs on a comparable basis over time by factoring out restructuring costs, acquisition-related charges and incidental charges which are not directly related to the operational performance the company. Adjusted gross SG&A costs and adjusted R&D costs is also used by the company as key financial measures to assess the operating performance of the company.

Philips Lighting
Adjusted SG&A costs in mEUR unless otherwise stated
2015 - 2016

	2015	2016
Selling expenses	(1,751)	(1,750)
G&A expenses	(233)	(248)
SG&A expenses	**(1,984)**	**(1,998)**
Restructuring	27	17
Acquisition-related charges	5	3
Incidental items	–	61
Adjusted SG&A expenses	**(1,952)**	**(1,917)**
Adjusted SG&A expenses %	(26.1%)	(26.9%)

Philips Lighting
Adjusted R&D costs in mEUR unless otherwise stated
2015 - 2016

	2015	2016
R&D expenses	(366)	(353)
Restructuring	1	13
Acquisition-related Charges	-	-
Incidental items	-	-
Adjusted R&D expenses	**(365)**	**(340)**
Adjusted R&D expenses %	(4.9%)	(4.8%)

Philips Lighting
Adjusted indirect costs in mEUR unless otherwise stated
2015-2016

	2015	2016
Selling expenses	(1,751)	(1,750)
G&A expenses	(233)	(248)
R&D expenses	(366)	(353)
Indirect costs	**(2,350)**	**(2,351)**
Restructuring	28	30
Acquisition-related charges	5	3
Incidental items	-	61
Adjusted indirect costs	**(2,317)**	**(2,257)**
Adjusted indirect costs %	(31.0%)	(31.7%)

Free cash flow

The company discloses free cash flow as a supplemental non-IFRS financial measure, as the company believes it is a meaningful measure to evaluate the performance of the company's business activities over time. The company understands that free cash flow is broadly used by analysts, rating agencies and investors in assessing the company's performance.
The company also believes that the presentation of free cash flow provides useful information to investors regarding the cash generated by the company's operations after deducting cash outflows for additions of intangible assets, capital expenditures on property, plant and equipment and proceeds from disposal of property, plant and equipment. Therefore, the measure gives an indication of the long-term cash generating ability of the company's business. In addition, because free cash flow is not impacted by purchases of businesses, it is less volatile than the total of net cash provided by / (used in) operating activities and net cash provided by / (used in) investing activities. Free cash flow is also used by the company as a key financial measure to assess the operating performance of the company.

Philips Lighting
Composition of cash flows in mEUR
2015-2016

	2015	2016
Cash flows from operating activities	717	505
Cash flows from investing activities	(65)	(62)
Cash flows before financing activities	**652**	**443**
Cash flows from operating activities	717	505
Net capital expenditures:	(85)	(87)
• Additions of intangible assets	(38)	(30)
• Capital expenditures on property, plant and equipment	(98)	(79)
• Proceeds from disposal of property, plant and equipment	51	22
Free cash flows	**632**	**418**

Net Debt

The net debt position as a percentage of the sum of the company's equity (shareholders equity and non-controlling interests) and net debt is presented to express the financial strength of the company. The company understands that this measure is used by analysts, rating agencies and investors in assessing the company's performance.

Philips Lighting
Composition of net debt to total equity in mEUR
2015-2016

	2015	2016
Long-term debt	2	1,224
Short-term debt	86	155
Short-term loans payable to Royal Philips	-	2
Total debt	**88**	**1,381**
Cash and cash equivalents	83	1,040
Net debt (cash) [1]	**5**	**341**
Shareholders' equity	3,513	2,704
Non-controlling interests	103	104
Total equity	**3,616**	**2,808**
Net debt and total equity	3,621	3,149
Net debt divided by net debt and total equity (in %)	0%	11%
Total equity divided by net debt and total equity (in %)	100%	89%

[1] Total debt less cash and cash equivalents.

Working capital

The company discloses working capital as a supplemental non-IFRS financial measure, as the company believes it is a meaningful measure to evaluate the company's ability to maintain a solid balance between growth, profitability and liquidity. Working capital is broadly analyzed and reviewed by analysts and investors in assessing the company's performance. This measure serves as a metric for how efficiently a company is operating and how financially stable it is in the short-term. It is an important measure of a company's ability to pay off short-term expenses or debts.

Philips Lighting
Working capital to total assets in mEUR
2015-2016

	2015	2016
Working capital (WoCa)	832	662
Eliminate liabilities comprised in WoCa:		
Accounts and notes payable	1,051	1,024
Accrued liabilities	459	502
Derivative financial liabilities	7	26
Income tax payable	6	57
Other current liabilities	312	346
Include assets not comprised in WoCa:		
Non-current assets	3,659	3,795
Current financial assets	–	–
Cash and cash equivalents	83	1,040
Assets classified as held for sale	34	3
Total assets	**6,443**	**7,455**

18. Definitions and abbreviations

Acquisition-related charges
Costs that are directly triggered by the acquisition of a company, such as transaction costs, purchase accounting related costs and integration-related expenses.

