# Annual Report 2017

Philips Lighting

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The Binhe Yellow River Bridge in Yinchuan, China is a double-cable suspension bridge that spans the width of the sixth longest river system in the world. It is illuminated by Philips Color Kinetics technology (www.colorkinetics.com/ActiveSite/), which provides architectural lighting effects and up to 16.7 million colors.


**Forward-looking statements and risks & uncertainties**
Please refer to Chapter 20, 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 and statutory financial statements.

# The big picture

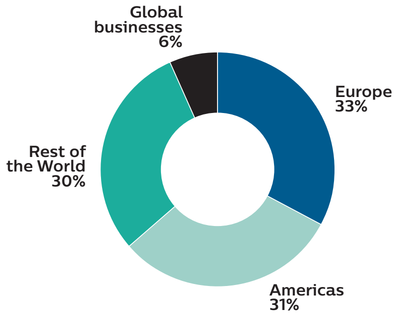
# 1. Performance highlights

## Financial performance

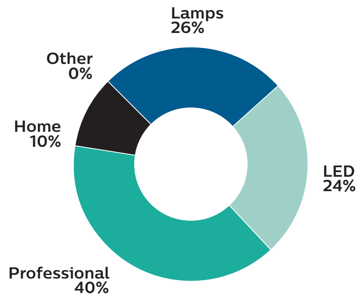
### Philips Lighting

| Comparable sales growth | LED-based sales | Adjusted EBITA margin | Net income | Free cash flow |
|---|---|---|---|---|
| 2017 | 2017 | 2017 | 2017 | 2017 |
| **0.5%** | **65%** | **10%** | **EUR 281 million** | **EUR 403 million** |
| 2016 | 2016 | 2016 | 2016 | 2016 |
| **(2.4%)** | **55%** | **9.1%** | **EUR 185 million** | **EUR 418 million** |

**Sales by geography**




**Sales by Business Group**




### Business Groups

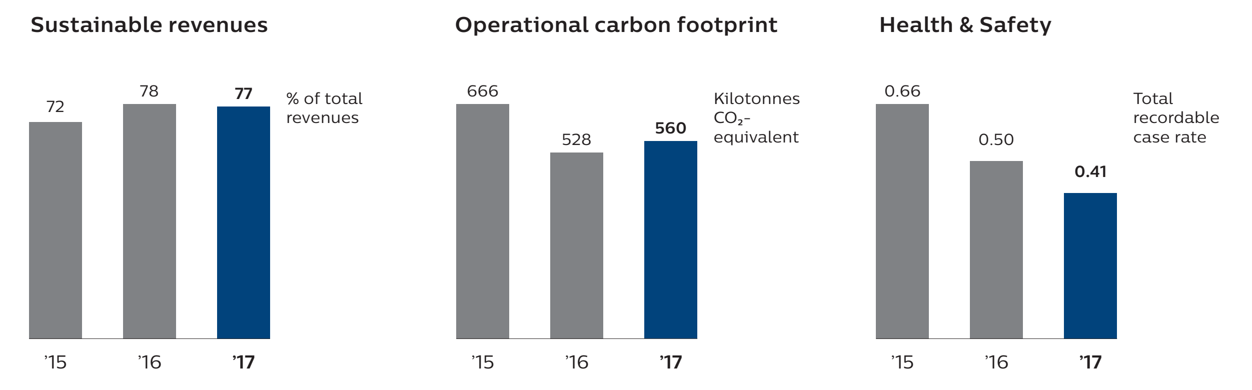
| Lamps | LED | Professional | Home |
|---|---|---|---|
| Sales | Sales | Sales | Sales |
| **EUR 1,820 million** | **EUR 1,703 million** | **EUR 2,755 million** | **EUR 684 million** |
| Nominal sales growth | Nominal sales growth | Nominal sales growth | Nominal sales growth |
| **(22%)** | **12.2%** | **2.7%** | **22.3%** |
| Comparable sales growth | Comparable sales growth | Comparable sales growth | Comparable sales growth |
| **(18.6%)** | **13.8%** | **4.6%** | **26.5%** |
| EBITA margin | EBITA margin | EBITA margin | EBITA margin |
| **19.2%** | **9.9%** | **6.6%** | **4.6%** |
| Adjusted EBITA margin | Adjusted EBITA margin | Adjusted EBITA margin | Adjusted EBITA margin |
| **20.3%** | **10.2%** | **8.2%** | **5.2%** |

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 18, Reconciliation of non-IFRS financial measures, of this Annual Report.

# Sustainability performance

## Environmental highlights

| Sustainable revenues | Carbon footprint (net) | Renewable electricity | Total manufacturing waste |
|---|---|---|---|
| 2017 | 2017 | 2017 | 2017 |
| **77%** | **325 kilotonnes** | **80%** | **43 kilotonnes** |
| 2016 | 2016 | 2016 | 2016 |
| **78%** | **406 kilotonnes** | **67%** | **40 kilotonnes** |




## Social highlights

| Employees (full-time equivalent) | Female executives (% of total) | Employee Net Promoter Score | Supplier sustainability performance |
|---|---|---|---|
| 2017 | 2017 | 2017 | 2017 |
| **32,130** | **17%** | **14** | **95%** |
| 2016 | 2016 | 2016 | 2016 |
| **34,256** | **17%** | **8** | **92%** |

# 2. Message from CEO

## 2017: Returning to growth

"In 2017, the successful execution of our strategy allowed us to return to growth for the full year and further improve our profitability. Our transformation journey continues and I am particularly pleased with the leadership position we established in LED products and the promising growth trajectory of our connected lighting systems."

Eric Rondolat, CEO Philips Lighting

Dear Stakeholder,

Looking back at 2017, I am proud of how we served our purpose – to unlock the extraordinary potential of light for Brighter Lives and a Better World. The delivery of our one billionth LED lamp as part of the Global Lighting Challenge is just one great illustration of this.

2017 was a good year, marked by the continuous transformation of the company and the achievement of all the commitments we made. Among the many important milestones, Royal Philips reduced its stake in Philips Lighting to under 30% through three sell downs. As part of our promise to repurchase up to EUR 300 million of shares before the end of 2018, we participated in each one, for a net total of EUR 272 million.

### Our strategy is paying off

We executed our strategy with a lot of rigor in 2017, in what was still a challenging global economic environment. We saw the growth of our LED and Systems & Services businesses more than offset the decline of our conventional lighting businesses.

- Our conventional business remained very profitable, cash generative, and our market share increased further in a declining market.
- Our comparable total LED-based sales grew by 19%, representing 65% of our sales in 2017. This was enabled by game-changing innovations including Philips TrueForce LED range and the Philips EasySmart TLED.
- Systems & Services grew by 51% in the Professional and Home spaces, now amounting to more than EUR 900 million. Important milestones demonstrating our commitment to both customers and innovation included: the 5th anniversary of the Philips Hue connected lighting system for the home, our 1,000th

installation of the Philips CityTouch connected street lighting system, and the 50,000th project of our Philip Color Kinetics professional LED lighting system.
- We substantially improved our customer services and further enhanced our customer centricity, resulting in a 14% increase in customer satisfaction.
- We implemented major plans to further simplify our ways of working to increase our speed and agility and decrease our indirect costs.

## Our financial performance is in line with our objectives

In 2017, we delivered on all our objectives:
- We returned to growth in the course of 2017 and achieved positive comparable sales growth of 0.5% for the full year.
- Our Home business broke even, achieving an adjusted EBITA margin of 5.2%.
- We improved our operational profitability by 90 basis points to 10.0%.
- We delivered a solid free cash flow of EUR 403 million.

Importantly, these results show continued progress toward achieving our strategic goals and medium-term financial objective to gradually improve our Adjusted EBITA margin to 11%-13%. Our balance sheet is solid and allows us to return money to shareholders, consider value-generating bolt-on acquisitions, and optimize our balance sheet. Again, we felt supported by our shareholders and see in this a sign of trust in our strategy and in the ability of our teams to deliver. For 2017, we have proposed a dividend of EUR 1.25 per share, which represents a 45% pay-out ratio and a 14% increase.

## The satisfaction of our customers improves

In 2017, we improved our customer Net Promoter Score and set up the foundations of a major multi-year program, 'Road to Excellence', aimed at operational excellence to achieve unequalled customer satisfaction.

## Innovation and partnerships drive growth

We stayed at the forefront of innovation in technology, products and system architectures, enabling us to capture new market opportunities. We released wireless connected architectures managed by our InteractOffice software, introduced pioneering offers in home entertainment lighting, undertook the world's largest LED horticultural lighting project in Russia, and partnered with American Tower Corporation to jointly deliver street light poles that enable smart telecommunication services.

## We prioritize our people development

In 2017, we ran our Edge programs aimed at further developing our people and decided to revive our Philips Lighting University to provide our employees with a unique platform for them to learn, grow and flourish. We improved our Employee Net Promoter Score with levels of participation above 78% and we started to measure how our values are embedded in the company on a quarterly basis.

## Our contribution to sustainability is recognized

Sustainability is an intrinsic part of our strategy. We were honored with the Industry Leader position in the Electrical Components and Equipment category of the Dow Jones Sustainability Index, which recognizes the achievements of our Brighter Lives, Better World program.

## Our thanks

On behalf of the Board of Management and the leadership team, I want to thank our talented employees who worked hard to ensure we delivered on our promises in 2017. It is important to be able to count on teams that believe in our purpose and live by our values.

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 us and in the exciting opportunities that our strategy reveals.

**In 2017, the teams of Philips Lighting unlocked some of 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 sale of innovative, energy-efficient lighting products, systems and services. We have pioneered many key breakthroughs in lighting over the past 126 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 now moving 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 optimize our free cash flow.

Our manufacturing footprint rationalization and product portfolio simplification brings 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 is becoming 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 seek to realize additional revenues from our installed base by offering new, value-added services. In doing so, we make people's lives safer, more productive, and more comfortable; businesses and cities more efficient and livable; and the world more sustainable.

| 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, future-proof 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 dynamic and flexible lighting | Creating adapted, 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.

- **Drive our operational excellence improvement journey** – 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 makes Philips Lighting the lighting company for the Internet of Things (IoT). By extending our industry leadership into the IoT, we can unlock additional value by 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.

## We made good progress on our strategic priorities in 2017

| Strategic priorities | Proof points in 2017 |
|---|---|
| • Optimize cash from conventional products to fund our growth | • Free cash flow as % of sales for Lamps improved by 400 bps |
| • Innovate in LED products commercially and technologically to outgrow the market | • LED lighting share increased from 55% to 65% of total sales |
| • Lead the shift to Systems, building the largest connected installed base<br>• Capture adjacent value through new Services business models | • Connected Systems & Services, for consumers and professionals, represented more than EUR 900 million of sales in 2017, CSG +51%<br>  • Professional Systems & Services sales of around EUR 650 million<br>  • Home Systems sales of close to EUR 300 million |
| • Be our customers' best business partner locally, leveraging our global scale | • Customer Net Promoter Score improved by 14% |
| • Continue our operational excellence improvement journey | • Adjusted EBITA margin improved by 90 basis points to 10.0%<br>• Adjusted indirect costs reduced by EUR 66 million, including investments for growth |

# Value Creation Model

To create value we balance financial, environmental, and social considerations. Our aim is to maximize long-term value creation along these three dimensions. The value creation model shows how our business activities depend on various financial, environmental, and social resources that get converted to outputs. Our activities and their outputs lead to outcomes in terms of the impact made on our stakeholders and society at large. By expressing these impacts in monetary terms, it enables our stakeholders to consider the indirect economic, social, and environmental effects of our business more effectively.

## Input

### Financial

We use financial capital to innovate and lead the lighting industry.

- **EUR 334** million R&D investments with **83%** sustainable innovation
- **EUR 2,321** million total equity
- **EUR 6,678** million total assets

### Environmental

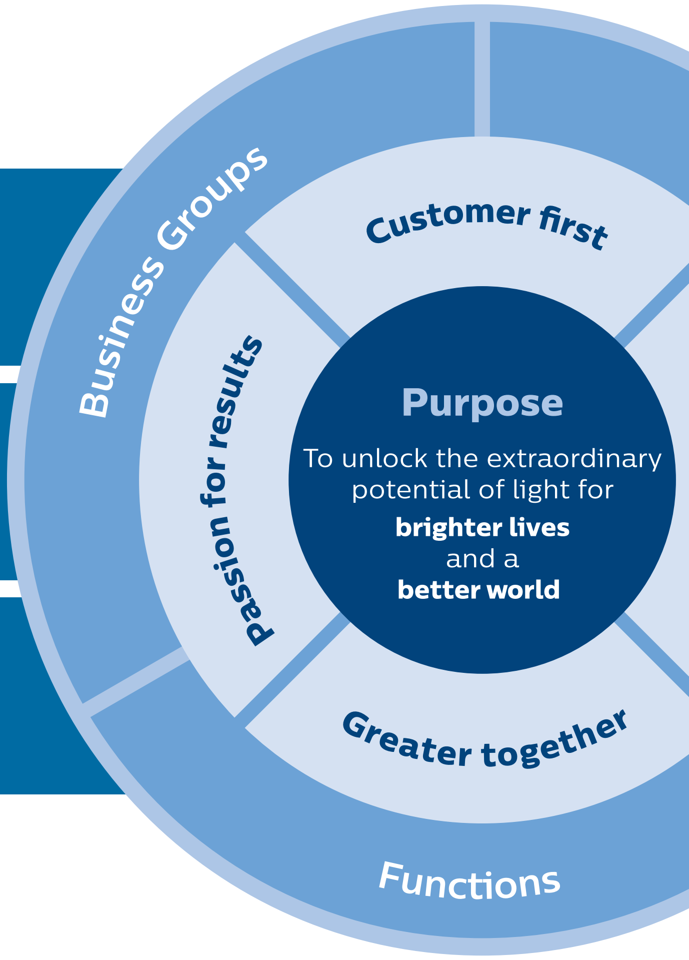
We use environmental capital to create sustainable lighting for our customers.

- **4,408** terajoules energy with **80%** renewable electricity
- **EUR 2,956** million materials
- **1.3** million m³ water

### Social

We use social capital to improve people's wellbeing.

- **32,130** FTE in 78 countries
- **2,400+** training courses offered
- **EUR 12.2** million spent on training
- **112** supplier audits
- **EUR 3.1** million to Philips Lighting Foundation




| Output | Impact |
|---|---|
| • **EUR 6,965** million sales<br>• **EUR 699** million Adjusted EBITA<br>• **EUR 403** million free cash flow<br>• **17,750** patent rights | We create **EUR 587** million in value for society through total shareholder returns and tax and interest payments. |
| • **325** kilotonnes net $CO_2$ emitted<br>• **43** kilotonnes waste with **87%** recycled<br>• **568** million LED lamps & luminaires, avoiding 14,148 kilotonnes $CO_2$<br>• **77%** Sustainable revenues | We cause **EUR 38** million in costs to society through our own environmental footprint. At the same time, we helped create **EUR 1,415** million in value through $CO_2$ avoided by LED lamps & luminaires delivered in 2017. * |
| • **184,000+** training courses taken<br>• **95%** supplier sustainability performance<br>• **15** projects delivered through the Philips Lighting Foundation<br>• **0.41** total recordable case rate | We create **EUR 1,143** million in value for society through employees' salaries & wages and learning & development combined with the costs to society of injuries & illnesses at work. |

* Avoided emissions are based on the difference in energy use between conventional and LED light technologies. Energy use of our LED lamps & luminaires results in 11,395 kilotonnes $CO_2$, equivalent to EUR 1,140 million in costs to society. For details on our methodology, please see: http://images.philips.com/is/content/PhilipsConsumer/PDFDownloads/Global/Corporate/ODLI20180212_001-UPD-en_AA-Methodology_for_calculating_societal_impact.pdf

> *Our aim is to maximize long-term value creation along financial, environmental, and social dimensions.*

Brockville, Canada

# Creating a new city identity and fostering community

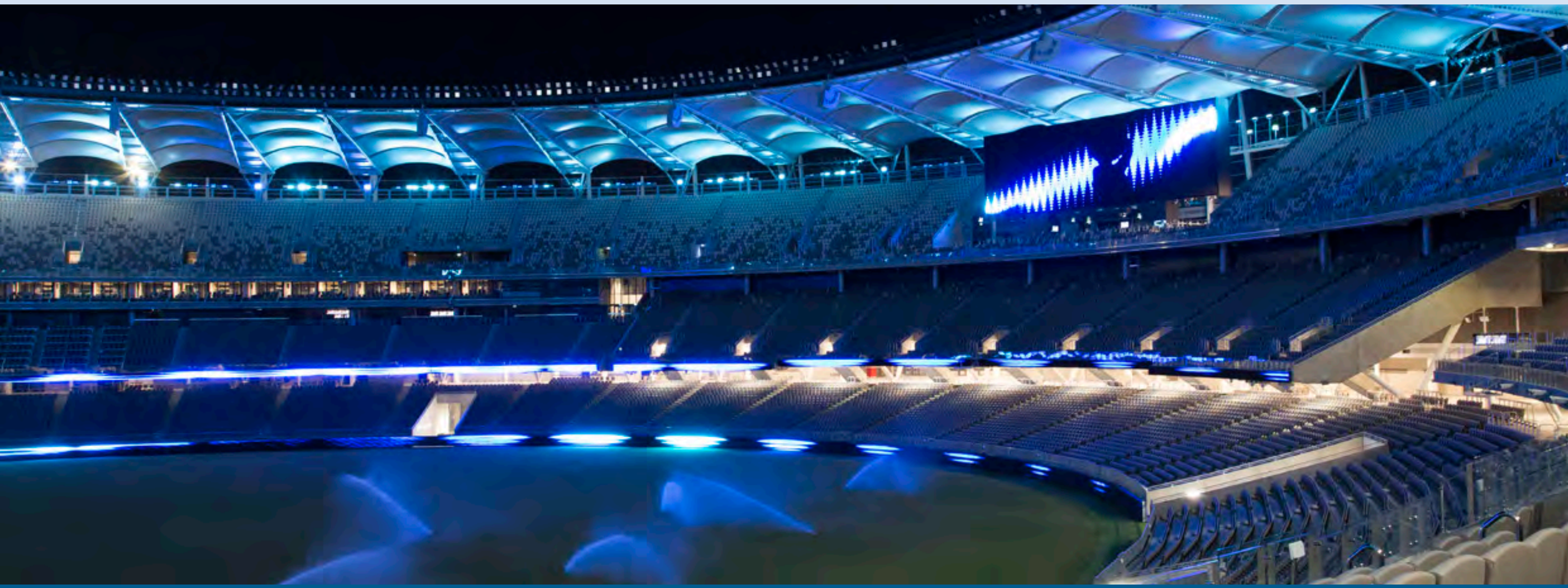
The historic Brockville Railway Tunnel, a pillar of Canada's pre-Confederation industrial heritage, has been transformed through an innovative restoration project that breathed new life into the aging monument. The result is a dynamic tourist destination supporting the community's economic development.

**The challenge**
Constructed between 1854 and 1860, the Brockville Tunnel was Canada's first. It was designed to provide a rail link from the timber trade of the Ottawa Valley to the Brockville port facilities on the St. Lawrence River ship route. Later the tunnel served as a gateway for goods coming from the United States via the St. Lawrence River, until service ceased in 1970. In 1983 the city of Brockville acquired the tunnel as a part of a heritage initiative.

**The solution**
The 525-metre tunnel was fitted with Philips Color Kinetics dynamic LED lighting, turning what had been a mostly unused passage under the city center into a visually stunning walkway. Special fixtures were chosen for the inside of the 155-year-old tunnel to showcase unique architectural and geological components, while others invitingly illuminate the entrances. The tunnel lighting runs a dynamic "Philips Light Show" 365 days a year, drawing both local residents and tourists.

Community leaders credit the newly illuminated tunnel with creating a new city identity, fostering livability and supporting the local economy. It has quickly become one of the must-see attractions in the Thousand Islands region of eastern Ontario, drawing tens of thousands of extra visitors to the city in the first months since it was opened.

Further adding to its appeal, residents are also able to request custom lightshows for events held on the waterfront. The reinvigorated railway tunnel has already become a central hub to host community events and festivals year-round, further cementing its position as an iconic landmark.



**Perth Stadium, Perth, Australia**

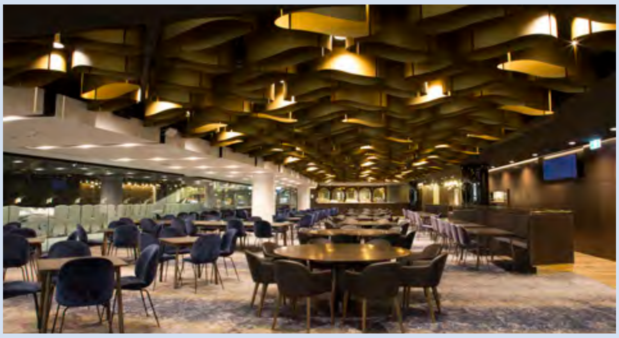
# Delivering an unrivalled spectator experience

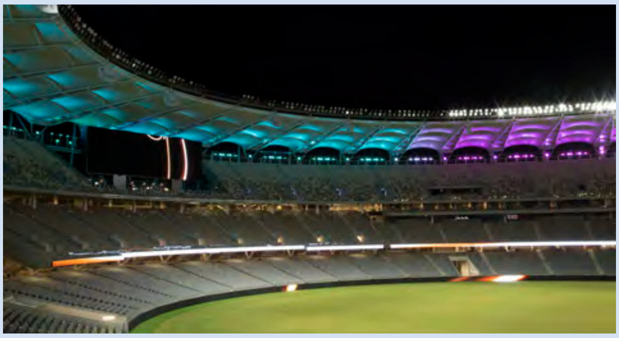
In 2017, Perth Stadium in Australia became the first fully LED-lit, multi-purpose stadium implementation in the Asia-Pacific region, supporting its mission to become the premier stadium venue in the southern hemisphere.

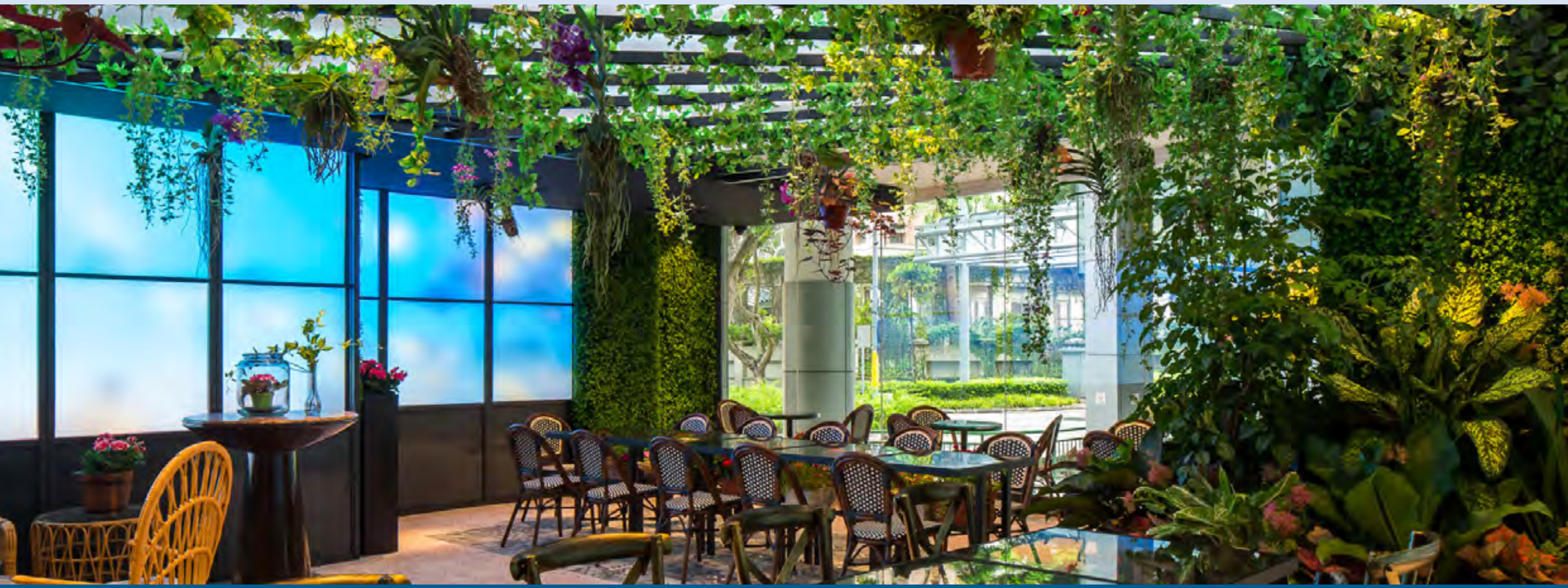
**The challenge**
As part of the West Australian Government's 'fans-first' approach, the stadium's lighting needed to be flexible enough to create a multi-purpose arena that would enable fans to watch anything from their home football and cricket teams, to world-famous rock concerts.

**The solution**
Philips Lighting provided a complete stadium lighting experience, encompassing lighting for the façade, pitch, offices and hospitality areas. The holistic LED stadium lighting system includes more than 15,000 controllable LED light fittings, managed from their own control platform. It has the flexibility to create a completely immersive lighting experience for the 60,000-capacity venue, making it ideal for a variety of events.

This system can be synchronized with external lighting consoles for other types of lightshows and events. The roof canopy acts as a giant canvas upon which spectacular light shows can be created with patterns and imagery via the connected light points.







Picnic restaurant, Singapore

# Bringing the garden indoors with connected lighting

Singapore's Picnic restaurant is an urban wonder – a 930-square meter mall location that with the help of connected lighting has been transformed into an indoor oasis, offering not only cuisine from around the world, but also a relaxing place to unwind and escape from the heat.

**The challenge**
Singapore is hot and humid all year round. So, for his garden-themed restaurant, restaurateur Cheng Hsin Yao envisioned a place combining the liveliness and energy of outdoor dining with the opportunity to relax in the comfort of an air-conditioned indoor environment. There were many challenges to overcome – including a busy mall location, limited natural light, and a relatively low ceiling.

**The solution**
To recreate the four seasons in Singapore's indoor city garden, Philips Lighting specialists worked with the design team to specify innovative and beautifully designed lighting systems for this project. A connected LED lighting system mimics the natural daylight of an actual outdoor park and creates changing scenes, ranging from passing clouds during the day to rosy sunsets and starry night skies. The lighting is synced with the weather forecast and tracks changes up to three times a day.

The system also has the flexibility to create dazzling light effects for special events and includes panels that integrate multi-colored LEDs seamlessly within beautiful fabric panels that help to absorb sound.

Lighting has become an integral part of the dining experience - not just for the ambience it creates, but also for the feelings and memories it evokes. It's a first-of-its-kind garden dining experience.

## 3.2 Supporting the SDGs

The United Nations Sustainable Development Goals (SDGs) are a set of 17 aspirational goals with 169 targets linked to them. As Philips Lighting, we believe we have an important role to play to achieve them.

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. We believe these targets and our expertise in lighting position us well to actively contribute to the SDGs. While all the SDGs are important, our capacity to support their individual achievement varies. There are four SDGs we focus most strongly on, as they are where our company can be most influential: SDGs 7, 11, 12 and 13.

Philips Lighting
**Sustainability targets**

| Program | Target 2020 |
|---|---|
| Sustainable revenues | 80% of revenues |
| LED lamps & luminaires | >2 billion LED lamps & luminaires delivered cumulatively since 2015 |
| Operational carbon footprint | Net 0 kt $CO_2$ emissions |
| Electricity | 100% of electricity from renewable sources |
| Waste to landfill | Zero waste to landfill |
| Health & Safety | Total recordable injury case rate of <0.35 |
| Sustainable Supply Chain | Performance rate of 90% |

**SDG 7: Affordable and clean energy**

Reaching our 2020 goal to deliver 2 billion LED lamps & luminaires is estimated to save an amount of energy equivalent to that generated by 60 medium-sized coal-fired power stations when combined with connected systems. We also provide access to light to communities that live off-grid or are underserved by the grid.

**SDG 11: Sustainable cities and communities**

Our sustainable operations' practices and our sustainable products, systems, and services help reduce the adverse environmental impact of cities. Through the Philips Lighting foundation, we provide humanitarian lighting in cases of emergency or disaster.

**SDG 12: Responsible consumption and production**

Sustainable lighting is energy efficient, saves material resources and helps 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. Through our Sustainable operations programs, we reduce the environmental impacts of our operations in terms of $CO_2$ and waste to landfill.

**SDG 13: Climate action**

Through our commitment to carbon neutrality, sourcing of renewable electricity, and the delivery of sustainable lighting, we support the transition to a low-carbon economy. We advocate climate action through our partnerships with UN agencies, governments, academia, NGOs and industry peers.

**Cardiff, United Kingdom**

# Realizing smart city ambitions with connected lighting

The City of Cardiff in Wales took a major step forward in its ambitions to become a smart city by installing more than 14,000 connected LED street lights managed by the Philips CityTouch software platform. The project marks another major milestone – the 1,000th installation using CityTouch.

**The challenge**
With approximately 360,000 residents and 20 million visitors a year, Cardiff officials considered many factors when deciding which connected lighting system to select. Top priorities included ensuring maximum benefit for citizens and capitalizing on potential cost- and energy savings. They also wanted an infrastructure that could grow with the city's needs and provide quality light to make citizens feel safer.

**The solution**
Philips CityTouch offers Cardiff a powerful lighting asset management capability. Through a web browser, a lighting manager has a map-based view of the city's lighting assets and can monitor network performance in near real time, pinpointing issues to precise locations, eliminating the need for night crews to drive around looking for faulty lights. The connected lighting system also makes it easier to identify incidents on the road and relay that information to emergency services.

Switching to connected LED lighting is also expected to reduce electricity used for lighting by 60% with estimated savings of more than GBP 750,000 per year. This efficiency will contribute to the UK's goal to lower $CO_2$ emissions by 34% by 2021.


**Schiphol Airport, Amsterdam, The Netherlands**

# Choosing circular lighting to modernize a transportation hub

Lounge 2 at Amsterdam's Schiphol Airport is the first large project using the Philips Circular lighting business model, helping the airport create both a more dynamic space and compete with other European airports in terms of quality and originality.

**The challenge**
As part of its mission to be the most sustainable airport in Europe, Schiphol decided to make reducing energy consumption a priority when remodeling Lounge 2. As one of Europe's busiest airports, nearly 15 million people visit Schiphol's Lounge 2 annually. So, in addition to aesthetics, it was important that luminaires can be easily repaired or replaced.

**The solution**
With no initial investment and a monthly service fee including energy and maintenance costs, the Philips Circular lighting service was Schiphol's choice. In this new model, lighting ownership is replaced by "pay as you go". Instead of buying luminaires, Schiphol buys light.

When the contract expires, Schiphol has the choice to either extend it by upgrading the existing lighting, or opt for new lighting. Luminaires can then be returned to Philips Lighting for reuse or recycling. The new lighting consumes 50% less power than the previous lighting and the luminaires have a 75% longer lifespan.

# 4. Corporate performance

## 4.1 Financial performance

### 4.1.1 2017 Highlights

In line with the company's objectives, Philips Lighting returned to positive comparable sales growth in the course of 2017. Growth in LED and connected lighting Systems & Services more than offset the decline in the conventional business for the first time in the transformation. The solid performance in LED, Professional and Home drove total LED-based comparable sales growth of 19%. Total LED-based sales now represent 65% of total sales compared to 55% in 2016. Adjusted EBITA margin reached 10.0%, an improvement of 90 basis points year-on-year. Net income increased from EUR 185 million to EUR 281 million. The company also delivered solid free cash flow of EUR 403 million in 2017.

Sales amounted to EUR 6,965 million, a decrease of 2.1% on a nominal basis. Adjusted for a 1.6% negative currency effect and 1.0% negative consolidation impact, comparable sales were 0.5% higher than in 2016. Lamps reported a decline, due to the continued market transition from conventional to LED lighting. LED showed double-digit volume growth, partly offset by price erosion and stronger growth in value products. Professional grew in 2017, with a solid performance in Europe and the Rest of the World, mainly driven by robust growth in Systems & Services that accounted for 24% of sales in 2017. Home delivered significant growth, mainly driven by Home Systems.

Philips Lighting
**Key figures** in mEUR unless stated otherwise
2016-2017

| | **2016** | **2017** |
|---|---:|---:|
| Sales | 7,115 | 6,965 |
| Comparable sales growth [1] | (2.4%) | 0.5% |
| Gross margin | 2,677 | 2,701 |
| *as a % of sales* | *37.6%* | 38.8% |
| Income from operations | 369 | 441 |
| Net financial income/expense | (67) | (43) |
| Income tax expense | (119) | (117) |
| Net income | 185 | 281 |
| | | |
| Adjusted gross margin [1] | 2,763 | 2,752 |
| Adjusted indirect costs [1] | (2,257) | (2,191) |
| Adjusted EBITA [1] | 645 | 699 |
| *as a % of sales* | *9.1%* | 10.0% |
| Restructuring, acquisition and incidental items [1] | (166) | (128) |
| EBITA [1] | 479 | 571 |
| | | |
| Earnings per share in EUR | 1.26 | 2.04 |
| Dividend per share in EUR [2] | 1.10 | 1.25 |
| | | |
| Shareholders' equity | 2,704 | 2,242 |
| Net debt [1] | 341 | 367 |
| Working capital [1] | 662 | 557 |
| Net cash provided by operational activities | 505 | 435 |
| Free cash flow [1] | 418 | 403 |

1) For a reconciliation to the most directly comparable IFRS financial measure, see chapter 18, Reconciliation of non-IFRS financial measures, of this Annual Report.
2) Dividend 2017 subject to approval by the 2018 Annual General Meeting of Shareholders.

In 2017, the gross margin improved to EUR 2,701 million, or 38.8% of sales, compared to EUR 2,677 million, or 37.6% of sales, in 2016. The improvement was driven by procurement savings and increased productivity, partly offset by price erosion. The gross margin in 2017 included EUR 52 million of restructuring and incidental charges, whereas 2016 included EUR 86 million of such charges. This is mainly due to lower restructuring costs in Professional. Adjusted gross margin amounted to EUR 2,752 million. The adjusted gross margin, as a percentage of sales, improved by 70 basis points to 39.5%.

Adjusted indirect costs decreased to EUR 2,191 million, compared to EUR 2,257 million in 2016. Adjusted SG&A expenses were reduced by EUR 60 million to EUR 1,857 million as a result of cost-reduction initiatives. The company is implementing various actions to drive benefits across multiple levers, including process and footprint optimization, simplification of the organizational structure and product portfolio, and optimization of its sourcing strategy. SG&A expenses in 2017 included EUR 102 million of restructuring and incidental items, compared to EUR 81 million last year. The increase can mainly be explained by an impairment of acquisition related intangible assets. Adjusted R&D expenses amounted to EUR 334 million compared to EUR 340 million in 2016. As a percentage of sales, adjusted R&D expenses remained stable compared to 2016, at 4.8%. R&D expenses in 2017 included EUR 20 million of restructuring costs, compared to EUR 13 million in 2016.

The improvements in gross margin and lower adjusted indirect costs, as a result of cost measures taken, have led to an improvement of income from operations from EUR 369 million in 2016 to EUR 441 million in 2017. Restructuring and incidentals amounted to EUR 128 million, of which restructuring costs were EUR 125 million. The restructuring costs were mainly related to Lamps and Professional. The company estimates that annual total restructuring costs will amount to 1.5%-2.0% of the company's total sales until 2019, with the majority of these restructuring costs expected to relate to the Lamps and Professional businesses.

EBITA increased to EUR 571 million, compared to EUR 479 million in 2016. Adjusted EBITA amounted to EUR 699 million, resulting in a 90 basis points increase in the Adjusted EBITA margin to 10.0%.

Over 2017 the company had lower interest expenses compared to 2016, driven by FX result and lower interest on pensions and debt structure. The effective tax rate for 2017 was 29.3%, compared to 39.1% in 2016, primarily due to non-recurring tax charges in 2016 related to the separation from Royal Philips. Net income increased by EUR 96 million to EUR 281 million, mainly driven by higher operating profit and lower financial expenses.

Net cash provided by operating activities decreased to EUR 435 million, due to higher inventories, partly offset by improved receivables and lower interest paid.

Free cash flow amounted to EUR 403 million compared to EUR 418 million in 2016. Free cash flow also included a restructuring pay-out of EUR 99 million and costs related to the separation from Royal Philips of EUR 24 million.

Shareholders' equity at year-end amounted to EUR 2,242 million, compared to EUR 2,704 million last year, due to the repurchase of shares, currency translation results and dividend distribution, which was partly offset by the net income for the period.

Net debt amounted to EUR 367 million, an increase of EUR 26 million compared to the end of 2016. This includes a dividend of EUR 157 million and share repurchases of EUR 307 million. The cash position reduced from EUR 1,040 million in 2016 to EUR 942 million in 2017. Gross debt reduced from EUR 1,381 million to EUR 1,309 million year-on-year.

During 2017, the net pension liability decreased from EUR 602 million to EUR 496 million. The reduction is mainly attributable to total contributions of EUR 45 million to the qualified pension plan in the United States and to a EUR 38 million exchange-rate impact.

Philips Lighting employed 32,130 full-time equivalents (FTEs) at year-end 2017, compared to 34,256 at year-end 2016.

### 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). Conventional 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 (OEMs) market and the replacement market.

Philips Lighting
**Key figures Lamps** in mEUR unless stated otherwise
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Sales | 2,333 | 1,820 |
| *Nominal sales growth (%)* | *(18.1%)* | *(22.0%)* |
| *Comparable sales growth (%)* [1] | *(15.8%)* | *(18.6%)* |
| Income from operations (or EBIT) | 433 | 349 |
| EBITA [1] | 435 | 350 |
| Adjusted EBITA [1] | 472 | 370 |
| *as a % of sales* | *20.2%* | *20.3%* |
| Number of employees (in FTEs) [2] | 13,237 | 11,224 |

1) For a reconciliation to the most directly comparable IFRS financial measure, see chapter 18, Reconciliation of non-IFRS financial measures, of this Annual Report.
2) FTEs per segment are now presented in line with the cost allocation.

### Strategic priorities
Lamps aims to optimize free cash flow through its last man standing strategy. While the overall conventional market continues to decline, Lamps' focus is on winning market share in key segments and markets. In addition, the Business Group maintains a focus on niche areas such as horticulture, special lighting and digital projection lighting. Lamps continues to pro-actively manage its manufacturing footprint and reduce operational costs.

### 2017 Business highlights
- **Philips EB-Ci lamps:** In 2017, we introduced EB-Ci lamps, an intelligent, single SKU solution for most common Fluorescent lamp wattages and combinations which gives significant simplicity for customers in managing their stock, ordering and lead-times, plus simplifies their onward solutions to end-users.
- **Manufacturing footprint rationalization:** The number of manufacturing plants in operation for conventional lamps was 16 at the end of 2017 compared to 45 at the end of 2008. No sites were closed in 2017, although EUR 41 million of restructuring costs were incurred in 2017 as a result of continued restructuring efforts related to the manufacturing footprint. For example, in Q4 2017, Lamps announced that the facility in Turnhout will be further downscaled. Lamps intends to continue proactively rationalizing its manufacturing footprint in line with market developments.

### 2017 Financial performance
Sales for 2017 amounted to EUR 1,820 million, a decline of 22.0% on a nominal basis and 18.6% on a comparable basis, due to the transition from conventional to LED lighting.

Income from operations reduced to EUR 349 million, due to the significant sales decrease, partly offset by pro-active rationalization of the manufacturing footprint as well as by productivity and procurement savings. EBITA amounted to EUR 350 million, compared to EUR 435 million in 2016. This includes EUR 41 million of restructuring costs which were partly offset by incidental items related to real estate gains of EUR 31 million. Adjusted EBITA for 2017 decreased to EUR 370 million compared to EUR 472 million in 2016. The Adjusted EBITA margin remained robust at 20.3% in 2017, in line with the company's objective to maintain the Adjusted EBITA margin above 16%.

### 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.

Philips Lighting estimates that the conventional lighting market declined at a faster pace than its Lamps business in 2017, which resulted in continued market share gains.

### 2018 and beyond
The performance of Lamps in 2017 reflected the successful implementation of the company's last man standing strategy to continue to extract value from the conventional business.
A continued reduction of the manufacturing footprint and cost base supports the objective to maintain an Adjusted EBITA margin of at least 16% until 2019. In 2018, Lamps will continue to execute its strategy and optimize free cash flow by leveraging the Business Group's cost advantage, scale, global footprint and lean manufacturing capabilities while responding to customer demand for conventional products.

## Performance LED

### About LED
LED sells a wide variety of LED lamps, namely spots, bulbs and tubes, to the professional and consumer channels. These products are replacing existing conventional lamps. In addition, the Business Group sells LED electronic components, consisting of LED drivers and LED modules, to luminaire OEMs for professional luminaire applications in the retail & hospitality, office & industry and outdoor segments. Based on internal research, the company believes that the

Business Group holds the number one position in sales in the global LED lamps and electronics market in 2017.

Philips Lighting
**Key figures LED** in mEUR unless stated otherwise
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Sales | 1,518 | 1,703 |
| *Nominal sales growth (%)* | *13.8%* | *12.2%* |
| *Comparable sales growth (%)* 1) | *16.1%* | *13.8%* |
| Income from operations (or EBIT) | 136 | 165 |
| EBITA 1) | 140 | 169 |
| Adjusted EBITA 1) | 142 | 174 |
| *as a % of sales* | *9.4%* | *10.2%* |
| Number of employees (in FTEs) 2) | 5,917 | 5,912 |

1) For a reconciliation to the most directly comparable IFRS financial measure, see chapter 18, Reconciliation of non-IFRS financial measures, of this Annual Report.
2) FTEs per segment are now presented in line with the cost allocation.

## Strategic priorities

The Business Group aims to further strengthen its leadership position in LED lamps and LED electronics by increasing sales through the ongoing introduction of new products and meaningful product differentiation. On the consumer LED lamps side, this includes broadening the multi-tier approach through private label business, and further growing in developing markets. On the professional LED lamps side, the Business Group focuses on growing business-to-business LED lamp sales by continuing to lead in product innovation, expanding business-to-business trade, further growing in developing markets and increasing focus on locally-relevant products. In the LED electronics business, the aim is to generate more revenues from global OEMs by increasing the number of OEM customers and growing the share of wallet with existing OEM customers.

## 2017 Business highlights

- **One billion LEDs:** Leading the UN's Global Lighting Challenge, we announced in November that we are the first company to deliver one billion LED lights and that we are on track to meet our commitment of two billion LED lamps and luminaires ahead of our 2020 target. The realized savings are equivalent to the energy generated by 30 medium-sized coal-fired power stations and $CO_2$ emissions from 12 million cars.
- **Philips TrueForce LED range:** We introduced the Philips TrueForce LED range, supporting our continuous innovation in LED products to outgrow the market. TrueForce LED reduces energy and maintenance costs, while providing uncompromised light quality. Its compatibility with existing ballasts and the versatility of the product design means that it can be installed quickly and used across a wide range of applications and environments, from convention centers and airport terminals to big box retailers and warehouses.
- **Philips EasySmart TLED:** Driving continuous innovation in LED products, we introduced Philips LED T8 lamps with EasySmart technology in the United States. Combining TLEDs with EasySmart technology enables easy integration with control devices, reducing energy, effort and costs of lighting, while providing intelligent control.
- **Philips T5 LED tube:** We expanded the Philips MASTER LED tubes portfolio with the Philips T5 LED tubes as part of our continuous innovation in LED products. The energy-saving T5 LED tubes offer high light output and quality, and easy installation with a simple lamp-for-lamp replacement.

## 2017 Financial performance

Sales were EUR 1,703 million, reflecting nominal sales growth of 12.2% and comparable sales growth of 13.8%. Volumes were higher due to price erosion and stronger growth in value products. All regions contributed to growth, with countries with low penetration rates continuing to show higher growth.

Income from operations improved to EUR 165 million compared to EUR 136 million in 2016, driven by operational leverage and procurement savings, offsetting price reductions and mix impact. EBITA increased to EUR 169 million, compared to EUR 140 million in 2016. Adjusted EBITA increased to EUR 174 million. This resulted in a robust improvement of the Adjusted EBITA margin by 80 basis points to 10.2%.

## Market developments

There is a market trend of both professional and consumers switching from buying (LED) lamps and luminaires to integrated LED luminaires, as anticipated in the company's strategy. We expect this integrated LED functional luminaires market to continue its double-digit growth annually through 2020. The company's ambition is to drive market share gains and leadership in this segment. Philips Lighting continues to expect that the LED lamps market will peak in 2020 in terms of volumes. The LED electronics market will continue to grow as all LED lighting products require a driver so the market for drivers will increase with the transition to LED lighting. Furthermore, modules are also used in LED luminaires and, as a result, this segment is expected to grow on the back of LED luminaires market growth.

## 2018 and beyond

LED's performance in 2017 illustrated the benefit of its strategy focused on innovation and operational leverage, resulting in an Adjusted

EBITA margin in 2017 that was already at the lower end of the 2019 target range of 10%-12%.

# 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 and Systems & Services with strong positions across key geographies. Professional products and Systems & Services are used in multiple market segments such as offices, commercial buildings, shops, hospitality, industry and outdoor environments including smart cities. The products in Professional have historically experienced a rapid shift from conventional to LED and have been integrated into broader Systems & Services capabilities.

Philips Lighting
**Key figures Professional** in mEUR unless stated otherwise
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Sales | 2,683 | 2,755 |
| *Nominal sales growth (%)* | *(2.7%)* | *2.7%* |
| *Comparable sales growth (%)* [1] | *(0.5%)* | *4.6%* |
| Income from operations (or EBIT) | (9) | 62 |
| EBITA [1] | 93 | *181* |
| Adjusted EBITA [1] | 145 | 225 |
| *as a % of sales* | *5.4%* | *8.2%* |
| Number of employees (in FTEs) [2] | 12,385 | 12,131 |

1) For a reconciliation to the most directly comparable IFRS financial measure, see chapter 18, Reconciliation of non-IFRS financial measures, of this Annual Report.
2) FTEs per segment are now presented in line with the cost allocation.

## 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. 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 its Systems & Services offering.

## 2017 Business highlights

- **InterAct Office:** In the US, we introduced InterAct Office, which is cloud-based software that enables wireless control of connected lighting systems, resulting in faster and easier office lighting renovations. InterAct Office also controls our Power-over-Ethernet (PoE) lighting systems, which have been deployed worldwide, and signals our continued leadership in lighting systems for the office segment. InterAct Office can deliver data-driven insights, enable energy savings of up to 70% and optimize operations via new applications including lighting energy, scene, and space management.
- **Alliance with American Tower Corporation:** Reinforcing our continued leadership in connected lighting systems, we formed an alliance with American Tower Corporation to develop smart light poles, integrating multiple 4G/5G base stations with connected street lights to enable telecommunication services from multiple providers.
- **Philips CityTouch:** Continuing our leadership in Systems & Services, Philips CityTouch added over 250 projects in 2017, bringing the total number of installations to more than 1,000 projects in 37 countries since 2012. Philips CityTouch allows municipalities to remotely monitor, control and manage their connected street lighting infrastructure through simple web applications and can help reduce energy consumption by up to 70%.

## 2017 Financial performance

Sales increased 2.7% on a nominal basis to EUR 2,755 million. This represents an increase of 4.6% on a comparable basis, mainly driven by robust growth in Europe and the Rest of the World. Market conditions in the Middle East remained challenging. The performance in the United States was impacted by softer market conditions, particularly for small- to medium-sized projects.

Professional reported income from operations of EUR 62 million in 2017. The Business Group benefited from operational leverage, procurement savings and a positive mix impact. EBITA amounted to EUR 181 million, compared to EUR 93 million in 2016. This included restructuring costs of EUR 45 million, mainly related to simplification of business structures, reduction of indirect costs and industrial footprint rationalization. Adjusted EBITA amounted to EUR 225 million. The Adjusted EBITA margin improved by 280 basis points to 8.2%.

## Market developments

Across professional products and Systems & Services, competition varies by geography as all regions have locally-relevant competitors. Traditional competitors in North America and Europe remain relatively concentrated. One of the contributing factors to the increased use of LED technologies is the expanding offering of systems which enable users to program and control lights through connectivity with sensors and networks. The transition to connected lighting is occurring rapidly, particularly in developed countries. Professional systems typically control a large network of lights and potential savings based on total cost of ownership tend to be significant.

### 2018 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 the company's ambition to increase the Adjusted EBITA margin to 11-14% for Professional by 2019.

# Performance Home

### About Home

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

Philips Hue, introduced in 2012, is the market leader in connected home lighting. The system enables users to control lights wirelessly through apps on smart devices, with their voice or with remote control switches and sensors, and to personalize their lighting to suit their preferences and needs.

Philips Lighting
**Key figures Home** in mEUR unless stated otherwise
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Sales | 559 | 684 |
| *Nominal sales growth (%)* | *8.7%* | *22.3%* |
| *Comparable sales growth (%)* [1] | *11.0%* | *26.5%* |
| Income from operations (or EBIT) | (48) | 27 |
| EBITA [1] | (46) | 31 |
| Adjusted EBITA [1] | (20) | 36 |
| *as a % of sales* | *(3.6%)* | *5.2%* |
| Number of employees (in FTEs) [2] | 1,636 | 1,783 |

1) For a reconciliation to the most directly comparable IFRS financial measure, see chapter 18, Reconciliation of non-IFRS financial measures, of this Annual Report.
2) FTEs per segment are now presented in line with the cost allocation.

### Strategic priorities

Home aims to realize profitable growth by driving the transition to LED luminaires and connected lighting. Its strategic priorities include strengthening the Home Systems offering and broadening the lower cost portfolio to drive volumes. Furthermore, Home Systems aims to further expand in growth markets.
Home Luminaires aims to create scalable platforms to drive growth in functional luminaires and strengthen the global portfolio. Operational excellence is an important strategic priority across the board.