Adjusted EBITA
EBITA excluding restructuring costs, acquisition-related charges and incidental charges.

Adjusted EBITA margin (%)
Adjusted EBITA divided by sales to third parties (excluding intersegment).

Adjusted gross margin
Gross margin, excluding restructuring costs, acquisition-related charges and incidental items attributable to cost of sales.

Adjusted indirect costs
Indirect costs, excluding restructuring costs, acquisition-related charges and incidental items attributable to indirect costs.

Adjusted research and development (R&D) expenses
Research and development expenses, excluding restructuring costs, acquisition-related charges and incidental items attributable to research and development expenses.

Adjusted selling, general and administrative (SG&A) expenses
Selling, general and administrative expenses, excluding restructuring costs, acquisition-related charges and incidental items attributable to selling, general and administrative expenses.

Ballasts
Lamp control gear inserted between the supply and one or more discharge lamps, which, by means of inductance, capacitance or a combination of inductance and capacitance, serves mainly to limit the current of the lamp(s) to the required value.

Carbon footprint
Carbon footprint is expressed in CO_2-equivalent or carbon dioxide equivalent, which is a quantity that describes, for a given mixture and amount of greenhouse gas, the amount of CO_2 that would have the same global warming potential (GWP), when measured over a specified timescale (generally 100 years).

Circular economy
A circular economy aims to decouple economic growth from the use of natural resources and ecosystems by using those resources more effectively. By definition it is a driver for innovation in the areas of material-, component- and product reuse, as well as new business models such as solutions and services. In a circular economy, the more effective use of materials creates more value, both by cost savings and by developing new markets or growing existing ones.

Compact fluorescent light (CFL)
CFLs usually combine a fluorescent light with an incandescent fixture.

CFLni
Non-integrated CFLs.

Comparable sales growth
The period-on-period growth in sales excluding the effects of currency movements and changes in consolidation.

Continuing net income
This equals recurring net income from continuing operations, or net income excluding discontinued operations and excluding material nonrecurring items.

Conventional lamps
Non-LED based light emitting light sources, including incandescent lamps, halogen lamps, fluorescent lamps and high intensity discharge lamps.

Conventional luminaires
Light fixtures with a conventional socket (e.g., a screw socket for a conventional lamp or LED lamp).

Dividend yield
Dividend yield is the annual dividend payment divided by Philips Lighting market capitalization. All references to dividend yield are as of December 31 of the previous year.

EBIT
Income from operations.

EBITA
Income from operations excluding amortization and impairments of acquisition related intangible assets and goodwill.

EBITDA
Income from operations excluding depreciation, amortization and impairments of non-financial assets.

Effects of changes in consolidation
In the event a business is acquired (or divested), the impact of the consolidation (or de-consolidation) on the company's figures are included (or excluded) in the comparable figures.

Effects of currency movements
Calculated by translating previous periods' foreign currency amounts into euro at the following periods' exchange rates in comparison to the euro as historically reported.

Electronics
Units that regulate the current going through a light source.

Electronic Industry Citizenship Coalition (EICC)
The Electronic Industry Citizenship Coalition was established in 2004 to promote a common code of conduct for the electronics and information and communications technology (ICT) industry. The EICC now includes more than 100 global companies and their suppliers.

Employees
Employees of Philips Lighting at period end expressed on a full-time equivalent (FTE) basis.

Employee net promoter score (NPS)
The net promoter score methodology is used to measure employee engagement. Employees are asked to rank how likely it is that they would recommend our company as a great place to work. The scoring for this answer is based on a 0 to 10 scale. Those who respond with a score of 9 to 10 are called Promoters. Those who respond with a score of 0 to 6 are labeled Detractors. Responses of 7 and 8 are labeled Passives. The NPS is calculated by subtracting the percentage of employees who are Detractors from the percentage of employees who are Promoters.

Fluorescent lamp
A lamp which produces light with an electric current conducted through an inert gas producing ultraviolet light that is invisible to the human eye.

Free cash flow
Net cash provided by operations minus net capital expenditures. Free cash flow includes interest paid and income taxes paid.

Global Reporting Initiative (GRI)
The Global Reporting Initiative is a network-based organization that pioneered the world's most widely used sustainability reporting framework. GRI is committed to the framework's continuous improvement and application worldwide. GRI's core goals include the mainstreaming of disclosure on environmental, social and governance performance.

Gross margin
Sales minus cost of sales.

Halogen lamp
A type of incandescent lamp with a capsule that holds a special halogen gas composition around the heated filament to increase the efficacy of the incandescence.

High intensity discharge lamp (HID)
A type of conventional lamp that use electricity arcs between two electrodes to create an intensely bright light where mercury, sodium, or metal halide gas act as the conductor.

Incidental charges
Any item with an income statement impact (loss or gain) that is deemed to be both significant and not part of normal business activity. Incidental items may extend over several quarters within the same financial year.

Incandescent lamp
A conventional lamp that produces visible light by heating a tungsten filament inside a glass bulb usually filled with an inert gas.

Indirect costs
The sum of selling, R&D and general and administrative expenses.

International Standardization Organization (ISO)
The International Standardization Organization is the world's largest developer and publisher of International Standards. ISO is a network of the national standards institutes of more than 160 countries, one member per country, with a Central Secretariat in Geneva, Switzerland, that coordinates the system. ISO is a non-governmental organization that forms a bridge between the public and private sectors.

LED
Light-emitting diode.

LED-based sales
Sales provided by products, systems and services based on LED lighting technologies.

LED drivers
Lighting electronics that convert input power into a current which remains constant despite fluctuations in voltage.

LED lamp
A solid-state semiconductor device that converts electrical energy directly into light.

LED luminaires
Light fixtures where LED modules are integrated into the luminaire as light source and cannot be separated from the luminaire by the user.

LED modules
Light generating units around which luminaires are built for the purpose of emitting distributed patterns of light.

Light-as-a-service contract
Contracts enabling an integrated solution for customers where customers pay for the provision of light to their premises, while the company plans and builds the lighting infrastructure and ensures its performance until the end of the contract.

Lighting services
Services offered to customers building on a lighting system and enabled by data.

Lighting systems
The combination of luminaires, controls and software.
The automation and related controls of lighting within a room, building or outdoor facilities for end-users.

Luminaire
Electrical devices that produce, control and distribute light. Also called light fixtures. They consist of one or more light sources, lamps or sockets that connect the lamps to the electrical power (as well as drivers in some luminaires), and the mechanical components required to support or attach the housing.

Net capital expenditures
Additions of intangible assets, capital expenditures on property, plant and equipment and proceeds from disposal of property, plant and equipment, and intangible assets.

Net debt
Short-term debt, short-term loans payable (receivable) to Royal Philips, long-term debt minus cash and cash equivalents.

Net leverage ratio
The ratio of consolidated total net debt to adjusted consolidated EBITDA for the purpose of calculating the facility covenant for the term loan and revolving credit facility.

Non-governmental organization (NGO)
A non-governmental organization is any non-profit, voluntary citizens' group which is organized at a local, national or international level.

OEM
Original equipment manufacturer.

Philips Lighting
Philips Lighting N.V and its subsidiaries within the meaning of Section 2:24b of the Dutch Civil Code.

Productivity
Philips Lighting uses Productivity internally and as mentioned in this Annual Report as a non-financial indicator of efficiency that relates the added value, being income from operations adjusted for certain items such as restructuring and acquisition-related charges plus salaries and wages (including pension costs and other social security and similar charges), depreciation of property, plant and equipment, and amortization of intangibles, to the average number of employees over the past 12 months.

R&D expenses
Research and development expenses.

Renewable electricity
Percentage of total electricity usage from renewable sources.

Restructuring costs
The estimated costs of initiated reorganizations, the most significant of which have been approved by the company, and which generally involve the realignment of certain parts of the industrial and commercial organization.

Royal Philips
Koninklijke Philips N.V. ('KPNV') and its subsidiaries within the meaning of Section 2:24b of the Dutch Civil Code.

SG&A expenses
Selling, general and administrative expenses.

Supplier sustainability performance
The supplier sustainability performance rate represents the percentage of risk suppliers with an audit score of at least 90 out of 100 points.

Sustainable innovation
Sustainable innovation comprises all research & development activities contributing to lighting technologies considered for sustainable products, systems or services. This means all products, systems, or services that demonstrate a measurable positive impact in energy efficiency (10% or greater), and preferably in one or more sustainable focal areas: Circularity, Weight & Materials, Packaging, Substances, Human Centric Lighting, Basic Needs or Access to Light.

Sustainable revenues
Sustainable revenues are measured as a percentage of total revenues per product category and tracked for each business group. Sustainable products, systems or services must demonstrate a measurable positive impact in energy efficiency (10% or greater), plus potentially in one or more sustainable focal areas: Energy, Circularity, Weight & Materials, Packaging, Substances, Human Centric Lighting, Basic Needs or Access to Light. Sustainable products outperform reference products (predecessor product in the particular product family), or product-specific eco-requirements, or by being awarded with a recognized eco-performance label. The lifecycle approach is used to determine the environmental impacts and improvements of our products over their total life cycle (raw materials, manufacturing, packaging, transportation, product use and disposal).