### 2017 Business highlights

- **Philips Hue Entertainment:** We unveiled Philips Hue Entertainment, further strengthening Philips Hue's position as the world's leading connected lighting system for the home. The free software update synchronizes lighting with gaming, movies and music to create an immersive end-user entertainment experience.
- **Philips Hue white and color ambiance candle light bulb:** We introduced the Philips Hue white and color ambiance candle light bulb, strengthening Philips Hue's position as the most extensive connected home lighting system. The candle, available in Europe and in North America, means Philips Hue can now be used in over 80% of light sockets in households around the world.
- **Philips Abelia LED lantern:** The new portable outdoor light, Philips Abelia LED lantern, was introduced as part of the company's continuous innovation in LED products. The introduction comes as consumers increasingly look for versatile outdoor lighting options, especially in urban areas, where space comes at a premium.
- **'Friends of Hue' partnership:** Philips Hue further strengthened its leadership position by adding Baidu as a 'Friends of Hue' partner in China, expanding voice control over Philips Hue lights to Baidu's DuerOS operating system. The partnership makes it easier for Chinese consumers to set-up connected lighting and accelerates the adoption of smart home technology in China.

Philips Lighting continues to optimize the speed of cloud-based communications between Philips Hue and voice-activated platforms, to strengthen its position as the world's leading connected home lighting system. The introduction of voice-activated platforms such as Amazon Alexa, Apple HomeKit, the Google Assistant and Microsoft Cortana, is helping to drive sales of Hue.

### 2017 Financial performance

Sales increased to EUR 684 million in 2017, with a nominal sales growth of 22.3% and comparable sales growth of 26.5%, driven by sustained growth in both Home Systems and Home Luminaires as a result of the continued focus on innovation. Demand for Philips Hue increased significantly in 2017, illustrating the success of Home's connected lighting system strategy, largely as a result of the company's continued focus on innovation, and its strong partnerships with the makers of recently introduced voice-activated smart home devices.

Home became profitable in 2017, in line with its objectives. Income from operations improved to EUR 27 million from EUR (48) million in 2016, driven by operational leverage and a continued focus on product cost innovation. EBITA amounted to EUR 31 million, compared to EUR (46) million in 2016, reflecting the benefits of sales growth and improved efficiency resulting from restructuring efforts in previous years. Adjusted EBITA was EUR 36 million. Excluding a real estate gain of EUR 15 million, the Adjusted EBITA margin was 3.1%.

### Market developments
The consumer lighting market is expected to benefit from the increasing adoption of connected home lighting systems, as well as the transition to LED luminaires. Within the consumer market, conventional as well as LED consumer luminaires, will remain the largest segments while home systems is expected to continue to grow strongly.

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

### 2018 and beyond
Home's performance in 2017 demonstrates the success of its strategy to focus on how consumers can enrich their experiences at home with lighting, leveraging its strengths in LED and connected lighting systems for the home. It is the company's ambition that this will result in continued double-digit sales growth and Home reaching an Adjusted EBITA margin in the range of 5%-8% by 2019.

# Performance Other

Other reported EBITA of EUR (160) million, including restructuring costs of EUR 29 million. 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. Adjusted EBITA amounted to EUR (106) million in 2017, compared to EUR (94) million in 2016. Other incidentals, which are not part of Adjusted EBITA, included EUR 24 million separation costs. The number of FTEs was 1,079 at the end of 2017, versus 1,080 at the end of 2016*.

## 4.1.3 Performance by geographic cluster
Nominal sales were negatively impacted by unfavorable currency effects. The ongoing transformation from conventional to LED lighting is reflected in all markets globally. Comparable sales in Europe increased by 4.5%, driven by a solid performance in, among others, the Benelux, Germany and Iberia. In the Americas, sales decreased by 2.3% on a comparable basis due to an accelerated decline in conventional lighting and softer market conditions, most notably in the United States. Comparable sales for the Rest of the World remained relatively flat at (0.8)%, with a solid performance in markets like India, Russia and Greater China, offset by continued challenging market conditions in the Middle East.

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

| | 2016 | 2017 | Change | CSG [1) 2)] |
|---|---|---|---|---|
| Europe | 2,208 | 2,292 | 3.8% | 4.5% |
| Americas | 2,245 | 2,151 | (4.2%) | (2.3%) |
| Rest of the World | 2,156 | 2,067 | (4.2%) | (0.8%) |
| Global business | 506 | 456 | (10.0%) | 1.0% |
| **Total** | **7,115** | **6,965** | **(2.1%)** | **0.5%** |

1) For a reconciliation to the most directly comparable IFRS financial measure, see chapter 18, Reconciliation of non-IFRS financial measures, of this Annual Report.
2) Comparable sales growth.

* FTEs per segment are now presented in line with the cost allocation.

## 4.2 Sustainability performance

### Social performance

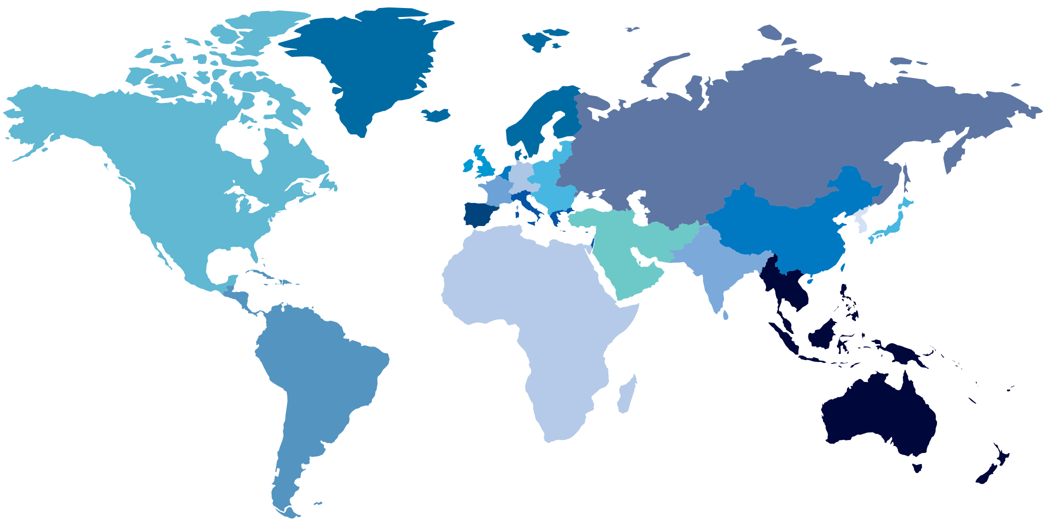
In 2017, our workforce decreased, particularly in Asia and the Americas, to a total of 32,130 FTEs (2016: 34,256 FTEs). This was primarily due to the rationalization of our industrial footprint and our focus on reducing indirect costs. At the same time, employee engagement improved strongly. This is measured through the employee Net Promoter Score, which had an overall score of 14 (2016: 8). Our safety performance indicator (TRC rate) showed improvements everywhere, with the exception of Europe, resulting in a TRC rate of 0.41 (2016: 0.50).

### Environmental performance

Our operational carbon footprint was 560 kilotonnes, an increase of 6% compared with 2016. This was due to increased logistics, especially in the Americas. We invested in carbon offsets to achieve a 20% net carbon footprint reduction year-on-year. Waste to landfill reduced to 1,807 tonnes (2016: 2,451 tonnes), due in part to the roll-out of our zero waste to landfill program. The percentage of waste recycled improved by two percentage points, to 87%.

Through our global presence, we drive our sustainability programs across 18 markets to manage our social and environmental performance.

**Sustainable performance per market**



| | FTE | | Manufacturing sites | | Safety TRC rate | | $CO_2$ emitted (kilotonnes $CO_2$) | | Waste recycled (%) | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2016 | 2017 | 2016 | 2017 | 2016 | 2017 | 2016 | 2017 | 2016 | 2017 |
| **Europe** | **13,692** | **13,717** | **20** | **17** | **0.44** | **0.56** | **169** | **167** | **87%** | **83%** |
| Benelux | 4,450 | 4,334 | 5 | 4 | 0.40 | 0.48 | 29 | 30 | 89% | 85% |
| Central & Eastern Europe | 6,023 | 6,421 | 6 | 6 | 0.36 | 0.43 | 94 | 99 | 79% | 83% |
| DACH (Germany, Austria, and Switzerland) | 677 | 664 | 1 | 1 | 0.33 | 0.9 | 13 | 5 | 89% | 89% |
| France | 973 | 786 | 2 | – | 1.51 | 1.53 | 15 | 17 | 95% | – |
| Iberia | 668 | 640 | 2 | 2 | 0.79 | 1.2 | 6 | 5 | 82% | 80% |
| Italy, Israel, and Greece | 284 | 268 | 2 | 2 | – | – | 3 | 4 | – | – |
| Nordics | 259 | 260 | 1 | 1 | 0.45 | – | 3 | 2 | – | – |
| UK & Ireland | 358 | 344 | 1 | 1 | – | 0.56 | 6 | 5 | 89% | 63% |
| **Americas** | **8,983** | **7,797** | **17** | **16** | **0.86** | **0.47** | **172** | **203** | **80%** | **86%** |
| Canada | 748 | 713 | 2 | 2 | 0.71 | 0.79 | 12 | 13 | 81% | 89% |
| Latin America | 4,972 | 4,067 | 6 | 6 | 0.39 | 0.21 | 32 | 40 | 81% | 90% |
| United States of America | 3,263 | 3,017 | 9 | 8 | 1.61 | 0.81 | 128 | 150 | 74% | 81% |
| **Rest of the World** | **11,581** | **10,616** | **12** | **11** | **0.21** | **0.19** | **187** | **190** | **92%** | **98%** |
| Africa | 142 | 126 | – | – | – | – | 6 | 7 | – | – |
| ASEAN & Pacific | 1,036 | 945 | 2 | 1 | 0.09 | 0.10 | 21 | 24 | – | – |
| Greater China | 5,092 | 4,725 | 5 | 5 | 0.16 | 0.11 | 69 | 68 | 91% | 92% |
| Indian subcontinent | 3,599 | 3,392 | 2 | 2 | 0.23 | 0.23 | 77 | 74 | 96% | 99% |
| Japan | 50 | 44 | – | – | – | – | 1 | 1 | – | – |
| Middle East & Turkey | 1,529 | 1,278 | 3 | 3 | 0.83 | 0.46 | 12 | 13 | – | – |
| Russia and Central Asia | 133 | 106 | – | – | – | – | 1 | 3 | – | – |

## 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.

On December 31, 2017, the issued share capital consisted 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 2018 Annual General Meeting of Shareholders to declare a dividend of EUR 1.25 per share (up to EUR 174 million), in cash, against the net income for 2017.

The balance sheet presented in this report, as part of the company financial statements for the period ended December 31, 2017, is before appropriation of the result for the financial year 2017.

## 4.4 Outlook

In 2018, we aim to improve our Adjusted EBITA margin to 10.0%-10.5%, in line with our medium-term outlook. We will continue to focus on our cost reduction initiatives, and expect to benefit from higher savings as of the second half of 2018. We also aim to deliver positive comparable sales growth for the full year, with a soft start in the first quarter. We expect to generate solid free cash flow in 2018, which is, however, expected to be somewhat lower than the level in 2017 due to higher restructuring payments.

# 5. Three-year overview

Philips Lighting
**Three-year financial summary** in mEUR unless stated otherwise
2015-2017

| | 2015 | 2016 | 2017 |
|---|---|---|---|
| **Income statement** | | | |
| Sales | 7,465 | 7,115 | 6,965 |
| *Comparable sales growth* [1] | *(3.5%)* | *(2.4%)* | *0.5%* |
| *Nominal sales growth* | *6.9%* | *(4.7%)* | *(2.1%)* |
| Sales of LED based products [2] | 43% | 55% | 65% |
| Gross margin | 2,655 | 2,677 | 2,701 |
| *as a % of sales* | *35.6%* | *37.6%* | *38.8%* |
| Income from operations (EBIT) | 331 | 369 | 441 |
| Net income (loss) | 240 | 185 | 281 |
| Adjusted EBITA [1] | 547 | 645 | 699 |
| *as a % of sales* | *7.3%* | *9.1%* | *10.0%* |
| EBITA [1] | 438 | 479 | 571 |
| Net income (loss) attributable to shareholders | 226 | 189 | 294 |
| Earnings per share in EUR | | 1.26 | 2.04 |
| Dividend per share in EUR [3] | | 1.10 | 1.25 |
| **Balance sheet** | | | |
| Total assets | 6,443 | 7,455 | 6,678 |
| Shareholders' equity | 3,513 | 2,704 | 2,242 |
| Net debt [1] | 5 | 341 | 367 |
| Working capital [1] | 832 | 662 | 557 |
| **Investments and cash flow** | | | |
| Cash flow from operating activities | 717 | 505 | 435 |
| Net capital expenditure | (85) | (87) | (31) |
| Free cash flow [1] | 632 | 418 | 403 |

1) For a reconciliation to the most directly comparable IFRS financial measure, see chapter 18, Reconciliation of non-IFRS financial measures, of this Annual Report.
2) As % of sales.
3) 2017 dividend subject to approval by the 2018 Annual General Meeting of Shareholders.

Philips Lighting
**Three-year sustainability summary**
2015-2017

| | 2015 | 2016 | 2017 |
|---|---|---|---|
| Sustainable revenues, in millions of euros | 5,343 | 5,536 | 5,363 |
| Sustainable revenues, as a % of total sales | 72% | 78% | 77% |
| Sustainable innovation, in millions of euros | 252 | 272 | 277 |
| Sustainable innovation, as a % of adjusted research & development spend | 69% | 80% | 83% |
| Operational carbon footprint, in kilotonnes $CO_2$-equivalent | 666 | 528 | 560 |
| Operational energy efficiency, in terajoules per million euro sales | 0.70 | 0.63 | 0.63 |
| Operational energy use in terajoules | 5,213 | 4,460 | 4,408 |
| Renewable electricity, as a % of total electricity usage | 58% | 67% | 80% |
| Water intake, in thousands $m^3$ | 1,751 | 1,451 | 1,321 |
| Total waste, in kilotonnes | 45 | 40 | 43 |
| Materials provided for recycling via external contractor per total waste, in % | 85% | 85% | 87% |
| Restricted substances, in kilograms | 7 | 6 | 5 |
| Emissions of VOC's in lacquering processes | 2,708 | 1,916 | 1,645 |
| ISO-14001 certification, as a % of all reporting organizations | 88% | 88% | 85% |
| Employee Net Promoter Score | (5) | 8 | 14 |
| Female executives, in % of total | 20 | 17 | 17 |
| Total recordable cases, per 100 FTEs | 0.66 | 0.50 | 0.41 |
| Lost workday injuries, per 100 FTEs | 0.34 | 0.22 | 0.27 |
| Fatalities | – | 2 | 1 |
| Initial and continual supplier conformance audits, number of audits | 66 | 103 | 112 |
| Suppliers audits, performance rate, in % | 90% | 92% | 95% |

# 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
Member of the Board of Management since May 2017

**René van Schooten**
Born 1959,
Dutch

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.

# 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. Currently Chairman of the Supervisory Board of BDR Thermea Group B.V. Chairman of the Supervisory Board of VanderLande Industries Holding B.V. until May 2017.

**Gerard van de Aast**
Born 1957,
Dutch

Vice-Chairman *

Committee(s) [A, B]

**Chairman of the Remuneration Committee**
**Member of the Supervisory Board since 2017; first term expires in 2021**
Former Chairman of the Boards of Management of Imtech and VolkerWessels. Currently Chairman of the Supervisory Board of Nederlandse Spoorwegen (*Dutch Railways*), member of the Supervisory Board of Witteveen+Bos and of Heisterkamp Transportation Solutions.

**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.

**Frans van Houten** **
Born 1960,
Dutch

Committee(s) [C]

**Member of the Supervisory Board since 2016;**
Currently Chief Executive Officer and Chairman of the Board of Management of Royal Philips and member of the Board of Directors of Novartis.

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

* As of January 1, 2018
** Frans van Houten was Vice-Chairman throughout 2017. As previously announced, he stepped down from the Supervisory Board on December 31, 2017

**Rita Lane**
Born 1962,
American

Committee(s) [A, C]

**Member of the Supervisory Board since 2016; first term expires in 2020**
Former Vice President of Operations at Apple Inc. Currently 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]

**Chair of the Audit Committee *****
**Member of the Supervisory Board since 2016; first term expires in 2018**
Former Chairman of the Board of Management of AkzoNobel.

**Jill Lee**
Born 1963,
Singaporean

Committee(s) [A]

**Member of the Supervisory Board since 2017; first term expires in 2021**
Currently member of the Board of Directors of Sulzer.

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

*** Jill Lee will take over the position of Chair of the Audit Committee as of April 1, 2018

# 8. Supervisory Board report

## 8.1 Introduction by the Chairman

2017 has been a successful and eventful year for Philips Lighting and the Supervisory Board.

In February, the company published its Annual Report for the first time and its first Annual General Meeting of Shareholders was held in Eindhoven in May. We also saw Royal Philips starting to sell down its shareholding in the company in three tranches to below 30%. This led to several changes to the composition to our board. Jill Lee and Gerard van de Aast were appointed by the shareholders meeting and joined our board. Frans van Houten, as one of the Royal Philips nominees, stepped down as Supervisory Board member at the end of the year. As a result, the Supervisory Board currently has six members who are all independent with the exception of Abhijit Bhattacharya, who was appointed upon nomination of Royal Philips in 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.

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 its committees performed their duties in 2017. We are happy to see the progress Philips Lighting has continued to make in 2017 operating as a listed standalone company, and look forward to making a contribution in years to come.

## 8.2 Key discussion topics and meetings in 2017

**Meetings and information**
The Supervisory Board held eight meetings in 2017, either in person or by means of a conference call. The Supervisory Board and committee meetings were well attended, with an attendance rate of 100% of each individual Supervisory Board member. As Frans van Houten and Abhijit Bhattacharya are also members of the board of management of Royal Philips, they did not participate in decision-making on dividend distribution and on the company's participation in sell down transactions by Royal Philips. Apart from these topics, there were no apparent conflicts of interest of material significance in 2017.

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.

Last year, the Supervisory Board discussed a range of topics, including:

- **Strategy and innovation**
  We had in-depth discussions on industry trends as well as opportunities and risks related to the Philips Lighting business model. In September, we had a dedicated session to discuss market developments and the competitive landscape, the company's current position and the company's strategy for the coming years.
  This was followed by a session in December in which the company presented its strategic plan together with its longer term financial objectives. On an ongoing basis, we have reviewed, challenged and advised the Board of Management on the company's implementation of its 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, we discussed the company's business performance. These included updates on the company's financial performance, business transformation, cost reduction initiatives - in particular those relating to the company's indirect costs, developments in working capital, the level of inventories and collection of receivables, and M&A.

- **Financial reporting**
  We discussed the quarterly results and the (semi-)annual financial statements for 2017, including related reports from the internal and external auditors and non-financial information. The Board of Management provided us with updates and feedback from investors and other stakeholders following each publication of financial results.

- **Risk management and Internal controls**
  We also discussed the company's risk management and internal controls, including significant changes and improvements thereto. The Supervisory Board had a dedicated session on the company's digital strategy and steps it is taking to mitigate cyber security-related risks. For more information on risk management and the company's business control framework, refer to chapter 12, Risk factors and risk management, of this Annual Report.

- **Operating as an independent company**
  Following its first full year as a standalone company in which we held our first Annual General Meeting of Shareholders, and in which we published our first Annual Report, we discussed the company's further progress in operating as a standalone company.
  We approved the participation of the company in the sell down transactions by Royal Philips by means of an accelerated book building process, which decreased Royal Philips' shareholding in Philips Lighting to below 30% and reviewed the consequences hereof for the company. Furthermore, we were updated on the company's steps in determining a new company name and the company's financing structure. The Supervisory Board also reviewed the company's organizational structure and its alignment with the changing business environment.

- **Operating plan for 2018**
  We discussed and approved the company's targets for 2018 within the context of its 2018 operating plan.

- **Capital allocation policy**
  We reviewed 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. We also discussed and approved the company's dividend proposal and its proposal to participate in share disposals by Royal Philips. Besides the regular discussion around annual dividend and the return of capital to shareholders, we approved the plan to make additional contributions to our US pension fund over the next few years.

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

- **Sustainability**
  In 2017, we discussed the company's sustainability and corporate social responsibility programs and progress made towards their respective goals.
  More information on these programs is provided in chapter 16, Sustainability statements, of this Annual Report.

## 8.3 Key activities of the Supervisory Board committees in 2017

### 8.3.1 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 until April 1, 2018), Rita Lane and Abhijit Bhattacharya are members of this committee which was expanded by Jill Lee and Gerard van de Aast in May 2017. Jill Lee will take over the position as chair as of April 1, 2018. The Audit Committee met six times in 2017; upon the conclusion of each quarter and additionally in February and December. The Audit Committee reported its findings to the full Supervisory Board after every meeting. Generally, the CEO, CFO, Group Controller, Head of Internal Audit, Chief Legal Officer and external auditor (Ernst & Young Accountants LLP) also attend these meetings.

In 2017, 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 functioning, 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 significant changes and improvements 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, and 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.

### 8.3.2 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 refer to chapter 10, Corporate governance, of this Annual Report). The committee is chaired by Arthur van der Poel. Rita Lane joined as member of the committee as per April 1, 2017. Frans van Houten has stepped down as member of the Supervisory Board and this committee as per the end of 2017.
The committee met seven times in 2017 and reported its findings to the full Supervisory Board after every meeting.

As last year, the committee devoted specific attention to the size, composition and diversity of the Supervisory Board. Following a selection process, the committee proposed the Supervisory Board to nominate Jill Lee and Gerard van de Aast as members of the Supervisory Board, who were both appointed by the Annual General Meeting of Shareholders in May 2017. As per the end of 2017, Frans van Houten stepped down as member of the Supervisory Board following a sell down by Royal Philips of its shareholding in Philips Lighting to below 30%. In view of Frans van Houten stepping down from the Supervisory Board, the committee proposed that Gerard van de Aast would be appointed as vice-chairman of the Supervisory Board and proposed that Kees van Lede remains a member of the Supervisory Board until the end of the Annual General Meeting of Shareholders in 2018. These proposals were approved by the Supervisory Board. Furthermore, the committee discussed candidates for appointment who match the profile of the Supervisory Board. Subsequently, it proposed the Supervisory Board to nominate Eelco Blok as Supervisory Board member.

The committee dedicated time to discuss changes in the Dutch Corporate Governance Code and its implementation within the company. Furthermore, the committee discussed the company's corporate governance structure and discussed revisions to the committee's own charter and the Supervisory Board Rules of Procedure.

Other matters that were discussed during the meetings of the committee included changes in key personnel positions, succession planning as well as the functioning of its members, and legislative developments as well as the Supervisory Board's performance evaluation procedures.

We believe that it is of strategic importance that our Board of Management and Supervisory Board are composed in line with Dutch and international corporate governance best practices and that they have the expertise needed for a good understanding of current affairs and longer-term risks and opportunities related to the company's business, taking into account our objectives that promote diversity at board level. In 2017, the Board of Management's gender diversity did not meet our policy targets. At the time of the IPO, the CEO and business leader Lamps of the Lighting business of Royal Philips were appointed as board members of Philips Lighting N.V. These appointments recognize the importance of continuity of the business while transforming and starting to operate as a standalone company.
In 2017, the Company had one vacancy in the Board of Management which was fulfilled by the appointment of Stéphane Rougeot at the Annual General Meeting of Shareholders in May 2017.
For any potential future vacancies of the Board of Management, the Company will of course take

into account the profile and all diversity objectives. 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. We are pleased to report that, since the end of 2017, the Supervisory Board meets the gender diversity targets. For more details on the profile including diversity of the Board of Management and Supervisory Board, please refer to chapter 10, Corporate governance, of this Annual Report. For more information on diversity and inclusion in the company, please refer to sub-section 16.2.4, Diversity & Inclusion, of this Annual Report.

### 8.3.3 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. As of his appointment as member of the Supervisory Board on May 9, 2017, Gerard van de Aast took over the position as chairman of the committee from Kees van Lede. Kees van Lede remains a member of the committee until he steps down as member of the Supervisory Board. Other members of the Committee are Arthur van der Poel and Abhijit Bhattacharya.

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 five times in 2017. 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 2017 included a review of the remuneration policy for the Board of Management, which resulted in the changes to the short-term incentive performance measures and the establishment of a new global long-term incentive plan as approved by the Annual General Meeting of Shareholders in May 2017.
The Committee supported the plan to grant a one-time special performance share award to a limited group of key employees below the level of the Board of Management. The purpose of this award is to focus these key leaders on achieving the company's 2019 operational profitability objective. Other matters discussed by the Remuneration Committee included the internal relativity of pay levels within the company, interim performance results, a remuneration scenario analysis and the results from a benchmark on the remuneration levels of the company's Board of Management.

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 2017.

## 8.4 Performance evaluation

We performed an evaluation of the performance of the Board of Management and of the Supervisory Board and its committees in 2017. The Board of Management performed an evaluation of its functioning and the functioning of its individual members in a meeting of the Board of Management. The results of this evaluation were reported to the Chairman and discussed in the Supervisory Board.

The members of the Supervisory Board and the members of the Board of Management filled in a questionnaire which evaluates the functioning of the Supervisory Board and its committees.
The questionnaire addresses specifically the composition and competences of the Supervisory Board, the meeting dynamics and the performance of each of the committees of the Supervisory Board. An additional section of the questionnaire enabled the members to provide general observations, concerns and recommendations. Following an evaluation of the questionnaires, one-on-one discussions take place between the Chairman and the individual Supervisory Board members. The conclusions and actions relating to the evaluation were discussed in the Corporate Governance and Nomination & Selection Committee, and in the Supervisory Board. Throughout 2018 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. To further strengthen the Supervisory Board, we recommend the appointment of Eelco Blok:

**Eelco Blok (Dutch, 60)** has been Chief Executive Officer of Dutch telecommunications provider KPN since 2011, after having served in its Board of Management since 2006. He has announced that he will step down from this position in April 2018. Blok started his career at KPN in finance in 1983, before moving to marketing and sales. He then held a number of senior management positions at the telecommunications company. He currently also serves as vice-chair of the Supervisory Board of PostNL.

## 8.5 Financial statements 2017 and dividend

Philips Lighting's Consolidated and Company financial statements for 2017, 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 Combined independent auditor's report. We have approved these financial statements.

We recommend the General Meeting of Shareholders to adopt the financial statements for 2017. We likewise recommend to shareholders that they adopt the proposal by the Board of Management to make a distribution of EUR 1.25 per ordinary share in cash, against the net income for 2017.

## 8.6 Appreciation

We would like to express our thanks to the Board of Management and to all employees, for their dedication and hard work for the company in 2017. Furthermore, we would like to extend a special word of gratitude to Frans van Houten for his valuable contributions as member of the Supervisory Board.

February 27, 2018

**Supervisory Board**
Arthur van der Poel
Gerard van de Aast
Abhijit Bhattacharya
Rita Lane
Kees van Lede
Jill Lee

# 9. Remuneration report

### Introduction

The remuneration levels, mix and all other contract terms for the members of the Board of Management are set by the Supervisory Board. The Philips Lighting remuneration policy, prepared in accordance with Dutch Corporate Governance Code and adopted in the General Meeting of Shareholders of Philips Lighting in 2017, is leading in determining the framework and content of the remuneration package.

## 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 consists of the following fixed and variable components: base salary, annual cash incentive, long-term equity-based incentive and pensions and other benefits. The targeted Total Direct Compensation levels (base salary, annual cash incentive and long-term equity-based incentive) are benchmarked regularly against relevant markets. The targeted Total Direct Compensation level typically is around the median level of a specific peer group, however remuneration levels of comparable roles in other companies and markets are also taken into consideration. These reference groups are established based on industry, ownership type, geographical presence, business characteristics and scope parameters. Input to the decision process around adjustments to the remuneration package is the above-mentioned benchmark, the approved remuneration policy, input from the Board of Management, advice from external and independent advisors and the input from the full Supervisory Board.

Our remuneration policy supports a pay-for-performance philosophy and long-term value creation. Approximately 2/3rd of the total package is variable pay with an annual component linked to financial and non-financial targets and the long-term component linked to the development of the Philips Lighting share price.

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 analyses performed, the Supervisory Board has concluded that the policy supports the pay-for-performance philosophy.

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

Philips Lighting
**Total direct compensation Board of Management** in EUR
2017

| | Base compen-sation/ 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 |
| S.L.A. Rougeot | 556,000 | 60% of annual base | 80% of annual base |
| C.L. van Schooten | 555,000 | 60% of annual base | 80% of annual base |

### 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. The base salary of each member of the Board of Management is a fixed cash compensation paid monthly. The base salary can be adjusted by the Supervisory Board in accordance with the remuneration policy following the results of benchmark studies, taking internal and external developments and discussions between the Board of Management and the Supervisory Board into consideration.

### 9.1.2 Annual (cash) incentive

Members of the Board of Management are eligible for an Annual Incentive. The pay-out of the

Annual Incentive follows an assessment of performance against a combination of financial- and non-financial targets set, using multiple performance measures. The targets as well as relevant measures are set annually by the Supervisory Board.

The Annual Incentive on-target opportunity is 80% of the base salary for the Chief Executive Officer and 60% for other board members and is capped at two times the on-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, but quantitative, individual/team targets.

The Supervisory Board can select annually two or three financial performance measures (and determine the relative weightings) from the following list: Comparable Sales Growth (CSG), Adjusted EBITA, Average Working Capital (AWoCa), Free Cash Flow (FCF), Return on Capital Employed (RoCE) and Net Income, subject to minor adjustments if required in order to provide a better indicator of the performance of the Board of Management. Adjusted EBITA, AWoCa and Net Income are measured as a percentage of sales.

### 9.1.3 Long-term equity-based incentive

All members of the Board of Management are eligible for a long-term equity-based incentive under the Company's Long-term Incentive Plan.

In addition to the Board of Management, another approximately 750 employees globally are eligible for participation in a similar Philips Lighting Long-term Incentive Plan.

The main characteristics of the Long-term Incentive Plan for the Board of Management are as follows:

For the Board of Management (and certain members of senior management), the Long-term Incentive Plan consists of performance shares only. Shares are conditionally granted annually. The annual on-target grant value is a percentage of the base salary. For the Chief Executive Officer, the annual on-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%). A strong performance on these performance measures is key for long-term value creation.

### 9.1.4 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 percentage. This percentage is compared to the TSR performance of companies included in the 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 relevant peers. In case a peer needs to be replaced due to a corporate event (merger, acquisition, etc.) the Supervisory Board will ensure that the adjusted peer group remains aligned with the strategic objectives, the geographical spread and the business characteristics of Philips Lighting by selecting an appropriate peer from a preselected peer group.

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 |

### 9.1.5 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. Vesting can vary between zero and two times the number of performance shares initially granted.

### 9.1.6 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.

The sustainability 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. Vesting can vary between zero and two times the number of performance shares initially granted.

Philips Lighting
**Sustainability targets**

| Program | 2017 result | 2020 target |
|---|---|---|
| Sustainable revenues | 77% of revenues | 80% of revenues |
| LED lamps | 1,196 million | > 2 billion LED lamps delivered cumulatively |
| Carbon neutral | Net 325 kilotonnes $CO_2$ | Net 0 kilotonnes $CO_2$ |
| Zero waste to landfill | 1,807 tonnes | 0 tonnes |
| Safe & Healthy Workplace | TRC = 0.41 | TRC = <0.35 |
| Sustainable Supply Chain | Supplier performance rate = 95% | Minimum performance rate of 90% |

### 9.1.7 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.

### 9.1.8 Share ownership guidelines and holding requirement

The members of the Board of Management must hold a certain value in shares in the company, 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).

### 9.1.9 Claw back and value adjustment

Annual cash incentives as well as the long-term equity-based incentives are subject to claw back provisions pursuant to Dutch law.

### 9.1.10 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 (for the year 2017) EUR 103,317 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 103,317. The Flex Pension Plan has a target retirement age of 67 (in 2017) and a target accrual rate of 1.85%;
- A gross Pension Allowance equal to 25% of the base compensation exceeding EUR 103,317;
- 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%). The temporary gross Transition Allowance only applies to members of the Board of Management who were employed before January 1, 2015 and still participated in the former Executive Pension Plan, before the change to the Flex Pension Plan per January 1, 2015 with the capping of pension accruals and increase of pensionable age in line with the retirement age for state pension (AOW). The level of the allowance is based on the age and salary of the Board Member on December 31, 2014.

Members of the Board of Management 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 29, 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.

### 9.1.11 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.

### 9.1.12 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.

### 9.1.13 Loans

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

## 9.2 Effectuation of the remuneration policy in 2017

### 9.2.1 Base salary

The annual compensation of the members of the Board of Management has been reviewed in April 2017 as part of the regular remuneration review. The annual base salary of Eric Rondolat has not been adjusted in April 2017 and remained unchanged at EUR 850,000. The annual base salary of Stéphane Rougeot was set at EUR 556,000. The annual base salary of René van Schooten was set at EUR 555,000.

### 9.2.2 Annual (cash) incentive

The financial performance measures used in the Annual Incentive to track performance were Comparable Sales Growth, Adjusted EBITA (measured as a percentage of sales) and Free Cash Flow.

The financial targets for 2017 were set within the context of the medium-term objectives of the company. Philips Lighting does not disclose these specific financial targets as these targets are considered commercially sensitive.

Philips Lighting
**Annual incentive realization** in EUR
2017 (pay-out in 2018)

| | realized annual incentive | on-target % of annual base | realized % of annual base (2017) |
|---|---|---|---|
| E.H.E. Rondolat | 753,440 | 80% | 88.6% |
| S.L.A. Rougeot | 369,629 | 60% | 66.5% |
| C.L. van Schooten | 368,964 | 60% | 66.5% |

Philips Lighting
**Annual incentive realization**
2017

| Performance measures | Weighting | |
|---|---|---|
| Comparable Sales Growth | 30% | |
| Adjusted EBITA | 30% | |
| Free Cash Flow | 20% | |
| Non-financial individual/ team targets | 20% | |
| **Multiple Achieved** | | **110.8%** |

### 9.2.3 Long-term equity-based incentive

In 2017 performance shares were granted to the members of the Board of Management. These grants are governed by the Philips Lighting Long-term Incentive Plan as approved in the Annual Shareholders meeting in 2017. The performance share awards granted by Royal Philips in 2014 vested in 2017.

The table below provides an overview of both the Philips Lighting and Royal Philips performance shares awarded.

Philips Lighting
**Performance shares**
2014-2017

| | Grant date | Number of performance shares originally granted | Value at grant date (in EUR) | End of vesting period | Number of performance shares vested in 2017 | Value at vesting date in 2017 (in EUR) |
|---|---|---|---|---|---|---|
| E.H.E. Rondolat | 2014 1,2) | 29,966 | 700,000 | 2017 | 31,914 | 1,020,929 |
| | 2015 1,2) | 28,217 | 725,000 | 2018 | n.a. | n.a. |
| | 2016 1,2) | 36,080 | 880,000 | 2019 | n.a. | n.a. |
| | 2017 3) | 31,253 | 850,000 | 2020 | n.a. | n.a. |
| S.L.A. Rougeot | 2017 3) | 16,355 | 444,800 | 2020 | n.a. | n.a. |
| C.L. van Schooten | 2014 1,2) | 14,983 | 350,000 | 2017 | 15,957 | 510,464 |
| | 2015 1,2) | 9,730 | 250,000 | 2018 | n.a. | n.a. |
| | 2016 1,2) | 15,785 | 385,000 | 2019 | n.a. | n.a. |
| | 2017 3) | 16,325 | 444,000 | 2020 | n.a. | n.a. |

1) Dividend performance shares not included
2) Shares under the Royal Philips Long-term Incentive Plan
3) Shares under the Philips Lighting Long-term Incentive Plan

### 9.2.4 Share ownership

On December 31, 2017 Eric Rondolat held 25,000 Philips Lighting shares, Stéphane Rougeot held 5,000 Philips Lighting shares and René van Schooten held 12,500 Philips Lighting shares.

### 9.2.5 Philips Lighting's internal pay ratio

In line with the revised Dutch Corporate Governance Code (2016), Philips Lighting takes into account the internal pay ratios within the organization when formulating the remuneration policy and determining the remuneration of individual members of the Board of Management.

In light of transparency and clarity, Philips Lighting applies a methodology to calculate the internal pay ratio that is IFRS-driven (i.e. linked to Philips Lighting's notes to the Consolidated financial statements).

Philips Lighting's internal pay ratio is calculated as the total CEO remuneration divided by the employee average remuneration. For purposes of this calculation:

- Total CEO remuneration consists of the following components for the full year 2017: base salary EUR 850,000 (2016: EUR 829,356) + short-term incentives EUR 753,440 (2016: EUR 973,844) + long-term incentives at fair value at grant EUR 850,000 (2016: EUR 880,000) + benefits EUR 357,760, (2016: EUR 354,534). All figures are full year, based on the information provided in note 29, Information on remuneration (2016: Note 31);
- Employee average remuneration based on total employee benefit expenses as disclosed in note 6, Employee benefit expenses, and total employees in FTEs (third party workers excluded) as disclosed in note 7, Employees.

Consequently, Philips Lighting's calculated pay ratio in 2017 is 44 (2016: 50), implying that the CEO pay is 44 (2016: 50) times the average pay of an employee.

### 9.2.6 Pool size

The number of shares to be granted on a yearly basis to all eligible employees under the Long-term Incentive Plan is approximately 1.5 million. The first main vesting of Philips Lighting shares under the Long-term Incentive Plan will occur in 2020.

The number of shares to be granted depends 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.

## 9.3 Remuneration outlook 2018

### 9.3.1 Base salary

The annual compensation of the members of the Board of Management has been reviewed in 2017 as part of the regular remuneration review. For 2018 the following increase of the base salaries have been agreed. The base salary for Eric Rondolat was increased from January 1, 2018 to EUR 875,000. The base salary of Stéphane Rougeot was increased from January 1, 2018 to EUR 572,500 and the base salary of René van Schooten was increased from January 1, 2018 to EUR 572,500.

### 9.3.2 Annual (cash) incentive

For 2018, the Supervisory Board has decided to use the same performance measures for the Annual Incentive Plan as were used in 2017: Comparable Sales Growth, Adjusted EBITA and Free Cash Flow.

### 9.3.3 Long-term equity-based incentive

No adjustments to the long-term equity-based incentive are foreseen in 2018.

# 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 held a 71.23% stake in the issued share capital of Philips Lighting N.V.

In February, April and November 2017, Royal Philips sold an aggregate of 65.35 million shares in the capital of Philips Lighting N.V. via accelerated bookbuild offerings to institutional investors and to Philips Lighting N.V. Philips Lighting N.V. cancelled the 9.8 million shares that it repurchased in these offerings. Currently, Royal Philips holds a 29.59% stake in the issued 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. Additionally, 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 to the company's corporate governance structure and to 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. The Board of Management focuses on long-term value creation for the company and its business, and takes the relevant stakeholders' interests into account.

Among other responsibilities, the Board of Management drives the company's management agenda, defines and deploys the strategic direction, identifies opportunities and risks connected with its business activities and strategy, 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 contact with the Chairman and other members of the Supervisory Board, attend most parts of the Supervisory Board meetings, and provides the Supervisory Board with all the information it 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 its Rules of Procedure which can be found on the company's website.

### Appointment and composition

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.

The composition of the Board of Management follows the profile which aims for an appropriate combination of knowledge and experience among its members, encompassing marketing, manufacturing, technology, financial, economic, social & environmental, quality & regulatory and legal aspects of international business and society, in relation to the global character of its business. The size of the Board of Management may vary over time, as considered appropriate to support its profile.

### 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

Philips Lighting attaches great importance to diversity and it is its ambition to increase the diversity of the company's entire workforce to better mirror its stakeholders and markets. Philips Lighting believes that this will positively impact the company's business performance in all countries the company does business.

In view of the above, Philips Lighting aims for the Board of Management and the Supervisory Board to be composed of members that bring a diversity of skills and expertise relevant for achieving the company's strategic and business objectives, different views and perspectives as well as different backgrounds (nationality, educational, working experience or otherwise), and that at least 30% are men and at least 30% are women. The latter is in line with Dutch legislation on board diversity which provides 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.

For further information, please refer to chapter 8, Supervisory Board report, of this Annual Report.

### 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 occurred during the financial year 2017 with the exception that Royal Philips nominees sitting on the Supervisory Board did not take part in the decision-making process with regard to the dividend distribution and the company's participation in sell down transactions by Royal Philips of its stake in the company.

### 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.

Dutch law provides for 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 or she already holds a supervisory position at more than two other "large Dutch companies" or if he or 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 or 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 the business of the group, 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 therein, to nominate candidates for appointment as member of the Supervisory Board (Royal Philips nominee). The Dutch large company regime (*structuurregime*) does not apply to Philips Lighting N.V. 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 end at the closing of the AGM to be held in the fourth year after appointment.

As per December 31, 2017, one of the two Royal Philips nominees stepped down. Since then, the Supervisory Board consists of six members of whom the remaining Royal Philips nominee (Abhijit Bhattacharya) is not independent. The other five members of the Supervisory Board are all independent. The Supervisory Board has appointed one of its independent members as chairman. Once Royal Philips holds less than 15% of the ordinary shares, Royal Philips will cause its remaining Royal Philips nominee to resign as member of the Supervisory Board if so requested by the company, as a result of which there shall no longer be a Royal Philips nominee on the Supervisory Board.

The composition of the Supervisory Board follows the profile which aims for an appropriate combination of knowledge and experience among its members, encompassing marketing, manufacturing, technology, financial, economic, social & environmental, quality & regulatory and legal aspects of international business and society, in relation to the global character of its business. The size of the Supervisory Board may vary over time, as considered appropriate to support its profile. The Supervisory Board aims to have one or more members with an executive or similar position in business or society no longer than five years ago. The composition of the Supervisory Board shall be in accordance with the best practice provisions on independence of the Dutch Corporate Governance Code as well as Dutch law restrictions on the overall number of supervisory positions that a member of the

Supervisory Board may hold. Each member shall be capable of assessing the broad outline of the overall management of the company.

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 member of the Supervisory Board consists of a fixed amount depending on the member's position on the board (chairman/vice chairman/ other board members), an additional fee for the function of chair or member of committees and compensation for travel. 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 independence requirements as stated in the Dutch Corporate Governance Code with the exception of the Royal Philips nominee, 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 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 its 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 per 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; the 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. On December 31, 2017, the issued share capital amounted to EUR 1.43 million, divided into 143 million ordinary shares and no preference shares. Subsequently, a further 2.8 million shares were cancelled, resulting in an issued ordinary share capital of EUR 1,402,000, divided into 140.2 million ordinary 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.

At the AGM held on May 9, 2017, 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 as at May 9, 2017 plus an additional 10% of the issued share capital as at the same date 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 as at May 9, 2017 plus an additional 10% of the issued capital as of that same date in connection with the execution of share repurchase programs for capital reduction purposes.

## 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. 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; 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, 2017. 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. In accordance with the Dutch Corporate Governance Code, the Supervisory Board selects and nominates an external auditor for appointment, upon advice by the Audit Committee. The Supervisory Board and the Audit Committee assess the functioning of the external auditor, taking the observations from the Board of Management into account. 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 that the external auditor provides 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, in 2017 except for best practice provision 2.1.7 of the Code. This provision states that no more than one member of the Supervisory Board may also be a member of the board of management of a single 10% shareholder of the company.

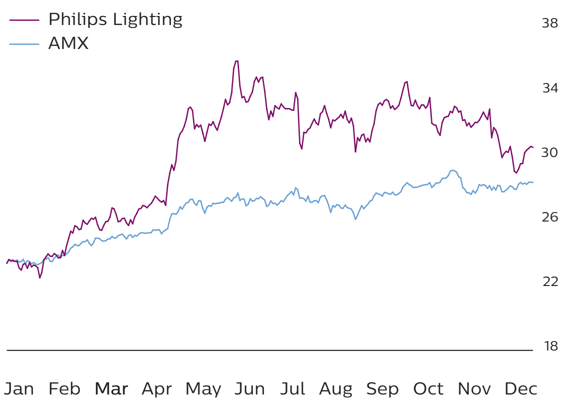
On December, 31 2017, one of the two Royal Philips nominees stepped down from the Supervisory Board, which means that the company now also complies with the above best practice provision.

# 11. Investor relations

## 11.1 Share performance

Philips Lighting share performed well in 2017 with the share price increasing by 30.8%, 9.3% above the Euronext midcap index and 11.8% above the S&P capital goods index. In 2017, EUR 429 million was used for share repurchases and to pay dividend related to 2016. Furthermore, Philips Lighting repurchased EUR 35 million of shares to cover obligations arising from its long-term incentive performance share plan and other employee share plans. The market capitalization at year-end 2017 was EUR 4.4 billion and the free float was 68.3%.

Philips Lighting
**share price development** in EUR
2017




## 11.2 Dialog with financial markets

We attach great value to maintaining an open dialog with financial markets to promote transparency. The management and investor relations teams attended a number of conferences during the year, as well as holding meetings with investors and analysts.
Each quarter, the company organizes conference calls to discuss the latest results, which can be accessed and replayed on the Philips Lighting Investor Relations website.

## 11.3 Capital allocation

### Capital allocation policy

Philips Lighting continues to exercise strict financial discipline in the generation and use of cash and remains committed to managing its financial ratios to maintain a financing structure compatible with an investment-grade profile, including disciplined management of its balance sheet. Furthermore, the company continues to consider seizing non-organic opportunities primarily through small- to medium-sized acquisitions.

### Dividend policy

Philips Lighting targets an annual dividend pay-out ratio of 40%-50% of continuing net income to be paid out annually in cash. Continuing net income is defined as net income excluding discontinued operations and excluding material non-recurring items such as restructuring, acquisition related and separation charges.
The payment of dividends, if any, and the amounts and timing thereof depend on a number of factors, including future sales, 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.

### Proposed dividend

A proposal will be submitted to the 2018 Annual General Meeting of Shareholders (AGM) to pay a cash dividend of EUR 1.25 per ordinary share, against the net income for 2017. This represents an increase of 14% compared with last year and a pay-out ratio of 45% of continuing net income. For the dividend related to full year 2017, continuing net income was calculated based on net income attributable to shareholders of Philips Lighting N.V. of EUR 294 million and adding back non-controlling interest and adjustments after tax of EUR 92 million. Philips Lighting's total continuing net income for 2017 was EUR 386 million.

The dividend payment is subject to approval by the 2018 AGM. 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.

Philips Lighting
**Dividend dates**

| | Ex-dividend date | Dividend record date | Dividend payment date |
|---|---|---|---|
| Philips Lighting shares | May 17, 2018 | May 18, 2018 | 29 May 2018 |

### Share repurchases

Given the company's capital position while maintaining a compatible investment-grade profile, Philips Lighting has and plans to return additional capital to shareholders. In 2017, Philips Lighting repurchased 9.8 million shares from Royal Philips for an aggregate amount of EUR 272 million. Furthermore, the company repurchased a total of 1.05 million shares for a total consideration of EUR 34.90 million in the period May 22, 2017 up to and including July 27, 2017. The purpose of the share repurchase was to cover obligations arising from its long-term incentive performance share plan and other employee share plans. Philips Lighting holds the repurchased shares in treasury until employee share awards vest. The company will continue to repurchase shares to cover obligations arising from its long-term incentive performance share plan and other employee share plans. For 2018, the company intends to repurchase up to EUR 150 million by participating in share disposals of Royal Philips.

## 11.4 Debt info

In May 2016, Philips Lighting entered into a credit agreement with a syndicate of financial institutions that established the Term Loan Facility and the Revolving Credit Facility.

Philips Lighting has drawn USD 500 million and 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. The multi-currency Revolving Credit Facility has an amount of EUR 500 million.

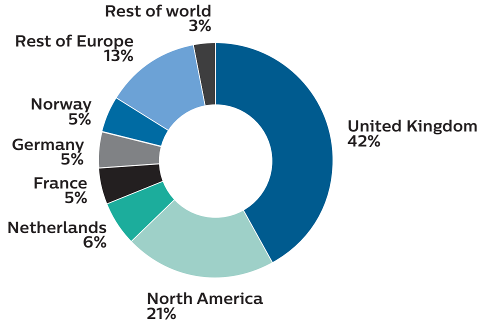
Both the Term Loan Facility and the Revolving Credit Facility have a term of five years from the date of the Credit Agreement. The loans under the Term Loan Facility will be repaid at the end of the term and may also be repaid without penalty at the option of Philips Lighting during the term.

At present, Philips Lighting has not drawn down any amounts under the Revolving Credit Facility.

## 11.5 Shareholder base

The company has a broad base of international shareholders, as shown in the chart below. The information is based on independent shareholder identification carried out at the end of 2017.

Philips Lighting
**Geographical distribution of shares [1)]**
2017




1) Excluding Royal Philips, treasury shares, prime brokerage and retail investors.

The Dutch Financial Markets Supervision Act requires institutions and individuals holding a (potential) 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 table below includes the total interests of 3% or more registered at the AFM on December 31, 2017, and the related actual interests.

Philips Lighting
**Shareholder structure**
December 31, 2017

| | % Actual interest | Total % registered [1)] |
|---|---|---|
| **Philips Lighting shareholders** | | |
| Koninklijke Philips N.V. | 29.01% | 29.01% |
| Standard Life Aberdeen Plc | 4.95% | 4.95% |
| Baillie Gifford & Co | 3.16% | 3.16% |
| JP Morgan Asset Management Holding Inc | 2.85% | 3.00% |

1) The total % registered includes the actual and potential interests such as options, futures, swaps, forward-rate agreements, and other derivatives contracts.

Source: AFM.

In 2017, Royal Philips decreased its holding in the capital of Philips Lighting N.V. from 71.2% to 29.0% by selling an aggregate of 65.35 million shares via accelerated book build offerings to institutional investors and to the company. As part of these offerings, Philips Lighting N.V. repurchased 9.8 million of its shares. The last part of these shares was canceled in February 2018. At the end of February 2018, Royal Philips holds a 29.6% stake in the share capital of Philips Lighting N.V.

Philips Lighting
**Financial calendar**
2018

| | |
|---|---|
| Q1 2018 financial report | April 26, 2018 |
| AGM 2018 | May 15, 2018 |
| First half 2018 financial report | July 27, 2018 |
| Q3 2018 financial report | October 26, 2018 |

## 11.6 Annual General Meeting of Shareholders

The 2018 Annual General Meeting of Shareholders will be held on May 15, 2018. The agenda and the explanatory notes to the agenda will be published on the company's website.