Switch
Wall mounted devices designed to (i) change the electric connections among its terminals or (ii) engage with the pins of a plug and having terminals for the connection of cables or cords (i.e., socket contacts).

Total Recordable Case rate
Number of injuries and illnesses sustained at work that result in medical treatment, restricted work, lost work-days, or fatality, divided by 100 FTE.

Weighted Average Statutory Tax Rate (WASTR)
The reconciliation of the effective tax rate is based on the applicable statutory tax rate, which is a weighted average of all applicable jurisdictions. This weighted average statutory tax rate (WASTR) is the aggregation of the result before tax multiplied by the applicable statutory tax rate without adjustment for losses, divided by the group result before tax.

Working capital
The sum of Inventories, Receivables, Other current assets, Derivative financial assets, Income tax receivable minus the sum of Accounts and notes payable, Accrued liabilities, Derivative financial liabilities, Income tax payable and Other current liabilities.

Zero waste to landfill
Zero waste to landfill refers to manufacturing sites diverting their manufacturing waste to recycling or incineration, opposed to landfill. To determine if a manufacturing site qualifies for the 'zero waste to landfill' status only regular operational non-hazardous waste is considered. Zero waste to landfill is reported in two consecutive periods (= semesters) before a site reaches zero waste to landfill status. When more than 99.5% of the total operational waste generated at that site is diverted from landfill, a site is considered to match the criterion 'zero waste to landfill'.

19. Forward-looking statements and other information

Forward-looking statements and risks & uncertainties

This document contains forward-looking statements that reflect the intentions, beliefs or current expectations and projections of Philips Lighting N.V together with its subsidiaries, including statements regarding strategy, estimates of sales growth and future operational results.

By their nature, these statements involve risks and uncertainties facing Philips Lighting and a number of important factors could cause actual results or outcomes to differ materially from those expressed in any forward-looking statement as a result of risks and uncertainties. Such risks, uncertainties and other important factors include but are not limited to: adverse economic and political developments, the impacts of rapid technological change, competition in the general lighting market, development of lighting systems and services, successful implementation of business transformation programs, impact of acquisitions and other transactions, impact of Philips Lighting operation as a separate publicly listed company, pension liabilities and costs, establishment of corporate and brand identity, adverse tax consequences from the separation from Royal Philips and exposure to international tax laws. Please see chapter 12, Risk factors and risk management, in this Annual Report and Philips Lighting prospectus, dated May 16, 2016 for discussion of material risks, uncertainties and other important factors which may have a material adverse effect on the business, results of operations, financial condition and prospects of Philips Lighting. Such risks, uncertainties and other important factors should be read in conjunction with the information included in the Annual Report.

Additional risks currently not known to Philips Lighting or that Philips Lighting has not considered material as of the date of this document could also prove to be important and may have a material adverse effect on the business, results of operations, financial condition and prospects of Philips Lighting or could cause the forward-looking events discussed in this document not to occur. Philips Lighting undertakes no duty to and will not necessarily update any of the forward-looking statements in light of new information or future events, except to the extent required by applicable law.

Market and industry information

All references to market share, market data, industry statistics and industry forecasts in this document consist of estimates compiled by industry professionals, competitors, organizations or analysts, of publicly available information or of Philips Lighting own assessment of its sales and markets. Rankings are based on sales unless otherwise stated.

Non-IFRS financial measures

Certain parts of this document contain non-IFRS financial measures and ratios, such as comparable sales growth, adjusted gross margin, EBITA, Adjusted EBITA, EBITDA, Adjusted EBITDA and free cash flow, and other related ratios, which are not recognized measures of financial performance or liquidity under IFRS. The non-IFRS financial measures presented are measures used by management to monitor the underlying performance of the Philips Lighting business and operations and, accordingly, they have not been audited or reviewed. Not all companies calculate non-IFRS financial measures in the same manner or on a consistent basis and these measures and ratios may not be comparable to measures used by other companies under the same or similar names. A reconciliation of these non-IFRS financial measures to the most directly comparable IFRS financial measures is contained in this document. For further information on non-IFRS financial measures, see chapter 17, Reconciliation of non-IFRS financial measures, of this Annual Report.

Fair value information

In presenting Philips Lighting'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 on 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.

IFRS basis of presentation

The financial information included in this document is based on IFRS, as explained in the significant accounting policies, unless otherwise indicated.

Statutory financial statements and management report

Chapter 14, Consolidated financial statements and chapter 15, Philips Lighting N.V. financial statements, of this Annual Report, contain the statutory financial statements of Philips Lighting N.V.. The introduction to chapter 14, Consolidated financial statements, of this Annual Report sets out which part of this annual report from the management report within the meaning of Section 2:391 of the Dutch civil Code and related Decrees.

Regulated information

This document contains regulated information within the meaning of the EU Transparency Directive.

PHILIPS Lighting