The record date for the 2018 Annual General Meeting of Shareholders is April 17, 2018, after processing of all settlements of that date. Those persons who are registered as shareholders in the designated registers on that date will be entitled to attend and vote on 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 investors. Visit www.lighting.philips.com/main/investor for financial reports, investor presentations, the financial calendar and other information for both retail and institutional investors.

# 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 12.6. The risk overview highlights the main risks known to the company, which could hinder it in achieving its strategic and financial business objectives. This 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 performance review cycle. The company's risk management and controls are designed to provide reasonable assurance that strategic and financial business 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. Management is responsible for identifying critical business risks and for the implementation of appropriate risk responses. The company's risk management 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 the company's 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, and in audit and risk committee meetings with Business Groups, Market Groups and Functions (Finance and IT). These audit and risk committees are also involved in determining the desired company-wide internal audit planning as approved by the Audit Committee of the Supervisory Board. Internal auditors monitor the quality of the business controls through risk-based operational audits, inspections of financial reporting controls and compliance audits. An in-depth description of the company's corporate governance structure can be found in chapter 10, Corporate governance, of this Annual Report.

### 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 controls of the company's operations, in order to ensure the integrity of the financial reporting and related disclosure, as well as compliance with applicable laws and regulations. The company has designed its BCF based on the Internal Control-Integrated Framework (2013) established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The company continuously evaluates and improves its BCF to align with business dynamics and good practice.

As part of the BCF, the company has implemented a global standard for internal controls over financial reporting (ICS). 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.

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 controls over financial reporting can be found in chapter 13, Statement of the Board of Management, of this Annual Report.

### General Business Principles

Acting with integrity is the cornerstone for the success of our business and key to achieving our purpose. It is integral to the values that define us as a company. Acting with integrity means making the right choices when faced with ethical dilemmas and holding ourselves and each other to high standards of behavior.

We define integrity through our General Business Principles (GBP). They apply to each of us as individuals wherever you are in the company. They define our commitment to act with integrity with each other, with our customers, business partners, shareholders and the wider community in which we operate.

The GBP have been adopted by the Board of Management. They are reviewed on a regular basis and revised where necessary. They apply to all employees of Philips Lighting N.V. and its controlled subsidiaries. The GBP are not all-encompassing, but formulate minimum standards of behavior. The underlying policies form an integral part of the GBP.

The GBP form an integral part of labor contracts in virtually every country in which Philips Lighting operates. Translations of the GBP are available in 32 languages, allowing our employees to read the GBP in a language they understand. Additional Codes of Ethics are in place for employees in Procurement and Finance (these documents are available at [http://www.lighting.philips.com/main/investor/governance](http://www.lighting.philips.com/main/investor/governance)).

Employees are requested to state their commitment with the GBP after having completed the GBP e-learnings. In 2017, all employees were mandated to complete one or more e-learnings on GBP and related legal compliance domains. Specific target groups were required to participate in face-to-face GBP trainings.

In addition, each year Finance and Procurement employees are asked to sign off on the Financial and the Procurement Codes of Ethics respectively. All executives are asked to sign off on the GBP each year to confirm their awareness and compliance with the GBP. Violations of the GBP will result in disciplinary action, up to and including dismissal.

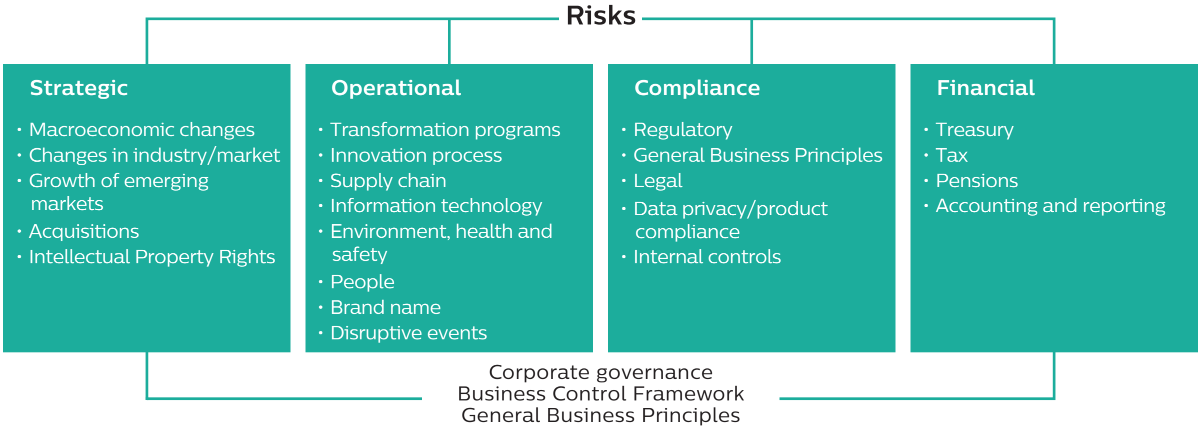
The GBP Review Committee is the ultimate body within Philips Lighting to administer the organization's GBP Legal Compliance Program. It does so by keeping oversight on the development and implementation of the GBP, including the monitoring of their effectiveness. The GBP Review Committee is chaired by the Chief Legal Officer. Its members include the Chief Executive Officer, Chief Financial Officer, Chief HR Officer and the Head of Legal Compliance, who is also the Secretary of the GBP Review Committee.

In order to increase the level of GBP awareness and to create global engagement, the company has established a network of GBP Compliance Officers in each market and country where the company has a presence and on each significant site. GBP Compliance Officers have also been appointed at Business Group and Functional level. The activities and responsibilities of this network are focused on providing expertise and support on GBP-related matters to managers and employees. The company will continue to further strengthen its communication efforts in order to increase awareness of the GBP during 2018.

The GBP are supported by mechanisms that ensure standardized reporting, escalation and investigation of concerns. These mechanisms are based on the GBP Reporting Policy that urges employees and third parties 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. An overview of the reporting activities for 2017 are given in chapter 16, Sustainability statements, of this Annual Report.

With a GBP self-assessment process 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 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.

## 12.2 Risk categories and factors




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 the company'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 reviews. 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 an integral part of the annual strategic review planning cycle with the respective management at the Business Groups, Market Groups and Function levels. During 2017, risk management workshops were held within these levels. 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. A Risk Workshop at Enterprise level is held with the company leadership team, at which, identified risks are ranked based on impact, likelihood, risk criticality and control effectiveness. Owners are assigned and accountable for ensuring adequate risk mitigation and monitoring measures are implemented and operating effectively. Each quarter developments are discussed during the audit and risk committee meetings. Reported risks and opportunities are analyzed for potential cumulative effects and are aggregated at Business Group, Market Group and at company level.

The company has a structured risk management process to address the following risk categories: strategic, operational, compliance and financial risks. Top risks are identified each year and, the risk appetite is captured for each in the risk mitigation activities and risk investments.
The risk appetite is different for each of the risk categories:

- Strategic risks and opportunities may affect the company's strategic ambitions. Strategic risks include economic and political developments and the effects of actions taken to anticipate and respond to market circumstances.
  The company 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. The company aims to minimize downside risks to maintain the high quality of its products, systems and services, reliable IT systems and sustainability commitments.

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

- Compliance risks cover unanticipated failures to implement, or comply with, appropriate laws, regulations, policies and procedures. The company has a zero-tolerance policy towards non-compliance in relation to breaches of regulations and its GBP.
- We recognize financial risks outside our control related to treasury, accounting and reporting, pensions and tax. To minimize their impact, we follow a conservative risk management approach in these areas. Furthermore, the company strives to ensure transparent and truthful accounting and reporting to enable financial statement users to make informed decisions which take the effect of these risks into consideration.

The company's risk appetite is described in various chapters of this Annual Report, including note 30, Details of treasury and other financial risks.

During 2017, the company:
- improved the workings of its enterprise risk management plan by partnerships with its leaders across the company, allocating resources and driving control activities;
- continued deploying and reinforcing our standard process framework within the Quality Systems;
- in respect of its operations in Saudi Arabia, is working on the remediation of weaknesses identified during the internal review. We implemented a change in management and other improvements like training and working models with customers are planned; and
- made significant progress in workings of its Corporate Security Office by monitoring and managing cyber threats.

Below the company describes the risk factors within each risk category, to give stakeholders an insight into which risks and opportunities it considers more prominent than others at the time. The risk overview highlights the main risks known to the company – 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 the company. 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 the company's business, strategic objectives, revenues, income, assets, liquidity, capital resources or achievement of the company'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 the company may change its view as to the relative significance of each risk factor.

## 12.3 Strategic risks

As the company's business 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.

The company's business environment is influenced by economic and political conditions in the domestic and global markets. The company continues to experience the impact of changes in macroeconomic development in various geographies – particularly in China, where in 2017 economic growth was at its 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 in 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 the company. The general global political environment remains volatile 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 may be adversely affected by potential exits from the Eurozone (Greece) and the European Union (UK), or secession of regions from European countries (for example Catalonia and Scotland). Economic and political uncertainty may have a material adverse impact on the company's financial condition or results of operations and may also make it more difficult for the company 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. the above-mentioned risks are also expected to grow and could have a material adverse effect on the company's financial condition and operating results.

The company 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 light-emitting diode (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 to LED lighting technologies has had, and is expected to continue to have, significant effects on the company's business model. It is difficult to predict the extent and speed of the transition from conventional 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. The transition to LED lighting due to characteristics of the business including competition, technology and lower entry barriers, could have a material adverse effect on the company's growth ambitions, financial condition and operating results.

The company's 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 the company. The company 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.
The company 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. The company's failure to achieve these could have a material adverse effect on growth ambitions, financial condition and operating result. The growth ambitions of the company 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 the company to integration risks and challenge management in continuing to reduce the complexity of the company.

The company's acquisitions may expose the company to integration risks in operational and commercial processes and may adversely impact the realization of an increased contribution from these acquisitions. The company may incur significant acquisition, administrative and other costs in connection with these transactions, including costs related to the integration of acquired businesses.

Additionally, 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. Impairment of these assets may have a material adverse effect on the company's earnings (see also note 14, Goodwill).

Intellectual property rights of the company are subject to litigation, with considerable impact to financial condition and operating results.

To enforce its intellectual property rights, the company may initiate litigation against third parties, which may result in counter claims, considerable costs and damage to these rights. Activities of the company may be covered by third party intellectual property rights that may be unavailable or available only on unfavorable terms.

## 12.4 Operational risks

The company has realized and expects to continue to achieve further cost savings, to maintain or improve profitability margins and cash generation. Its ability to continue implementing cost-saving initiatives is not permanently guaranteed, and could have an adverse effect on the company's financial condition and operating result.

The company 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. The company's past and current business transformation programs have been or are costly, and the company is exposed to potential expenses 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 the company's business.

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

Making further improvements in the company's 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 advantages are important in realizing the company's profitable growth ambitions.

The emergence of new low-cost competitors, 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 like 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, the company cannot determine in advance the ultimate effect that new systems and product creations will have on its financial condition and operating results. If the company 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 a material adverse effect on its financial condition and operating results.

### If the company is unable to ensure effective supply chain management, for example 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.

The company 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, the company is continuing initiatives to reduce assets through outsourcing. These processes may result in increased dependency on external suppliers and providers. Although the company 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.

The company depends on external suppliers for certain raw materials (e.g., rare earth metals, copper, phosphor, steel, aluminum, noble gases and oil-related products) and critical components. Market prices for raw materials are subject to significant volatility, such as the fluctuations experienced in the phosphor market in 2012. During periods of increasing costs of raw materials, the company may not be able to compensate for cost increases through productivity improvements or passing cost increases on to customers. By contrast, in times of falling prices for raw materials, the company may not fully benefit from such price decreases, for example, because the company attempts to reduce the risk of rising raw material prices through long-term contracting. A general shortage of raw materials, including as a result of unforeseen natural disasters, may also result in increases in market prices and potential disruption to production. Any failure by the company to effectively address rising prices or shortages of raw materials or critical components may have a material adverse effect on the business, results of operations, financial condition and prospects of the company.

### The company 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, given the very fast pace of technological change, the company's 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 the company's financial condition and operating results. 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 the company or its 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. Enhanced protection measures can involve significant costs. Although the company has experienced cyber-attacks and, to date, has 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 the company will be as successful in avoiding damage from cyber-attacks. Additionally, successful outsourcing of business processes is highly dependent on secure and well-controlled IT systems.

The company 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 the company's products involves complex processes, and defects might occur in the company's products. In addition, it is possible that certain of the company's products may not perform as expected. These defects or shortfalls may cause the company to incur significant warranty, support and replacement costs.

Furthermore, the company may become subject to actions by regulatory authorities. 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 the company's products may lead to claims for property damage and personal injury.

In particular, the company has on occasion been 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 the company. Although to date such claims have not resulted in material loss, the company, on the same basis as other lamp and luminaire manufacturers, expects that it will continue to be subject to legal proceedings seeking to hold the company 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 the company.

Reputational and adverse effects on business due to activities in Environment, Health & Safety or individual behavior

The company 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 the company'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.

The company 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.

The company is dependent on its personnel for leadership and specialized skills. As a result, the loss of its ability to attract and retain talented personnel would have an adverse effect on its business.

The attraction and retention of talented employees in sales and marketing, research and developments, finance and general management, is critical to the 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 the company will continue to be successful in attracting and retaining the highly-qualified employees and key personnel needed in the future.

The company 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, the company 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. The company may use the Philips brand name for an initial period of ten years from February 2016, which term may be extended with two periods of five years if certain financial targets and other conditions are met. The company also has the right to use the Philips company name for a period of 18 months after the date that it is no longer controlled by Royal Philips.

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

Philips Lighting is exposed to risks that could cause direct damage to assets and indirect damage from supply chain disruption, impacting its financial condition and operating results.

The company's global operations are subject to the risk of natural disasters, such as, earthquakes, typhoons, fires and floods. It is widely recognized that continued emission of greenhouse gases will cause further warming of the earth and that warming above 2° Celsius (2°C), relative to the pre-industrial period, could result in increased severity of extreme weather events such as cyclones and floods. Additionally, large disasters, terrorist attacks, riots and civil commotion or other casualty events may disrupt operations. A catastrophic loss of lives, businesses and infrastructure may have an indirect impact on the company by affecting its employees, customers, business partners and suppliers, and may consequently affect production, sourcing and reduce the demand for its products. In addition, risks may not be insured or the company's insurance cover may not protect it against all damages or related business interruptions resulting from the events described above. With or without relevant insurance coverage, damage to any of its offices, branches, plants or distribution networks or to third parties (e.g., suppliers), due to natural disasters, terrorist attacks or other casualty events, may have a material adverse effect on the company's results of operations and financial condition.

## 12.5 Compliance risks

The company's global presence exposes it to regional and local regulatory rules, changes to which may affect the realization of business opportunities and investments in the countries in which the company operates.

The company has established subsidiaries in 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. For example, policy actions in response to the Paris Agreement, which looks to constrain the adverse effects of climate change and policy actions that seek to promote adaptation to climate change. Possible implications include the implementation of carbon-pricing mechanisms to reduce GHG emissions, obligatory shifting of energy use toward lower emission sources, and adopting energy-efficiency solutions. The failure to comply with applicable laws and regulations, including as a result of any such changes, may affect the realization of business opportunities or impair the company's local investments. In addition, the effects of policy implementations could result in unforeseeable fluctuations in prices of parts, components, and services from our suppliers and could also lead to supply chain interruptions if suppliers are unable to meet the demands of policy regulations implemented.

The company is exposed to non-compliance with business conduct rules and regulations and governmental investigation and legal proceedings in relation thereto.

The company's attempts to realize its growth ambitions could expose it to the risk of non-compliance with business conduct rules and regulations, such as 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. The company's financial condition and operating results could be materially affected by governmental investigations and litigation, as well as any related claims.

The company is involved or may become involved in legal proceedings.

The company, including a certain number of its current and former companies, is involved in legal proceedings, regulatory and other governmental proceedings, relating to such matters as commercial transactions, intellectual property disputes, product warranty claims, property damage and personal injury that were caused or allegedly caused by its products as well as environmental pollution and business conduct rules.

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, the company's financial condition and operating results could be affected materially by adverse outcomes.

Please refer to note 26, Contingent liabilities, for additional disclosure relating to specific legal proceedings.

The company is exposed to non-compliance with privacy and data protection and product safety regulations and laws.

The company's brand image and reputation would be adversely impacted by non-compliance with various privacy and data protection, as well as product regulations and laws. In light of the company's system solution strategy, data privacy and data protection laws are increasingly important. The company 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.

Defective internal controls would adversely affect the company's 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 condition and operating results, and hamper expected growth. Furthermore, such flaws could affect the reliability of the company's financial reporting and public disclosures.

Correct and complete financial reporting and disclosure provides investors and other market professionals with significant information for a better understanding of the company'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 company's share price.

## 12.6 Financial risks

The company 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 bank and global liquidity markets could affect the ability of the company to raise or re-finance debt or could lead to significant increases in the cost of such borrowing in the future.

The company operates in more than 100 countries and its earnings are therefore exposed to fluctuations in exchange rates of foreign currencies against the euro, the company's reporting currency. The company'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, the company'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 the company, 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 could have a material adverse effect on the company's financial condition and operating results.

The company'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 the company 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.

The company is exposed to interest rate risk, particularly in relation to its debt position; this risk can take the form of both fair value and cash flow risk. Failure to effectively hedge this risk could impact the company's financial condition and operating results.

For further analysis, please refer to note 30, Details of treasury and other financial risks.

The company is exposed to various tax risks and uncertainties which could impact the local tax results.

The company 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 the company's financial condition and operating results.

In the field of transfer pricing, the company is closely monitoring the OECD and Base Erosion & Profit Shifting developments in order to be compliant with changing local/international tax laws and regulations. The company 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, and 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 company's deferred tax assets, including tax losses and credits carried forward, is dependent upon the generation of future taxable income in the countries where the temporary differences, unused tax losses and unused tax credits were incurred and during the periods in which the deferred tax assets become deductible. Additionally, in certain instances, realization of such deferred tax assets is dependent upon the successful execution of tax planning strategies. Accordingly, there can be no absolute assurance that all (net) tax losses and credits carried forward will be realized.

For further details, please refer to the tax risks paragraph in note 11, Income taxes.

### The company 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 the company's financials.

A significant number of (former) employees 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 (for example 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.

### The company is exposed to a number of reporting risks.

The following factors are considered to be critical in the overall financial risk: 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 the company 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 related to the use of estimates and application of judgment.

### Changes to taxation or the interpretation or application of tax laws could have an adverse impact on the company's results of operations and financial condition.

The company's business is subject to various taxes in the Netherlands and elsewhere as it operates on a global basis. The various taxes to which the company is subject include, among others, corporate income tax, regional trade tax, value added tax (VAT), excise duty, registration tax and other direct and indirect taxes. This exposes the company to the risk that the overall tax burden that it suffers may increase in the future. Also, as a global business, the company's effective average tax rate from period to period will be affected by many factors, including changes in tax legislation, global mix of earnings, the tax characteristics of the company's income, the timing and recognition of goodwill impairments, acquisitions and dispositions and adjustments to the company's reserves related to uncertain tax positions.

Changes in tax laws or regulations or in the position of the relevant tax authorities regarding the application, administration or interpretation of these laws or regulations, particularly if applied retrospectively, could have negative effects on the company's current business model and have a material adverse effect on the company's operating results, business and financial condition. In addition, tax laws are complex and subject to subjective evaluations and interpretative decisions, and the company will periodically be subject to tax audits aimed at assessing its compliance with direct and indirect taxes. The tax authorities may not agree with the company's interpretations of, or with the positions the company has taken or intends to take on, tax laws applicable to its ordinary activities and extraordinary transactions. In case of challenges by the tax authorities to the company's interpretations, the company could face long tax proceedings that could result in the payment of penalties and have a material adverse effect on the company's operating results, business and financial condition.

# 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, and based on current state of affairs, it is justified that the financial reporting has been prepared on a going concern basis;
- The management report included in this Annual Report gives a true and fair view concerning the position on the balance sheet date and the development and performance of the business of Philips Lighting N.V. and the undertakings included in the consolidation taken as a whole during the financial year
- The management report included in this Annual Report describes the principal risks and uncertainties that the company faces, and those that are relevant to the expectation of the company's continuity for the period of twelve months after the date of publication of this Annual Report.

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. It reports on and is accountable for internal risk management and control systems to the Supervisory Board and its Audit Committee. The company has implemented a risk management and internal control system designed to provide reasonable assurance that strategic objectives are met by creating focus, integrating management control over the company's operations, ensuring compliance with applicable laws and regulations and by safeguarding its assets and the reliability of its financial reporting and its disclosures.

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 its 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 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 influences and variables, are described in more detail in chapter 12, Risk factors and risk management, of this Annual Report. Audit results, relevant investigative activities as well as significant changes and improvements in the company's risk management and internal control system are discussed with the Audit Committee and the Supervisory Board.

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 company 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:
- The management report provides sufficient insights into failings, if any, in the effectiveness of the internal risk management and control systems; and
- 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.

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 27, 2018

**Board of Management**
Eric Rondolat
Stéphane Rougeot
René van Schooten

# Corporate statements

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# 14. Consolidated financial statements

## Introduction

The audited Consolidated financial statements including the notes thereon 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 2017 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 chapters of this Annual Report:
- 3, Our strategic focus
- 4, Corporate performance
- 6, Board of Management
- 7, Supervisory Board
- 8, Supervisory Board report, sub-section 8.3.2 Corporate Governance and Nomination & Selection Committee
- 9, Remuneration report
- 10, Corporate governance
- 11, Investor Relations, section 11.5, Shareholder base
- 12, Risk factors and risk management
- 13, Statement of the Board of Management
- 16, Sustainability statements
- 18, Reconciliation of non-IFRS financial measures
- 19, Definitions and abbreviations
- 20, 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 sections 4.3, Proposed distribution to shareholders, 10.1, Philips Lighting organization and chapter 17, Combined independent auditor's report, of this Annual Report.

Ernst & Young Accountants LLP has issued a Combined independent 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 chapter 17, Combined 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

| | | 2016 | 2017 |
|---|---|---|---|
| [5] | Sales | 7,115 | 6,965 |
| | Cost of sales | (4,438) | (4,264) |
| | **Gross margin** | **2,677** | **2,701** |
| | Selling expenses | (1,750) | (1,738) |
| | Research and development expenses | (353) | (354) |
| | General and administrative expenses | (248) | (221) |
| | Impairment of goodwill | (2) | (1) |
| [9] | Other business income | 60 | 72 |
| [9] | Other business expenses | (15) | (18) |
| [5] | **Income from operations** | **369** | **441** |
| [10] | Financial income | 11 | 8 |
| [10] | Financial expenses | (78) | (51) |
| | Results relating to investments in associates | 2 | - |
| | **Income before taxes** | **304** | **398** |
| [11] | Income tax expense | (119) | (117) |
| | **Net income** | **185** | **281** |
| | | | |
| | **Attribution of net income for the period:** | | |
| | Net income (loss) attributable to shareholders of Philips Lighting N.V. | 189 | 294 |
| | Net income (loss) attributable to non-controlling interests | (4) | (12) |
| | | | |
| [12] | **Earnings per common share attributable to shareholders** | | |
| | Weighted average number of ordinary shares outstanding used for calculation (in thousands): | | |
| | • Basic | 150,000 | 143,778 |
| | • Diluted | 150,000 | 144,202 |
| | Net income attributable to shareholders per ordinary share in EUR | | |
| | • Basic | 1.26 | 2.04 |
| | • Diluted | 1.26 | 2.04 |

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

## 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

| | 2016 | 2017 |
|---|---|---|
| **Net income for the period** | **185** | **281** |
| | | |
| Pensions and other post-employment plans: | | |
| • Remeasurements | (8) | 3 |
| • Income tax effect on remeasurements | 1 | (2) |
| **Total of items that will not be reclassified to profit or loss** | **(7)** | **1** |
| | | |
| Currency translation differences: | | |
| • Net current period change, before tax | 66 | (289) |
| • Income tax effect | – | – |
| Cash flow hedges: | | |
| • Net current period change, before tax | 2 | (3) |
| • Income tax effect | – | – |
| **Total of items that are or may be reclassified to profit or loss** | **68** | **(292)** |
| | | |
| **Other comprehensive income (loss)** | **61** | **(291)** |
| **Total comprehensive income (loss)** | **246** | **(10)** |
| | | |
| Total comprehensive income (loss) attributable to: | | |
| • Shareholders of Philips Lighting N.V. | 247 | 14 |
| • Non-controlling interests | (1) | (24) |

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

| | | | 2016 | | 2017 |
|---|---|---|---|---|---|
| | **Non-current assets** | | | | |
| [3] [13] | Property, plant and equipment | | | | |
| | • At cost | 2,522 | | 2,333 | |
| | • Less accumulated depreciation | (1,956) | | (1,841) | |
| | | | 566 | | 492 |
| [3] [14] | Goodwill | | 1,899 | | 1,694 |
| [3] [15] | Intangible assets, excluding goodwill | | | | |
| | • At cost | 2,238 | | 2,018 | |
| | • Less accumulated amortization | (1,470) | | (1,455) | |
| | | | 768 | | 562 |
| | Non-current receivables | | 25 | | 49 |
| [4] | Investments in associates | | 26 | | 21 |
| [31] | Other non-current financial assets | | 11 | | 12 |
| [11] | Deferred tax assets | | 472 | | 440 |
| | Other non-current assets | | 28 | | 35 |
| | **Total non-current assets** | | **3,795** | | **3,306** |
| | **Current assets** | | | | |
| [16] | Inventories | | 886 | | 924 |
| [17] | Other current assets | | 52 | | 77 |
| [31] | Derivative financial assets | | 29 | | 16 |
| [11] | Income tax receivable | | 50 | | 39 |
| [27] | Receivables: | | | | |
| [18] | • Accounts receivable | 1,489 | | 1,311 | |
| | • Other current receivables | 111 | | 62 | |
| | Receivables | | 1,600 | | 1,373 |
| | Assets classified as held for sale | | 3 | | 1 |
| [30] | Cash and cash equivalents | | 1,040 | | 942 |
| | **Total current assets** | | **3,660** | | **3,372** |
| | **Total assets** | | **7,455** | | **6,678** |

| | | 2016 | | 2017 | |
|---|---|---|---|---|---|
| | **Equity** | | | | |
| [19] | Share capital | 2 | | 1 | |
| | Share premium | 2,369 | | 2,163 | |
| | Retained earnings | 139 | | 287 | |
| | Currency translation differences | 190 | | (87) | |
| | Cash flow hedges | 4 | | 1 | |
| | Treasury shares | – | | (124) | |
| | | | 2,704 | | 2,242 |
| [4] | Non-controlling interests | | 104 | | 79 |
| | **Total equity** | | **2,808** | | **2,321** |
| | **Non-current liabilities** | | | | |
| [20] | Long-term debt | | 1,224 | | 1,170 |
| [21] [22] | Long-term provisions | | 881 | | 777 |
| [11] | Deferred tax liabilities | | 35 | | 27 |
| [23] | Other non-current liabilities | | 150 | | 167 |
| | **Total non-current liabilities** | | **2,290** | | **2,140** |
| | **Current liabilities** | | | | |
| [20] | Short-term debt | | 157 | | 140 |
| [31] | Derivative financial liabilities | | 26 | | 8 |
| [11] | Income tax payable | | 57 | | 79 |
| [25] [27] | Account and notes payable | | 1,024 | | 1,001 |
| [24] | Accrued liabilities | | 502 | | 475 |
| [21] [22] | Short-term provisions | | 244 | | 204 |
| | Liabilities directly associated with assets classified held for sale | | 1 | | – |
| [24] | Other current liabilities | | 346 | | 309 |
| | **Total current liabilities** | | **2,357** | | **2,216** |
| | **Total liabilities and total equity** | | **7,455** | | **6,678** |

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

# 14.4 Consolidated statements of cash flows

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

| | | 2016 | 2017 |
|---|---|---|---|
| | **Cash flows from operating activities** | | |
| | Net income (loss) | 185 | 281 |
| | Adjustments to reconcile net income (loss) to net cash provided by operating activities: | 447 | 383 |
| | • Depreciation, amortization and impairment of non-financial assets | 291 | 286 |
| | • Impairment (reversal) of goodwill, other non-current financial assets and investments in associates | 7 | – |
| | • Net gain on sale of assets | (12) | (53) |
| | • Interest income | (6) | (7) |
| | • Interest expense on debt, borrowings and other liabilities | 48 | 41 |
| | • Income tax expense | 119 | 117 |
| | Decrease (increase) in working capital: | 119 | (33) |
| | • Decrease (increase) in receivables and other current assets | (27) | 74 |
| | • Decrease (increase) in inventories | 104 | (124) |
| | • Increase (decrease) in accounts payable, accrued and other current liabilities | 42 | 17 |
| | Increase (decrease) in non-current receivables, other assets and other liabilities | (66) | 7 |
| | Increase (decrease) in provisions | (71) | (101) |
| | Interest paid | (29) | (15) |
| | Income taxes paid | (96) | (101) |
| | Other items | 16 | 14 |
| | **Net cash provided by (used for) operating activities** | **505** | **435** |
| | **Cash flows from investing activities** | | |
| | Net capital expenditures: | (87) | (31) |
| | • Additions of intangible assets | (30) | (20) |
| | • Capital expenditures on property, plant and equipment | (79) | (76) |
| | • Proceeds from disposal of property, plant and equipment | 22 | 64 |
| | Net proceeds from (cash used for) derivatives and current financial assets | (5) | 7 |
| | Proceeds from other non-current financial assets | 3 | 3 |
| | Purchases of other non-current financial assets | (7) | (5) |
| | Purchases of businesses, net of cash acquired | – | (3) |
| | Proceeds from sale of interests in businesses, net of cash disposed of | 34 | 4 |
| | **Net cash provided by (used for) investing activities** | **(62)** | **(26)** |
| | **Cash flows from financing activities** | | |
| | Funding by (distribution to) Royal Philips | (1,400) | 3 |
| | Dividend paid | (10) | (158) |
| | Capital contribution from Royal Philips | 692 | – |
| [20] | Proceeds from issuance (payments) of debt | 1,225 | (22) |
| | Purchase of treasury shares | – | (307) |
| | **Net cash provided by (used for) financing activities** | **506** | **(484)** |
| | **Net cash provided by (used for) operations** | **949** | **(75)** |
| | Effect of changes in exchange rates on cash and cash equivalents and bank overdrafts | 8 | (39) |
| | Cash and cash equivalents and bank overdrafts at the beginning of the year | 83 | 1,040 |
| [30] | **Cash and cash equivalents and bank overdrafts at the end of the year** | **1,040** | **925** |

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

## 14.5 Consolidated statements of changes in equity

Philips Lighting
**Consolidated Statements of changes in equity** in mEUR unless otherwise stated
2016-2017

| | Owner's net invest-ment | Share capital | Share premium | Retained earnings | Currency trans-lation differ-ences | Cash flow hedges | Treasury shares | Total share-holders' equity | Non-con-trolling interests | Equity |
|---|---|---|---|---|---|---|---|---|---|---|
| **Balance as of January 1, 2016** | **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** |
| | | | | | | | | | | |
| **Balance as of January 1, 2017** | **–** | **2** | **2,369** | **139** | **190** | **4** | **–** | **2,704** | **104** | **2,808** |
| Net Income | – | – | – | 294 | – | – | – | 294 | (12) | 281 |
| Other comprehensive income (loss) | – | – | – | 1 | (277) | (3) | – | (279) | (12) | (291) |
| **Total comprehensive income (loss)** | **–** | **–** | **–** | **295** | **(277)** | **(3)** | **–** | **14** | **(24)** | **(10)** |
| Movement in non-controlling interests | – | – | – | – | – | – | – | – | (1) | (1) |
| Dividend distributed | – | – | (11) | (146) | – | – | – | (157) | – | (157) |
| Purchase of treasury shares | – | – | – | – | – | – | (307) | (307) | – | (307) |
| Cancellation of treasury shares | – | (0) | (183) | – | – | – | 183 | – | – | – |
| Re-issuance of treasury shares | – | – | (1) | – | – | – | 1 | – | – | – |
| Share-based compensation plans | – | – | 10 | – | – | – | – | 10 | – | 10 |
| Income tax share-based compensation plans | – | – | 2 | – | – | – | – | 2 | – | 2 |
| Funding by (distribution to) Royal Philips [1] | – | – | (24) | – | – | – | – | (24) | – | (24) |
| **Balance as of December 31, 2017** | **–** | **1** | **2,163** | **287** | **(87)** | **1** | **(124)** | **2,242** | **79** | **2,321** |

1) Includes a negative adjustment of EUR 30 million related to the re-measurement of deferred taxes following the reduction of the US federal income tax rate.

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, 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 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 and the 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 Consolidated statements of cash flows present 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.

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. Due to rounding, amounts may not add up to totals provided.

### [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 made are goodwill, deferred tax asset recoverability, revenue recognition, impairments, provisions, employee benefit obligations, inventory valuation and obsolescence provision, estimation of allowances for doubtful accounts as well as fair value of derivatives and other financial instruments. For further discussion on these significant judgements and estimates, reference is made to the respective accounting policies and notes within these Consolidated financial statements that relate to the above topics.

**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. These transactions mainly occur in the Professional business. Philips Lighting applies judgement for determining relative fair values.

Revenues are recorded net of sales taxes, customer discounts, rebates and similar charges. Judgement is required in determining the probability that discounts will be granted. The estimate is updated throughout the term of the contract. 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 related to sales to third parties are recorded as selling expenses. When shipping and handling is part of a project and billed to the customer, then the related expenses are recorded as cost of sales. Shipping and handling billed to customers is recognized as revenue. Service revenue related to repair and maintenance activities for goods sold is recognized ratably over the service period or as services are rendered.

A provision for product warranty is made at the time of revenue recognition and reflects the estimated costs of replacement and free-of-charge services that will be incurred by 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 from intellectual property rights, 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.

### 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.

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.

### Deferred tax asset and other tax liabilities

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 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. 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. 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.

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. 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.

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 provisions - 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.

Philips Lighting has certain guarantees, environmental remediation and legal proceedings at the reporting dates. Refer to notes 26, Contingent liabilities, and 30, Details of treasury and other financial risks, for further details.

### 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. Intangible assets are initially capitalized at cost, with the exception of 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 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 annually and whenever impairment indicators require impairment testing. Philips Lighting performed and completed annual impairment tests in the last quarter of the financial year. Judgement is required when analyzing impairments triggers and tests of goodwill and intangible assets. These analyses are based on estimates of future cash flows. The review for impairment is carried out at the level where cash flows occur that are independent of other cash flows.

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.

**Employee benefits**

Post-employment benefit obligations

Post-employment benefits are retirement benefits (such as pensions and lump sum payments on retirement), post-employment life insurance and post-employment medical care. Distinction is being made between defined contribution plans and defined benefit plans. 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. 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 distinction is made for the short-term portion. The defined benefit obligation is calculated annually by qualified actuaries using the projected unit credit method. For plans with a relatively low defined benefit obligation, Philips Lighting may decide to calculate the defined benefit obligation with a lower frequency. Assets recognized, 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. For obligations denominated in EUR and USD, Aon Hewitt corporate bond curves will be used. The calculation of the defined benefit obligations for the German and US plans are based on the full corporate bond curves. For the other plans, a single point discount rate based on corporate bonds is used. However, for countries without a deep corporate bond market, the discount rate is 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.

Re-measurements 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 re-measurements 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.

### Other long-term employee benefits
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.

### 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.

### 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.

**Financial assets and liabilities**
Financial assets and liabilities are recognized initially at fair value when Philips Lighting becomes a party to the contractual provisions of the instrument. 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. Financial assets and liabilities comprise cash and cash equivalents, receivables, other non-current financial assets, debt and other financial liabilities that are not designated as hedges.

Subsequent to initial recognition, financial assets are measured at amortized cost or fair value. 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. 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. Impairment and reversal of impairment is recognized in the Consolidated statements of income.

**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**
Philips Lighting presents financial assets and financial liabilities on a gross basis as separate line items in the Consolidated balance sheets unless the offset criteria are met.

The offsetting criteria are met 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. 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.

Master netting agreements may be entered into when Philips Lighting undertakes several 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 all offsetting criteria are met.

**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 if the offset requirements are met. The present value of estimated future cash flows is determined using value adjustments for

uncollectible amounts. Philips Lighting determines the present value of estimated future cash flows, based on an individual or collective assessment of the collectability of trade and other receivables. The identification of doubtful debtors requires the use of judgement and estimates. 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 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. 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.

As soon as individual trade accounts receivable can no longer be collected in a normal course of business 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.

**Derivative financial instruments, including hedge accounting**

Philips Lighting manages their exposure on foreign currency purchases and sales using forward foreign exchange contracts, which are reported at fair value. 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.

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 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.

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 hedge accounting which 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.

**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.

**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. 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.

## 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.

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.

### 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**
Philips Lighting's investments in associates are accounted for using the equity method. Investments in associates are recognized initially at cost.

Investments in associates are those entities in which Philips Lighting has significant influence, but no control or joint control, over the financial and operating policies.

Philips Lighting's share of the net income of associates are 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.

**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.

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 to 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.

Cash flows in foreign currencies have been translated into euros using the exchange rate at the date of the cash flow.

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 approximating to the exchange rates ruling 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. If the operation is not a 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 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.

**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 is 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.

**Share-based compensation expenses**
Equity-settled transactions
The cost of equity-settled transactions is determined by the fair value at the date when the grant is made using an appropriate valuation model, further details of which are given in note 28, Share-based compensation.

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. The cumulative expense recognized for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the company's best estimate of the number of equity instruments that will ultimately vest. The expense or credit in the statement of profit or loss for a period represents the movement in cumulative expense recognized as at the beginning and end of that period.

Service and non-market performance conditions are not taken into account when determining the grant date fair value of awards, but the likelihood of the conditions being met is assessed as part of the company's best estimate of the number of equity instruments that will ultimately vest. Market performance conditions are reflected within the grant date fair value.

No expense is recognized for awards that do not ultimately vest because non-market performance and/or service conditions have not been met. Where awards include a market or non-vesting condition, the transactions are treated as vested irrespective of whether the market or non-vesting condition is satisfied, provided that all other performance and/or service conditions are satisfied.

Royal Philips Long-term Incentive Plan
Until the settlement of the IPO of Philips Lighting in 2016, eligible employees of Philips Lighting as well as members of the Board of Management participated in grants made under the Royal Philips Long-term Incentive Plan. Those employees remain to participate in the Royal Philips LTI Plan until the shares from the last grant in 2016 will vest in 2019.

The share-based payment plan, for which Royal Philips has the obligations to settle with the equity instruments of Royal Philips, 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.

Based on the recharge arrangement between Royal Philips and Philips Lighting, 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.

**Other non-current financial assets**
Other non-current financial assets include loans and other receivables, available-for-sale financial assets and financial assets at fair value through profit or loss. Loans and other receivables are stated at amortized cost, less impairment.

**Debt, 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. Debt and trade and other payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

**Financial 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 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 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 of Philips Lighting N.V. 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, conditional shares and performance shares granted to employees.

**Government grants**

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.

**Changes in accounting policies and disclosures**

Other changes

The presentation of the line item "Results relating to investments in associates" was moved into the subtotal "Income before taxes" in the Consolidated statements of income. This change did not impact the income of operations or financial position.

**IFRS accounting standards adopted as from 2017**

Changes to policies, following from amendments to standards, interpretations and the annual improvement cycles, effective 2017, did not have a material impact on the Consolidated financial statements.

**IFRS accounting standards to be adopted as from 2018 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, 2018 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 introduces a new expected loss impairment model, amendments to classification and measurement for financial assets and guidance for hedge accounting. 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. The standard was endorsed by the EU. Philips Lighting finalized the impact assessment of the new standard.
The implementation of IFRS 9 in respect of our positions as per December 31, 2017 and our hedging relationship designated during 2017 under IAS 39 will lead to the following conclusions:

Classification and measurement

The new classification and measurement requirements will not have a material impact on financial assets of Philips Lighting, which mainly include trade and other receivables, loans and derivatives, nor on the classification and measurement of financial liabilities.

### Impairment

Philips Lighting concludes that timing of recognition of the expected credit losses is accelerated compared to the IAS 39 requirements for assets in the scope of the IFRS 9 impairment model. The new impairment calculation methodology for trade accounts receivable, which is utilizing the historical overdue and collection data as well as the forward-looking country specific credit default estimations, will lead to an increase of the bad debt allowance of approximately EUR 10 million before tax as at January 1, 2018. As these trade accounts receivables do not contain a significant financing component, Philips Lighting will apply the simplified approach whereby the lifetime expected credit loss on the receivables is recognized based on a matrix model calculated per country. For other assets in scope of IFRS 9 the new impairment methodology will not have a material impact.

### Hedge accounting

Philips Lighting 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.

For compliance with IFRS 9 hedge accounting Philips Lighting will 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. However, 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 the option to defer the changes in the fair value of the forward element via other comprehensive income was introduced. Philips Lighting considered this opportunity but decided not to change its current way of working and will continue to recognize forward points in profit and loss at the inception of the hedge.

Philips Lighting concludes that the types of hedge accounting relationships that Philips Lighting currently designates will continue to meet the requirements of IFRS 9. Philips Lighting completed certain changes to its internal documentation and monitoring processes to align with IFRS 9 hedge accounting requirements. Accordingly, there will be no significant impact on the accounting for hedging relationships.

### Transition

The new standard will be applied retrospectively starting from January 1, 2018 with the practical expedients permitted under the standard. Comparatives for 2017 will not be restated in 2018.

**IFRS 15 Revenue from Contracts with Customers**

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognized. This standard replaces existing revenue recognition guidance, including IAS 18 Revenue, IAS 11 Construction Contracts and IFRIC 13 Customer Loyalty Programmes.

Philips Lighting finalized the impact assessment for its Consolidated financial statements, distinguishing three main streams of revenue based on current revenue recognition patterns: sale of goods, transactions that have separately identifiable components and royalty income.

### Sale of goods

Currently, most of the company's revenue is recognized when goods are delivered to the customer, which is the point in time at which the customer accepts the goods and the related risks and rewards of ownership are transferred. Under IFRS 15, revenue will be recognized when a customer obtains control of the goods. Philips Lighting concluded that for Philips Lighting the timing of revenue recognition under IFRS 15 is consistent with the risk- and rewards model applied under IAS 18. Philips Lighting further considered the guidance on variable consideration and the constraint as provided by IFRS 15 and concluded that the accounting for sales incentives and other instances where the consideration may be variable, such as in case of a right to return, is consistent with the current accounting treatment.

Philips Lighting offers a range of connected lighting products, for which functionality is partly cloud-enabled. When applying IFRS 15, for products that are sold together with cloud-enabled services, part of revenue is deferred and recognized over time, together with associated costs. Currently this related revenue is recognized at the time of sale of the product and hence this constitutes a change compared to current practice, although the overall impact is not material. Furthermore, there is no impact on retained earnings at January 1, 2018 as all related contracts from 2017 and before are considered complete as of December 31, 2017 under the transitional guidance.

### Transactions that have separately identifiable components

Transactions that have separately identifiable components mainly occur in parts of business group Professional. Guiding principle under the current guidance 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 consideration is probable. Consequently, for some contracts recognition of revenue is 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. Philips Lighting concluded that by 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 timing of revenue recognition for this type of transactions under the new standard differs from current practice. In instances where, under the existing guidance, recognition of revenue is postponed until all performance obligations under the contract are fulfilled and installation is complete, revenue may instead be recognized over time based on an appropriate measure of progress when applying IFRS 15. The impact from this change is not expected to be material, also because the contract duration is typically less than one year.

### 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 using the actual or estimated related sales of the licensees. Under the new revenue recognition standard, for sales- or usage-based royalties that are attributable to a license of intellectual property, revenue is recognized at the later of when the subsequent sale or usage occurs, and the satisfaction or partial satisfaction of the performance obligation to which some or all of the sales- or usage-based royalty has been allocated. Hence, for the sales- or usage-based royalty agreements as typically encountered within Philips Lighting, under the new standard, revenue will be recognized over time, in line with the occurrence of the related sale or usage. This revenue recognition pattern is consistent with current revenue recognition, and hence IFRS 15 does not have a material impact with regards to timing of revenue recognition from these contracts.

### Costs of obtaining a contract

Under IFRS 15, the incremental costs of obtaining a contract must be recognized as an asset if the entity expects to recover those costs. Those incremental costs are limited to the costs that the entity would not have incurred if the contract had not been successfully obtained (e.g. ‘success fees’ paid to agents). Under the current guidance, these costs are expensed when incurred.

Philips Lighting will apply the available practical expedient, allowing the incremental costs of obtaining a contract to be expensed if the associated amortization period is 12 months or less. As a result, Philips Lighting expects no impact from adoption of the new standard on accounting for costs to obtain a contract on the company’s Consolidated financial statements.

### Transition

As of January 1, 2018, Philips Lighting will adopt IFRS 15 using the cumulative effect method, whereby comparative figures are not restated, but instead retained as reported under the previous standards. The cumulative effect of applying IFRS 15 will be accounted for as an adjustment to the opening balance of equity as at the date of initial application (January 1, 2018). Philips Lighting will apply the new standard only to contracts that are not considered completed contracts at the date of initial application.
The quantitative impact from transition to the new standard is immaterial.

**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. IFRS 16 has been endorsed by the EU.

Philips Lighting continues to assess 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 limited exposure is expected from other operating leases. In this respect, Philips Lighting identified EUR 332 million of off-balance undiscounted operating lease obligations per December 31, 2017 (refer to note 25, 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 decided whether it will use any of the optional exemptions and has not yet completed the decision-making process on which transition method will be applied.

## [3] Information by segment and main country

Operating segments are components of the company's business activities about which separate financial information is available that is evaluated regularly by the chief operating decision maker (the Board of Management of the Company). 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.

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
2016-2017

| | Sales | Sales including intersegment | Depreciation and amortization 1) | EBITA 2) | EBITA as a % of sales |
|---|---|---|---|---|---|
| **2017** | | | | | |
| Lamps | 1,820 | 1,838 | (48) | 350 | 19.2% |
| LED | 1,703 | 1,827 | (13) | 169 | 9.9% |
| Professional | 2,755 | 2,760 | (49) | 181 | 6.6% |
| Home | 684 | 689 | (12) | 31 | 4.6% |
| Other 3) | 3 | 13 | (33) | (160) | |
| Intersegment elimination | | (162) | | | |
| **Philips Lighting** | **6,965** | **6,965** | **(156)** | **571** | **8.2%** |
| Amortization 4) | | | | (130) | |
| **Income from operations** | | | | **441** | |
| **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%) |
| Other 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** | |

1) Excluding amortization and impairment of acquisition related intangible assets and goodwill.
2) Income from operations excluding amortization and impairment of acquisition related intangible assets and goodwill ("EBITA").
3) Considering the nature of Other, EBITA as a % of sales for Other is not meaningful.
4) Amortization and impairment 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, tangible and intangible assets by main countries**
in mEUR
2016-2017

| | 2016 | | 2017 | |
|---|---|---|---|---|
| | Sales | Tangible and intangible assets 1) | Sales | Tangible and intangible assets 1) |
| Netherlands | 529 | 142 | 570 | 129 |
| United States | 1,718 | 2,152 | 1,613 | 1,797 |
| Germany | 453 | 12 | 480 | 8 |
| China | 445 | 89 | 463 | 78 |
| India | 406 | 25 | 439 | 19 |
| Saudi Arabia | 203 | 226 | 149 | 183 |
| Other countries | 3,361 | 587 | 3,251 | 534 |
| **Total countries** | **7,115** | **3,233** | **6,965** | **2,748** |

1) Including goodwill.

Goodwill can be specified as follows:

Philips Lighting
**Goodwill allocated to the cash-generating units** in mEUR
2016-2017

| | Balance as of January 1 | Impairment | Divestments, transfers to assets classified as held for sale and other changes | Translation differences | Balance as of December 31 |
|---|---|---|---|---|---|
| **2017** | | | | | |
| Lamps | 70 | - | - | (10) | 60 |
| LED | 28 | - | - | - | 28 |
| Professional | 1,671 | - | (1) | (187) | 1,484 |
| Home | 129 | - | - | (7) | 122 |
| **Philips Lighting** | **1,899** | **-** | **(1)** | **(204)** | **1,694** |
| **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** |

## [4] Interests in entities

In this note the nature and risks associated with the Company's interests in its consolidated entities and associates are discussed 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 more than 5% of either the consolidated company sales, income from operations or net income (before any intra-company eliminations). All the entities are 100% owned.

Philips Lighting
**Interests in materially wholly-owned subsidiaries**
in alphabetic order
2017

| Legal entity name | Principal country of business |
|---|---|
| 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 North America Corporation | United States |
| Philips Lighting Poland Sp. z o.o. | Poland |
| PT. Philips Indonesia | Indonesia |

### Not wholly-owned subsidiaries

In total, 13 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%. The sales of this entity are less than 3% of the consolidated financial data.
The non-controlling interest of 49% represents an amount of EUR 78 million as per December 31, 2017 (2016: EUR 102 million).

The minority share of the consolidated company sales, income from operations and net income of the remaining not wholly-owned subsidiaries (before any intra-company eliminations) are less than 1% 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.

## [5] Income from operations

### Sales and costs by nature

Philips Lighting
**Sales and costs by nature** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Sales | 7,115 | 6,965 |
| Cost of materials used | (3,032) | (2,956) |
| Employee benefit expenses | (1,993) | (1,987) |
| Depreciation and amortization | (291) | (286) |
| Shipping and handling | (227) | (236) |
| Advertising and promotion | (170) | (172) |
| Lease expenses [1] | (120) | (103) |
| Other operational costs [1] | (958) | (838) |
| Other business income, net | 45 | 54 |
| **Income from operations** | **369** | **441** |

1) Prior-year amounts have been reclassified to conform to the current year presentation.

The sales consist primarily of sales of goods (2017: 96%, 2016: 96%).

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 17 million (2016: EUR 22 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 1 million (2016: 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 impairment.

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 27, 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
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Salaries and wages | (1,188) | (1,135) |
| Social securities | (209) | (211) |
| Post-employment benefits | (90) | (93) |
| Cost of termination plans | (63) | (113) |
| Temporary personnel | (107) | (102) |
| Share-based compensation | (23) | (36) |
| Other | (313) | (296) |
| **Total** | **(1,993)** | **(1,987)** |

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 29, Information on remuneration.

For further information on the share-based compensation, refer to note 28, 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
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Employees | 31,272 | 29,202 |
| Third party workers | 3,995 | 4,734 |
| **Total** [1] | **35,267** | **33,936** |

1) 3,374 FTEs work in The Netherlands (2016 : 3,642); 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 impairment

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

Philips Lighting
**Depreciation, amortization and impairment** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Property, plant and equipment | (148) | (126) |
| Internal-use software | (7) | (12) |
| Other intangible assets | (108) | (130) |
| Development costs | (28) | (18) |
| **Total** | **(291)** | **(286)** |

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
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Result on disposal of businesses: | | |
| • Income | 3 | 1 |
| • Expense | (3) | – |
| Result on disposal of fixed assets: | | |
| • Income | 17 | 53 |
| • Expense | (5) | (1) |
| Result on other remaining businesses: | | |
| • Income | 40 | 18 |
| • Expense | (7) | (17) |
| **Other business income (expenses)** | **45** | **54** |
| Total other business income | 60 | 72 |
| Total other business expense | (15) | (18) |

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 2017, the result includes a EUR 15 million gain mainly allocated to Lamps in the Netherlands, a EUR 15 million gain in Home in China and a gain of EUR 21 million in Lamps in Indonesia. In 2016, a EUR 8 million gain was the result of a sale mainly allocated to Lamps in Thailand.

In 2017, the net result on other remaining businesses mainly arises from the movements in the provisions with Royal Philips originating from the separation. In 2016, the result 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] Financial income and expenses

Financial income and expenses include:

Philips Lighting
**Financial income and expenses** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Interest income | 6 | 7 |
| Net change in fair value of financial assets at fair value through profit or loss | 2 | - |
| Other financial income | 3 | 1 |
| **Financial income** | **11** | **8** |
| Interest expense | (49) | (41) |
| Provision-related accretion and other interest | (5) | (4) |
| Net foreign exchange losses | (15) | (3) |
| Impairment loss of financial assets | (3) | (1) |
| Other financial expenses | (6) | (3) |
| **Financial expense** | **(78)** | **(51)** |
| **Financial income and expenses** | **(67)** | **(43)** |

During the year, interest paid to third parties amounted to EUR 25 million (2016: EUR 30 million, including EUR 15 million interest on loans received from Royal Philips) (please refer to note 20, Short-term and long-term debt, for further details). Interest on pensions amounted to EUR 16 million (2016: EUR 19 million) (please refer to note 22, Post-employment benefits, for further details).

## [11] Income taxes

The income tax expense amounted to EUR 117 million (2016: EUR 119 million).
The components of income before taxes and income tax expense are as follows:

Philips Lighting
**Income tax expense** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Netherlands | (80) | 271 |
| Foreign | 384 | 127 |
| **Income before taxes** | **304** | **398** |
| Netherlands: | | |
| • Current tax benefit (expense) | - | (41) |
| • Deferred tax benefit (expense) | 19 | (24) |
| **Total tax expense (Netherlands)** | **19** | **(65)** |
| Foreign: | | |
| • Current tax benefit (expense) | (91) | (85) |
| • Deferred tax benefit (expense) | (47) | 33 |
| **Total tax expense (foreign)** | **(138)** | **(52)** |
| **Income tax expense** | **(119)** | **(117)** |

The components of income tax expense are as follows:

Philips Lighting
**Current tax expense** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Current tax expense | (89) | (124) |
| Prior year benefit (expense) | (2) | (2) |
| **Current tax expense** | **(91)** | **(126)** |

Philips Lighting
**Deferred income tax expense** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Origination and reversal of temporary differences | 33 | 11 |
| Change in tax losses, tax credits and temporary differences recognized | (61) | 1 |
| Tax rate changes | (2) | (7) |
| Prior year benefit (expense) | 2 | 4 |
| **Deferred income tax benefit (expense)** | **(28)** | **9** |

Philips Lighting's operations are subject to income taxes in various jurisdictions.
The statutory income tax rates vary from 9% to 39%, which results in a difference between the weighted average statutory income tax rate and the Netherlands' statutory income tax rate of 25% (2016: 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 stated otherwise
2016-2017

| | 2016 | % | 2017 | % |
|---|---|---|---|---|
| **Income before taxes** | **304** | | **398** | |
| Weighted average statutory income tax rate | (86) | (28%) | (86) | (22%) |
| Non-deductible expenses | (16) | (5%) | (19) | (5%) |
| Tax incentives and exempt income | 18 | 6% | 26 | 7% |
| Deferred tax expense related to de-recognition of deferred tax assets - net | (14) | (5%) | (16) | (4%) |
| Changes in the liability for uncertain tax positions | (6) | (2%) | (1) | - |
| Prior year tax expense | (11) | (4%) | 2 | 1% |
| Other | (4) | (1%) | (23) | (6%) |
| **Income tax expense recognized in Consolidated statements of income** | **(119)** | **(39%)** | **(117)** | **(29%)** |

The weighted average statutory income tax rate decreased in 2017 compared to 2016 by 6%, as a consequence of a favorable change in the geographical mix of profits and losses in the various countries, mainly due to one-off transactions in relation to the separation in 2016.

The effective income tax rate is higher than the weighted average statutory income tax rate in 2017 and 2016, mainly due to the net deferred tax expense related to derecognition of deferred tax assets, and specifically for 2017 the impact of tax law changes - which is included in other. For 2017, the line item “Other” includes a EUR 7 million non-cash tax expense related to the impact on deferred taxes mainly following the statutory tax rate reductions in the United States and Belgium.

**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
2016-2017

| | Assets | Liabilities | Net |
|---|---|---|---|
| **2017** | | | |
| Intangible assets | 191 | (113) | 78 |
| Property, plant and equipment | 17 | (9) | 8 |
| Inventories | 38 | (4) | 34 |
| Prepaid pension cost | – | – | – |
| Other receivables and assets | 57 | (2) | 55 |
| Provisions for pensions and other postretirement | 86 | – | 86 |
| Provisions for termination benefits | 24 | – | 24 |
| Other provisions | 35 | – | 35 |
| Other liabilities | 40 | (40) | – |
| Deferred tax assets on tax attributes [1] | 93 | – | 93 |
| **Total allocations** | **581** | **(168)** | **413** |
| Set-off of deferred tax | (141) | 141 | – |
| **Net deferred tax assets** | **440** | **(27)** | **413** |
| **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 postretirement | 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).

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 depends 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 413 million (2016: EUR 437 million) consists of deferred tax assets of EUR 440 million (2016: EUR 472 million) in countries with a net deferred tax asset position and deferred tax liabilities of EUR 27 million (2016: EUR 35 million) in countries with a net deferred tax liability position. An amount of EUR 54 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 2017 are as follows:

Philips Lighting
**Movement in deferred tax balances during the year** in mEUR
2016-2017

| | Balance as of January 1 | Recog-nized in income | Other | Balance as of Decem-ber 31 |
|---|---|---|---|---|
| **2017** | | | | |
| Intangible assets | 3 | 52 | 23 | 78 |
| Property, plant and equipment | – | 12 | (4) | 8 |
| Inventories | 52 | (13) | (5) | 34 |
| Prepaid pension assets | (1) | 2 | (1) | – |
| Other receivables | 73 | (17) | (1) | 55 |
| Other assets | – | – | – | – |
| Provisions: | | | | |
| • Pensions and other postretirement benefits | 151 | (21) | (44) | 86 |
| • Guarantees | – | – | – | – |
| • Termination benefits | 4 | 15 | 5 | 24 |
| • Other provisions | 40 | (3) | (2) | 35 |
| Other liabilities | (8) | 7 | 1 | – |
| Tax loss carryforwards (including tax credit carryforwards) | 123 | (25) | (5) | 93 |
| **Net deferred tax assets** | **437** | **9** | **(33)** | **413** |
| **2016** | | | | |
| 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 |
| Other assets | – | – | – | – |
| Provisions: | | | | |
| • Pensions and other postretirement benefits | 5 | (15) | 161 | 151 |
| • Guarantees | – | – | – | – |
| • Termination benefits | 39 | 1 | (36) | 4 |
| • Other provisions | 68 | 24 | (52) | 40 |
| Other liabilities | 24 | 1 | (33) | (8) |
| Tax loss carryforwards (including tax credit carryforwards) | 154 | (64) | 33 | 123 |
| **Net deferred tax assets** | **133** | **(28)** | **332** | **437** |

The column "Other" primarily includes foreign currency translation differences, and the impact of the remeasurement of the deferred tax balances relating to Pensions and other postretirement benefits and Tax loss carryforwards of EUR 30 million in the United States following the reduction of the federal income tax rate. The impact of the change in tax rate has been recognized in equity to the extent that it relates to items previously recognized in equity.

At December 31, 2017, the temporary differences associated with investments, including potential income tax consequences on dividends for which no deferred tax liabilities are recognized, aggregate to EUR 262 million (2016: EUR 314 million).

At December 31, 2017, net operating loss carry-forwards expire as follows:

Philips Lighting
**Expiry year operating loss carry-forwards** in mEUR
2017

| | **2017** |
|---|---|
| Total | 797 |
| 2018 | 3 |
| 2019 | – |
| 2020 | 91 |
| 2021 | 11 |
| 2022 | 2 |
| After 2022 but not unlimited | 82 |
| Unlimited | 608 |

At December 31, 2017, the amount of operating loss and tax credit carry-forwards for which no deferred tax assets have been recognized in the balance sheet was EUR 460 million (2016: EUR 417 million).

Out of EUR 460 million, an amount of EUR 449 million should not be limited in time, EUR 4 million will expire by 2018, EUR 1 million will expire by 2020, EUR 5 million will expire by 2021 and the remaining EUR 1 million expires after 2022, but carry-forward is limited in time.

At December 31, 2017, the amount of deductible temporary differences for which no deferred tax asset has been recognized in the balance sheet is EUR 117 million (2016: EUR 148 million). Classification of the income tax payable and receivable is as follows:

Philips Lighting
**Income tax receivables and payables** in mEUR
2016-2017

| | **2016** | **2017** |
|---|---|---|
| Income tax receivable under current assets | 50 | 39 |
| Income tax receivable under non-current receivables | 9 | 8 |
| Income tax payable | (57) | (79) |

**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. Consequently, 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 a foreign Philips Lighting organization, 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 40 million as disclosed in note 23, Other non-current liabilities. In addition, related to similar uncertainties, an indemnification liability to Royal Philips of EUR 66 million and an indemnification receivable of EUR 9 million is recorded. The total net liability decreased in 2017 by EUR 13 million mainly due to settlements and expirations.

## [12] Earnings per share

Philips Lighting
**Earnings per share** in mEUR unless otherwise stated
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Net income attributable to shareholders of Philips Lighting N.V. | 189 | 294 |
| Weighted average number of ordinary shares outstanding (after deduction of treasury shares) during the year | 150,000,000 | 143,777,590 |
| Plus incremental shares assumed from conversions of: | | |
| • Performance shares | - | 293,340 |
| • Conditional shares | - | 116,906 |
| • Restricted shares | - | 14,518 |
| Diluted weighted average number of ordinary shares outstanding (after deduction of treasury shares) during the year | 150,000,000 | 144,202,354 |
| Net income attributable to shareholders per ordinary share in EUR | | |
| • Basic | 1.26 | 2.04 |
| • Diluted | 1.26 | 2.04 |

## [13] Property, plant and equipment

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

Philips Lighting
**Property, plant and equipment movement schedule** in mEUR
2016-2017

| | Land and buildings | Machinery and instal-lations | Other equipment | Prepay-ments and construc-tion in progress | Total |
|---|---|---|---|---|---|
| **Balance as of January 1, 2016** | | | | | |
| Cost | 643 | 1,543 | 391 | 43 | 2,620 |
| Accumulated depreciation/impairment | (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) | – |
| 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) |
| Impairment | – | (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/impairment | (335) | (1,299) | (322) | – | (1,956) |
| **Book value** | **261** | **193** | **74** | **38** | **566** |
| Change in book value: | | | | | |
| Capital expenditure | 5 | 5 | 13 | 60 | 84 |
| Asset available for use | 14 | 23 | 24 | (60) | – |
| Sales and disposals | – | (1) | (1) | (2) | (4) |
| Divestments and transfers to assets classified as held for sale | (4) | – | – | – | (4) |
| Depreciation | (27) | (54) | (35) | – | (117) |
| Impairment | (1) | (7) | (1) | – | (9) |
| Translation differences and other movements | (10) | (9) | (4) | (2) | (25) |
| **Total changes** | **(24)** | **(43)** | **(5)** | **(3)** | **(74)** |
| **Balance as of December 31, 2017** | | | | | |
| Cost | 576 | 1,375 | 346 | 35 | 2,333 |
| Accumulated depreciation/impairment | (339) | (1,225) | (277) | – | (1,841) |
| **Book value** | **237** | **150** | **69** | **35** | **492** |

Land with a book value of EUR 16 million was not depreciated in 2017 (2016: EUR 18 million).
The impairment losses were mainly driven by manufacturing footprint rationalization. Property, plant and equipment includes financial lease assets with a book value of EUR 17 million at December 31, 2017 (2016: EUR 20 million).

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

Philips Lighting
**Useful lives property, plant and equipment** in years
2016-2017

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

## [14] Goodwill

The movements in goodwill are as follows:

Philips Lighting
**Goodwill movement schedule** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| **Balance as of January 1** | | |
| Cost | 2,566 | 2,638 |
| Accumulated amortization/ impairment | (722) | (739) |
| **Book value** | **1,844** | **1,899** |
| Change in book value: | | |
| Divestments, transfers to assets classified as held for sale and other changes | (12) | (1) |
| Impairment | – | – |
| Translation differences | 67 | (204) |
| **Total changes** | **55** | **(205)** |
| **Balance as of December 31** | | |
| Cost | 2,638 | 2,381 |
| Accumulated amortization/ impairment | (739) | (687) |
| **Book value** | **1,899** | **1,694** |

The decrease of EUR 204 million of 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. 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, 2016 and December 31, 2017. The amounts associated as of December 31, 2016, and December 31, 2017, are presented below.

Philips Lighting
**Goodwill allocated to the cash-generating unit** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Professional | 1,671 | 1,484 |
| Other | 228 | 210 |
| **Book value** | **1,899** | **1,694** |

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 2017, the estimated recoverable amount of the cash-generating units tested approximated or exceeded the carrying value of the units. Therefore, no impairment loss was recognized.

Key assumptions used in the impairment tests for the units were sales growth rates, 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 2018 to 2020 that matches the period used for our strategic process. Projections were extrapolated with 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 2017 and 2016 were based on the key assumptions included in the table below:

Philips Lighting
**Key assumptions** in %
2016-2017

| | Compound sales growth rate 1) | | | |
|---|---|---|---|---|
| | Initial forecast period | Extra polation period | Used to calculate terminal value 2) | Pre-tax discount rates |
| Professional | | | | |
| 2017 | 4.7 | 4.8 | 2.7 | 12.4 |
| Professional | | | | |
| 2016 | 5.0 | 4.3 | 2.7 | 13.9 |

1) Compound sales growth rate is the annualized steady growth rate over the forecast period.
2) The historical long-term growth rate is only applied to the first year after the five-year extrapolation period, after which no further growth is assumed for the terminal value calculation.

The results of the annual impairment test of Professional have indicated that a reasonably possible change in key assumptions would not cause the value in use to fall to the level of the carrying value.

## [15] Intangible assets excluding goodwill

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

Philips Lighting
**Intangible assets movements schedule** in mEUR
2016-2017

| | Product develop-ment | Tech-nology based | Customer relation-ships | Brand names | Software | Other | Total |
|---|---|---|---|---|---|---|---|
| **Balance as of January 1, 2016** | | | | | | | |
| Cost | 180 | 358 | 1,245 | 357 | 24 | 28 | 2,192 |
| Accumulated amortization/ impairment | (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 |
| Accumulated amortization/ impairment | (147) | (259) | (807) | (235) | (16) | (6) | (1,470) |
| **Book value** | **32** | **108** | **473** | **127** | **19** | **9** | **768** |
| Change in book value: | | | | | | | |
| Additions | 13 | 1 | – | – | 4 | – | 19 |
| Amortization | (14) | (18) | (72) | (14) | (7) | (1) | (126) |
| Acquisitions | – | – | – | – | 1 | – | 1 |
| Impairment | (4) | – | (21) | (3) | (5) | – | (32) |
| Translation differences and other movements | (1) | (4) | (46) | (13) | – | (3) | (67) |
| **Total changes** | **(6)** | **(21)** | **(138)** | **(30)** | **(7)** | **(3)** | **(206)** |
| **Balance as of December 31, 2017** | | | | | | | |
| Cost | 167 | 339 | 1,142 | 331 | 27 | 12 | 2,018 |
| Accumulated amortization/ impairment | (141) | (252) | (807) | (234) | (15) | (6) | (1,455) |
| **Book value** | **26** | **87** | **335** | **97** | **12** | **6** | **562** |

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 2017 contain internally generated assets of EUR 13 million for product development, and EUR 4 million for software.

The impairment charges in 2017 include an impairment charge of EUR 20 million, of which EUR 17 million relates to customer relations and EUR 3 million to brand names in Professional. The impairment charge is based on a trigger-based test on a global specific business within Professional following lower forecasted sales compared to earlier expectations. The basis of the recoverable amount of the cash-generating unit is the value in use and was estimated at EUR 22 million. In this test, a pre-tax discount rate of 9.5% is applied. After the impairment charge, the carrying amount of the related intangible assets is zero.

The capitalized product development costs and software, for which amortization has not yet commenced, amounted to EUR 11 million as of December 31, 2017 (2016: 13 million).

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

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

| | |
|---|---|
| 2018 | 93 |
| 2019 | 91 |
| 2020 | 83 |
| 2021 | 82 |
| 2022 | 71 |

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 | 1-5 |
| Software | 1-10 |
| Technology | 1-20 |
| Customer relations | 2-20 |
| Brand names | 2-20 |
| Other | 2-10 |

At December 31, 2017, the carrying amount of the customer relationships originating from the Genlyte acquisition was EUR 175 million (USD 209 million) with a remaining amortization period of 5.1 years (2016: EUR 261 million, USD 275 million; 5.9 years).

## [16] Inventories

Inventories are summarized as follows:

Philips Lighting
**Inventories** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Raw materials | 276 | 300 |
| Work in progress | 26 | 25 |
| Finished goods | 584 | 599 |
| **Total** | **886** | **924** |

The write-down of inventories to realizable value amounted to EUR 25 million for the year ended December 31, 2017, (2016: EUR 10 million). For the year ended December 31, 2016, a reversal of impairment of inventories to realizable value of EUR 5 million was recorded. The write-down and reversal are included in cost of sales.

## [17] Other current assets

Philips Lighting
**Other current assets** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Prepayments | 31 | 37 |
| Other, including indirect taxes recoverable | 21 | 40 |
| **Other current assets** | **52** | **77** |

## [18] Receivables

Philips Lighting
**Account receivables-net** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Trade receivables (net) | 1,489 | 1,311 |
| **Accounts receivable - net** | **1,489** | **1,311** |

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

Philips Lighting
**Aging analysis** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Current | 1,312 | 1,186 |
| Overdue 1-30 days | 45 | 38 |
| Overdue 31-180 days | 94 | 56 |
| Overdue >180 days | 38 | 30 |
| **Accounts receivable - net** | **1,489** | **1,311** |

The changes in allowance for doubtful accounts are as follows:

Philips Lighting
**Allowance for doubtful accounts movement** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| **Balance as of January 1** | **(110)** | **(89)** |
| Additions charged to expense | (31) | (33) |
| Reclassification | 27 | - |
| Utilizations | 4 | 5 |
| Releases | 21 | 23 |
| Translation differences and other movements | - | 9 |
| **Balance as of December 31** | **(89)** | **(85)** |

The allowance for doubtful accounts has been primarily established for receivables that are past due. For the year ended December 31, 2016, the reclassification in allowance for doubtful accounts was related to balances that were fully provided for, which were transferred to indemnification positions with Royal Philips.

As per December 31, 2017, the allowance for doubtful accounts included allowances for individually impaired receivables of EUR 80 million (2016: EUR 85 million).

Bad debt allowances are recorded as part of Selling expenses. For more information on credit risk management, please refer to note 30, Details of treasury and other financial risks.

## [19] Equity

### Share capital

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.

On December 31, 2017, 29.01% (2016: 71.23%) of the issued share capital is held by Royal Philips, 68.31% (2016: 28.78%) is publicly traded at the Euronext Stock Exchange in Amsterdam and 2.68% (2016: Nil) are held as treasury shares.

### Ordinary shares

On December 31, 2017, the issued and fully paid share capital consisted of 143,000,000 ordinary shares with a nominal value of EUR 0.01 per share (December 31, 2016: 150,000,000).

### Preference shares

As a defense measure, 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 of December 31, 2017, this right had not been exercised therefore no preference shares have been issued.

**Dividend distribution**
In May 2017, the Company settled a dividend of EUR 1.10 per ordinary share, representing a total value of EUR 157 million including costs.

A proposal will be submitted to the 2018 Annual General Meeting of Shareholders to pay a dividend of EUR 1.25 per ordinary share, in cash, from the 2017 net income.

**Restricted and performance shares**
The Company has granted rights to receive common shares in the future (see note 28, Share-based compensation).

**Treasury shares**
Shares which have been repurchased and are held in Treasury for (i) delivery of shares under the Company's long-term incentive performance share plan and other employee share plans, and (ii) capital reduction purposes, are accounted for as a reduction of shareholders' equity. Treasury shares are recorded at cost, representing the market price on the acquisition date.
When issued, shares are removed from treasury shares on a first-in, first-out (FIFO) basis.

When treasury shares are delivered under the Company's share plans, the difference between the market price of the shares delivered and the cost is recorded in retained earnings, the market price is recorded in share premium.

The following table shows the movements in the outstanding number of shares over the last two years:

Philips Lighting
**Outstanding number of shares** in number of shares
2016-2017

| | 2016 | 2017 |
|---|---|---|
| **Balance as of January 1** | **–** | **150,000,000** |
| Formation of the Company | 150,000,000 | – |
| Purchase of treasury shares | – | (10,850,000) |
| Delivery of treasury shares | – | 24,079 |
| **Balance as of December 31** | **150,000,000** | **139,174,079** |

In May 2017, the Company started a share buyback program to cover obligations arising from its long-term incentive performance share plans and other employee share plans. In 2017, the following transactions took place:

Philips Lighting
**Employee share plan transactions**
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Shares acquired | – | 1,050,000 |
| Average market price | – | EUR 33.23 |
| Amount paid | – | EUR 35 million |
| Shares delivered | – | 24,079 |
| Average price (FIFO) | – | EUR 31.73 |
| Cost of delivered shares | – | EUR 1 million |
| **Total shares in treasury at year-end** | **–** | **1,025,921** |
| **Total cost** | **–** | **EUR 34 million** |

In January 2017, the Company announced that it intended to return up to EUR 300 million to its shareholders over the period 2017-2018, by participating in share disposals by its main shareholder. To reduce the share capital, the following transactions took place:

Philips Lighting
**Share capital transactions**
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Shares acquired | – | 9,800,000 |
| Average market price | – | EUR 27.79 |
| Amount paid | – | EUR 272 million |
| Reduction of capital stock (shares) | – | 7,000,000 |
| Reduction of capital stock | – | EUR 183 million |
| **Total shares in treasury at year-end** | **–** | **2,800,000** |
| **Total cost** | **–** | **EUR 90 million** |

In February 2018, the 2.8 million shares in treasury were cancelled reducing the issued share capital to 140,200,000 shares. After cancellation, Royal Philips' shareholding in the issued share capital of Philips Lighting increased to 29.59%.

In 2018, the Company intends to repurchase shares for an amount up to EUR 150 million by participating in share disposals by its main shareholder.

**Funding by (distribution to) Royal Philips**
Funding by (distribution to) Royal Philips includes a negative adjustment of EUR 30 million related to the re-measurement of deferred taxes following the reduction of the US federal income tax rate. For further information, refer to note 11, Income taxes.

### Limitations in the distribution of shareholders' equity

As at December 31, 2017, pursuant to Dutch law, certain limitations exist relating to the distribution of shareholders' equity of EUR 103 million. Such limitations relate to ordinary shares of EUR 1.4 million, legal reserves required by Dutch law of EUR 184 million, other reserves of EUR 3 million both included in share premium, unrealized currency translation losses of EUR 87 million and unrealized gains related to cash flow hedges of EUR 1 million.

The unrealized losses related to currency translation differences of EUR 87 million, although qualifying as a legal reserve, reduce the distributable amount by their nature.

The legal reserve required by Dutch law of EUR 184 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.

As at December 31, 2016, these limitations in distributable reserves were EUR 392 million, related to ordinary shares of EUR 1.5 million, legal reserves required by Dutch law EUR 196 million, unrealized currency translation gains of EUR 190 million and unrealized gains related to cash flow hedges of EUR 4 million.

### Non-controlling interests

For information on Non-controlling interests, refer to note 4, Interests in entities.

### Objectives, policies and processes for managing capital

The company manages capital based upon the following measures; working capital, net debt and cash flows before financing activities. These measures are used by the company to evaluate the capital efficiency of its businesses. Working capital is defined as 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. Net debt is 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
**Working capital** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Inventories | 886 | 924 |
| Receivables | 1,600 | 1,373 |
| Account and notes payable | (1,024) | (1,001) |
| Accrued liabilities | (502) | (475) |
| Other | (298) | (264) |
| **Working capital** | **662** | **557** |

Philips Lighting
**Composition of net debt to total equity** in mEUR
unless stated otherwise
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Short-term debt | 155 | 140 |
| Short-term loans payable to Royal Philips | 2 | – |
| Long-term debt | 1,224 | 1,170 |
| **Gross debt** | **1,381** | **1,309** |
| Cash and cash equivalents | 1,040 | 942 |
| **Net debt (cash)** 1) | **341** | **367** |
| Shareholders' equity | 2,704 | 2,242 |
| Non-controlling interests | 104 | 79 |
| **Total equity** | **2,808** | **2,321** |
| Net debt and total equity | 3,149 | 2,688 |
| Net debt divided by net debt and total equity (in %) | 11% | 14% |
| Total equity divided by net debt and total equity (in %) | 89% | 86% |

1) Gross debt less cash and cash equivalents.

Philips Lighting
**Composition of cash flows** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Cash flows from operating activities | 505 | 435 |
| Cash flows from investing activities | (62) | (26) |
| **Cash flows before financing activities** | **443** | **409** |

The net debt position as a percentage of the sum of net debt and total equity is presented to express the financial strength of the company. This measure is used by Treasury management of the company and investment analysts and is therefore included in the disclosure. The net debt position is managed in such a way that we expect to retain a strong investment-grade profile. Furthermore, the company's policy is to target an annual payment of a regular cash dividend in line with its dividend policy at 40%-50% of continuing net income.

In 2017, total net debt increased by EUR 26 million. Repayments amounted to EUR 132 million. Translation differences and other movements led to a decrease of EUR 50 million.

## [20] Short-term and long-term debt

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

Philips Lighting
**Short-term and long-term debt** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Facility (EUR) | 735 | 736 |
| Facility (USD) | 473 | 417 |
| Finance lease | 17 | 19 |
| Other debt | 156 | 120 |
| **Subtotal** | **1,381** | **1,292** |
| Bank overdrafts | - | 17 |
| **Total** | **1,381** | **1,309** |
| | | |
| Of which: | | |
| Short-term debt | 157 | 140 |
| Long-term debt | 1,224 | 1,170 |
| **Total** | **1,381** | **1,309** |

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 in connection with the separation. The term loan facility is repayable at the end of the term and may also be repaid without penalty at the option of Philips Lighting during the term. 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 0.65% as of December 31, 2017, and is subject to semi-annual 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 a five-year committed Revolving Credit Facility of EUR 500 million in May 2016. As of December 31, 2017, 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 loan and Revolving Credit Facility agreement also include a financial covenant which is suspended as per year-end 2017 as a result of the financial strength of the company. The facilities are guaranteed by the Company and certain subsidiaries of the Company incorporated in the Netherlands, the United States, Germany, the People's Republic of China, Poland and Belgium.

Other debt includes various local (bank) loans. The main other debt position are loans of Philips Lighting in Saudi Arabia amounting to EUR 45 million (2016: EUR 80 million) with nominal average interest rate of 3.53% and which are denominated in SAR.

New borrowings and repayments of short-term and long-term debt resulting from financing activities are as follows:

Philips Lighting
**Movement schedule of short and long term debt** in mEUR
2016-2017

| | Long term debt | Short term debt | Total |
|---|---|---|---|
| **Balance as of January 1, 2016** | **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, 2016** | **1,224** | **157** | **1,381** |
| | | | |
| New borrowings | - | 110 | 110 |
| Repayments | - | (132) | (132) |
| Translation differences and other movements | (55) | 5 | (50) |
| **Balance as of December 31, 2017** | **1,170** | **140** | **1,309** |

## [21] Provisions

Philips Lighting
**Provisions** in mEUR
2016-2017

| | 2016 | | 2017 | |
|---|---|---|---|---|
| | Long-term | Short-term | Long-term | Short-term |
| Provision for defined benefits | 602 | - | 497 | - |
| Restructuring related provisions | 16 | 116 | 37 | 108 |
| Environmental provisions | 101 | 52 | 104 | 26 |
| Product warranty | 19 | 38 | 15 | 31 |
| Other provisions | 143 | 38 | 124 | 40 |
| **Total** | **881** | **244** | **777** | **204** |

Provisions can be analyzed as follows:

### Restructuring-related provisions

Philips Lighting
**Restructuring-related provision** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| **Balance as of January 1** | **178** | **132** |
| Additions | 95 | 132 |
| Utilizations | (118) | (99) |
| Releases | (27) | (23) |
| Translation differences and other movements | 4 | 4 |
| **Balance as of December 31** | **132** | **145** |

In 2017, the main significant restructuring projects were related to the manufacturing footprint rationalization in Lamps and simplification of the business structure in Professional. The restructuring projects mostly took place in Belgium, the Netherlands, and France. The release of the provision mainly originates from long term manufacturing footprint rationalization projects in which the final voluntary leave rates were higher than expected. 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
2016-2017

| | 2016 | 2017 |
|---|---|---|
| **Balance as of January 1** | **163** | **153** |
| Additions | 4 | 9 |
| Utilizations | (15) | (27) |
| Releases | (5) | (5) |
| Change in discount rate | (2) | 2 |
| Accretion | 2 | 2 |
| Translation differences and other movements | 6 | (5) |
| **Balance as of December 31** | **153** | **129** |

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 26, 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
2016-2017

| | 2016 | 2017 |
|---|---|---|
| **Balance as of January 1** | **60** | **57** |
| Additions | 35 | 25 |
| Utilizations | (36) | (33) |
| Translation differences and other movements | (2) | (4) |
| **Balance as of December 31** | **57** | **46** |

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
2016-2017

| | 2016 | 2017 |
|---|---|---|
| **Balance as of January 1** | **169** | **181** |
| Additions | 68 | 49 |
| Utilizations | (43) | (38) |
| Reclassifications | 6 | 3 |
| Releases | (18) | (24) |
| Change in discount rate | - | - |
| Accretion | 1 | 2 |
| Translation differences and other movements | (2) | (10) |
| **Balance as of December 31** | **181** | **164** |

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 26, 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. More than half of the provision for legal claims is expected to be used within the next year.

## [22] Post-employment benefits

Employee post-employment benefit plans have been established in many countries in accordance with the legal requirements, customs and local practice in the countries involved.

### Defined contribution plans

Most employees that take part in a company pension plan are covered by defined contribution pension plans. The largest defined contribution plans are in the Netherlands and in the US. The total contribution paid in 2017 by the company was EUR 83 million, of which EUR 56 million to the Dutch plan and EUR 15 million to the US plan.

### Defined benefits plans

The company also sponsors several 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 few defined benefit retiree medical plans. The benefits provided by these plans typically cover part of the healthcare insurance costs after retirement.

The largest defined benefit post-employment benefit plans are in the US and Germany. At the end of 2017 these plans accounted for 87% of the defined benefit obligation.

#### United States

The US-defined benefit qualified pension plan covers certain hourly workers and salaried workers hired before January 1, 2005. The plan is closed for new entrants and for further benefit accruals. Employees only accrue benefits in a defined contribution plan. The company pays the administration cost and contributions to cover the funding deficit of the qualified pension plan. The plan assets are governed by an Investment Committee. The company also has an unfunded non-qualified pension plan in place for higher salaried employees and a post-retirement welfare plan. The first is also closed for new entrants and for further benefit accruals.

The company made contributions to the qualified pension plan of USD 54 million in 2017 of which USD 50 million as part of a three-year funding plan (2017-2019) to improve the funding level. As part of this plan, the company intends to contribute USD 150 million to the US qualified pension plan over the period 2017-2019 to further reduce the funding deficit.

#### Germany

Employees with a salary above a certain salary threshold participate in a defined benefit pension plan, which has an unfunded liability of EUR 2 million. This plan is closed for new entrants effectively from January 1, 2018, and a new defined contribution plan will become available in 2018 for new hires. The company also sponsors a multi-employer defined contribution plan with the Philips Pensionskasse. Further, the company has an unfunded liability of EUR 228 million in other closed defined benefit plans.

#### Brazil

The defined benefit and defined contribution pension plans in Brazil that were operated by the Philips' pension fund in Brazil were fully terminated in 2017. All Philips Lighting employees in Brazil have been transferred to an insured defined contribution pension plan for future service.

Since all risks for the company with respect to the defined benefit pension plan have been eliminated, the company recognized a settlement in 2017. The decrease of the defined benefit obligation due to the settlement amounts to EUR 102 million. At the moment of the settlement the plan had a surplus. As the surplus was not recognized in the balance sheet due to the asset ceiling test, the company only recognized the additional payments of EUR 90,000 as result of the settlement as settlement loss, as per the company's accounting policy.

The surplus in the defined contribution pension plan has been distributed to the participants and the company. The company recognized the refund in the defined contribution pension plan of EUR 2 million as a negative defined contribution pension cost.

### 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, committees or 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 presents all net defined benefit post-employment obligations on one line under non-current provisions.

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

**Summary of pre-tax costs for post-employment benefits**
The table below 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
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Defined-benefit plans | | |
| • Included in operating cost | 7 | 10 |
| • Included in financial expense | 19 | 16 |
| Defined-contribution plans including multi-employer plans | | |
| • Included in operating cost | 83 | 83 |
| **Total of pre-tax costs for post-employment benefits** | **109** | **109** |

**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
2016-2017

| | 2016 | | | 2017 | | |
|---|---|---|---|---|---|---|
| | Obligation | Plan assets | Net liability | Obligation | Plan assets | Net liability |
| **Balance as of January 1** | **43** | **–** | **43** | **1,243** | **(641)** | **602** |
| Transfer from Royal Philips | 1,153 | (546) | 607 | – | – | – |
| Service cost | 10 | – | 10 | 11 | – | 11 |
| (Negative) past service cost | (4) | – | (4) | (1) | – | (1) |
| Admin expenses paid | – | 1 | 1 | – | 1 | 1 |
| Settlements | (2) | 2 | – | (104) | 104 | – |
| Interest (cost) / income | 47 | (28) | 19 | 39 | (23) | 16 |
| **Included in Statements of income** | **51** | **(25)** | **26** | **(55)** | **82** | **27** |
| Actuarial gains / (losses) | | | | | | |
| • Demographic assumptions | (12) | – | (12) | (1) | – | (1) |
| • Financial assumptions | 47 | (1) | 46 | 37 | (46) | (9) |
| • Experience adjustment | (28) | – | (28) | 4 | – | 4 |
| Exchange rate differences | 49 | (37) | 12 | (98) | 60 | (38) |
| Miscellaneous | 40 | (38) | 2 | – | – | – |
| **Included in Statements of comprehensive income** | **96** | **(76)** | **20** | **(58)** | **14** | **(44)** |
| Employee contributions | 1 | (1) | – | 1 | (1) | – |
| Employer contributions | – | (55) | (55) | – | (51) | (51) |
| Benefits paid | | | | | | |
| • Benefits paid direct by employer | (36) | – | (36) | (34) | – | (34) |
| • Benefits paid from plan assets | (62) | 62 | – | (57) | 57 | – |
| Reclassifications | (3) | – | (3) | (4) | – | (4) |
| **Other** | **(100)** | **6** | **(94)** | **(94)** | **5** | **(89)** |
| **Balance as of December 31** | **1,243** | **(641)** | **602** | **1,036** | **(540)** | **496** |

### Plan assets allocation

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

Philips Lighting
**Plan assets allocation** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Debt securities | 393 | 376 |
| Equity securities | 162 | 92 |
| Other | 104 | 72 |
| **Total assets** | **659** | **540** |

The assets in 2017 contain 13% unquoted assets. Plan assets in 2017 do not include property occupied by or financial instruments issued by the company.

Some 87% 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 of the US qualified pension plan is closely aligned to that of the plan's pension liabilities. The remaining 13% of the total plan assets is mainly the market value of insured pension benefits.

The pension plan in Brazil had a surplus of EUR 18 million at year-end 2016 and was not recognized due to asset ceiling restrictions. The surplus reduced to zero as of December 31, 2017 due to the settlement of the pension plan.

### Assumptions

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

- US: Base table RP-2014 White Collar, projected with mortality improvements from the base year of the table, 2014, with MP-2017.
- Germany: Richttafeln 2005G K. Heubeck.

For the US, the same mortality table has been used as for the 2016 valuation but with a new longevity improvement scale which was released by the Society of Actuaries in October 2017. The new table shows a lower degree of longevity improvement than reflected in the improvement scale 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 obligations** in %
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Discount rate | 3.9 | 3.0 |
| Pension and healthcare cost increases | 0.6 | 0.6 |
| Wage increases | 1.0 | 1.1 |

The average duration of the defined benefit obligation of the pension plans is 10.6 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 of 1% in the respective assumptions 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
2016-2017

| | 2016 | 2017 |
|---|---|---|
| **Increase** | | |
| Discount rate (1% movement) | (121) | (96) |
| Wage change (1% movement) | 4 | 6 |
| Pension cost change (1% movement) | 26 | 22 |
| Longevity (see explanation) | 40 | 32 |
| Healthcare cost change (1% movement) | 9 | 8 |
| **Decrease** | | |
| Discount rate (1% movement) | 142 | 112 |
| Wage change (1% movement) | (3) | (5) |
| Pension cost change (1% movement) | (24) | (21) |

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 2018

For 2018, the company expects cash outflows in relation to post-employment benefits, which are estimated at EUR 166 million and consist of:

- EUR 46 million employer contributions to defined benefit plans, which includes a USD 50 million contribution in the US pension plan as part of de-risking;
- EUR 32 million employer expected cash outflows in relation to unfunded defined benefit plans;
- EUR 88 million employer contributions to defined contribution plans.

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

The service and administration cost for 2018 is expected to amount to EUR 11 million.
The interest expense for 2018 is expected to amount to EUR 12 million. The cost for defined contribution pension plans in 2018 is expected to amount to EUR 57 million in the Netherlands and EUR 31 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
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Deferred income | 23 | 48 |
| Other tax liabilities | 42 | 40 |
| Other liabilities | 85 | 78 |
| **Other non-current liabilities** | **150** | **167** |

Other liabilities are mainly related to indemnification balances, for additional information, please refer to note 27, Related party transactions. For further details on tax related liabilities refer to note 11, Income taxes.

## [24] Other current and accrued liabilities

Other current and accrued liabilities are summarized as follows:

Philips Lighting
**Other current and accrued liabilities** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| **Other current liabilities** | | |
| Customer rebates payables | 201 | 162 |
| Advances from customers | 34 | 19 |
| Other taxes including social security premiums | 74 | 94 |
| Other liabilities | 37 | 35 |
| **Total** | **346** | **309** |
| **Accrued liabilities** | | |
| Personnel related costs: | | |
| • Salaries and wages | 153 | 146 |
| • Accrued holiday entitlements | 48 | 43 |
| • Other personnel related costs | 23 | 23 |
| Fixed asset related costs: | | |
| • Gas, water, electricity, rent and other | 17 | 16 |
| Communication and IT costs | 24 | 17 |
| Distribution costs | 53 | 44 |
| Sales related costs: | | |
| • Commissions payable | 13 | 13 |
| • Advertising and marketing related costs | 23 | 29 |
| • Other sales related costs | 9 | 6 |
| Material related costs | 28 | 26 |
| Deferred income | 55 | 41 |
| Other accrued liabilities | 56 | 70 |
| **Total** | **502** | **475** |

## [25] Contractual obligations

The following table presents the contractual cash obligations of Philips Lighting as of December 31, 2017.

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

Philips Lighting
**Contractual cash obligations** in mEUR
2017

| | | Payments due by period 1) | | | |
|---|---|---|---|---|---|
| | Total | 2018 | 2019-2020 | 2021-2022 | after 2022 |
| Long-term debt 2) | 1,156 | 1 | 1 | 1,154 | - |
| Finance lease liabilities 3) | 20 | 5 | 9 | 5 | - |
| Short-term debt | 135 | 135 | - | - | - |
| Operating lease obligations | 332 | 84 | 117 | 63 | 68 |
| Derivative liabilities | 8 | 8 | - | - | - |
| Interest on debt 4) | 72 | 23 | 40 | 9 | - |
| Purchase obligations 5) | 52 | 28 | 20 | 2 | 2 |
| Trade payables | 1,001 | 1,001 | - | - | - |
| **Contractual cash obligations** | **2,775** | **1,284** | **187** | **1,234** | **69** |

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 13 million.
4) Interest on Long-term debt is based on floating rate adjustments according to market expectations.
5) 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
2017

| | |
|---|---|
| 2018 | 5 |
| 2019 | 5 |
| 2020 | 5 |
| 2021 | 4 |
| 2022 | 1 |
| Thereafter | 1 |

Philips Lighting
**Finance lease liabilities** in mEUR
2017

| | Future minimum lease pay-ments | Interest | Present value of minimum lease pay-ments |
|---|---|---|---|
| 2018 | 5 | 1 | 5 |
| 2019-2022 | 15 | 1 | 14 |
| After 2022 | - | - | - |
| **Finance lease total** | **20** | **1** | **19** |

## [26] Contingent liabilities

**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 27, 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, intellectual property disputes, product liability, environmental pollution and business conduct rules.

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 beneficiaries of the settlement have now been confirmed. The remaining individual claims are assessed on a case by case basis and are in various phases of litigation.

## [27] 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 either controlled, or had significant influence over, Philips Lighting during the periods presented.

On November 28, 2017, Royal Philips further reduced its shareholding in Philips Lighting. Following this transaction, Royal Philips no longer has control over Philips Lighting and therefore ceased to consolidate Philips Lighting. Philips Lighting remains an associate of Royal Philips and hence Royal Philips remains a related party of Philips Lighting. Amounts disclosed are therefore reflecting the full year.

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. Following Royal Philips losing control, these transactions no longer qualify as with related 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.

On June 30, 2017, Royal Philips sold an 80.1% interest in the combined Lumileds and Automotive businesses. As of that date, the companies representing those businesses are no longer considered a related party of Philips Lighting.

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

Philips Lighting
**Related party transactions** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Sales to Royal Philips | 25 | 9 |
| Purchases from Royal Philips | (66) | (5) |
| Repurchases of shares from Royal Philips | - | (272) |
| Movement in funding from (to) Royal Philips | (1,193) | (24) |
| Capital contribution | 692 | - |
| Brand license fee costs | 36 | 39 |
| Transfer settlement transactions as part of separation | (555) | - |
| Transfer of pension obligations as part of separation | (607) | - |
| Transition Service Level Agreement costs charged by Royal Philips | 122 | 53 |

Philips Lighting
**Related party balances** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Accounts receivable from Royal Philips | 7 | 7 |
| Accounts payable to Royal Philips | (44) | (26) |
| Indemnification receivable from Royal Philips | 34 | 26 |
| Indemnification payable to Royal Philips | (95) | (75) |
| Short-term loans payable to Royal Philips | (2) | - |

In addition to these transactions and balances, please refer to note 28, Share-based compensation for disclosures on the accounting for Philips Lighting employees participating in the Royal Philips LTI Plan.

Indemnification receivable from (payable to) Royal Philips mainly relates to the indemnification for tax assets (liabilities) arising after Separation which are attributable to Philips Lighting. Philips Lighting uses the Philips brand name under the Trademark License Agreement with 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 29, Information on remuneration.

## [28] Share-based compensation

**Philips Lighting Long-term Incentive Plan**

In 2017, Philips Lighting introduced the Philips Lighting Long-term Incentive Plan (LTI Plan), which was approved by the Annual General Meeting of shareholders on May 9, 2017. Under the Philips Lighting LTI Plan, which is equity settled, eligible employees are granted both conditional shares and performance shares. Conditional shares have a three-year cliff vesting period and will vest if a grantee is still employed with Philips Lighting at the vesting date.

Vesting of performance 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% of the shares), Free Cash Flow (FCF) (40% of the shares) and Sustainability (20% of the shares). In addition, vesting is conditional to the grantee still being employed with Philips Lighting at the vesting date.

For the Board of Management and certain members of senior management, the LTI Plan consists of performance shares only. Shares are conditionally granted annually.

In addition to shares awarded under the Philips Lighting LTI Plan, Philips Lighting may in individual cases, such as in the hiring process of members of (senior-) management, also grant restricted shares. Restricted shares have either three-year cliff vesting period or vest gradually over the vesting period of one, two or three years.

Under the terms of the employee stock purchase plan (ESPP) established by Philips Lighting in 2017 in various countries, employees are eligible to purchase a limited number of Philips Lighting shares at discounted prices through payroll withholdings. Since the introduction of the Philips Lighting ESPP in 2017, employees of Philips Lighting could no longer participate in the Royal Philips ESPP.

**Philips Lighting performance shares**

TSR performance measurement is a market performance condition.

The fair value of shares granted under TSR is measured based on Monte Carlo simulation.
The closing share price at grant date is adjusted for the present value of expected dividends during the vesting period, as participants are not compensated for Philips Lighting dividend payouts. Monte Carlo simulation takes into account 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 %
2017

| | 2017 |
|---|---|
| Risk-free interest rate | (0.6%) |
| Expected share price volatility | 31% |

The assumptions were used for these calculations only and do not necessarily represent an indication of Philips Lighting management's expectation of future developments for other purposes. Historic volatility was measured over the same timeframe as the simulation period (weighted average 2.6 years).

The amount calculated as an expense for TSR shares is not adjusted for actual performance.

FCF and Sustainability measurements are non-market performance conditions. Fair value of shares granted under FCF and Sustainability conditions equals the closing share price on the grant date, again adjusted for the present value of expected dividends during the vesting period.

The amount calculated as an expense for FCF and Sustainability shares is adjusted for actual performance.

A summary of Philips Lighting performance shares movements and outstanding balance as of December 31, 2017, is presented below.

Philips Lighting
**Philips Lighting performance shares**
2017

| | Shares | Weighted average grant-date fair value |
|---|---|---|
| EUR-denominated | | |
| **Balance as of December 31, 2016** | **–** | **–** |
| Granted | 904,075 | 36.06 |
| Vested | (2,105) | 38.76 |
| Forfeited | (71,627) | 36.04 |
| Performance adjustment | – | – |
| **Balance as of December 31, 2017** | **830,343** | **36.05** |

On December 31, 2017, estimated unrecognized costs related to non-vested performance shares amounted to EUR 19 million. These costs are expected to be recognized over a weighted-average period of 2.2 years.

**Philips Lighting conditional shares**
Fair value of conditional shares is determined by subtracting the present value of expected dividends from the closing share price on the grant date as participants are not compensated for Philips Lighting dividend payouts.

A summary of Philips Lighting conditional shares movements and outstanding balance as of December 31, 2017, is presented below.

Philips Lighting
**Philips Lighting conditional shares**
2017

| | Shares | Weighted average grant-date fair value |
|---|---|---|
| EUR-denominated | | |
| **Balance as of December 31, 2016** | **–** | **–** |
| Granted | 369,594 | 29.21 |
| Vested | (784) | 29.23 |
| Forfeited | (29,622) | 29.23 |
| **Balance as of December 31, 2017** | **339,188** | **29.21** |

Costs related to non-vested conditional shares amounted to EUR 6 million. These costs are expected to be recognized over a weighted-average period of 2.2 years.

**Philips Lighting restricted shares**
The fair value of restricted shares is equal to the share price on the grant date, as participants are compensated for Philips Lighting dividend payouts during the vesting period.

Philips Lighting granted 90,813 restricted shares with weighted average grand date fair value of 27 EUR.

On December 31, 2017, estimated unrecognized costs related to non-vested restricted shares amounted to EUR 1 million. These costs are expected to be recognized over a weighted-average period of 1.1 years.

**Royal Philips Long-term Incentive Plan**
Until the settlement of the IPO of Philips Lighting in 2016, eligible employees of Philips Lighting as well as members of the Board of Management participated in grants made under the Royal Philips Long-term Incentive Plan. Those employees remain to participate in the Royal Philips LTI Plan, which is equity settled, until the shares from the last grant in 2016 will vest in 2019. The expense for Philips Lighting, calculated and accounted for in accordance with IFRS 2, equals the recharge from Royal Philips to Philips Lighting. Philips Lighting is not charged for any additional costs upon delivery of shares. No new grants are made or will be made by Royal Philips to employees of Philips Lighting after the settlement of the IPO of Philips Lighting.

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.

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

On November 28, 2017, Royal Philips further reduced its shareholding in Philips Lighting. Following this transaction, Royal Philips no longer has control over Philips Lighting and therefore ceased to consolidate Philips Lighting. This does not affect the accounting for the Royal Philips LTI Plan in Philips Lighting financial statements.

**Royal Philips 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.

A summary of the status of Royal Philips performance share plans applicable to Philips Lighting employees as of December 31, 2017, and changes during the year are presented below.

Philips Lighting
**Royal Philips performance shares**
2017

| | Shares | Weighted average grant-date fair value |
|---|---|---|
| **EUR-denominated** | | |
| **Balance as of December 31, 2016** [1] | **2,113,412** | **25.30** |
| Granted | – | – |
| Vested | (700,841) | 22.46 |
| Forfeited | (116,790) | 25.81 |
| Performance adjustment | 102,043 | 27.20 |
| **Balance as of December 31, 2017** | **1,397,824** | **26.82** |
| **USD-denominated** | | |
| **Balance as of December 31, 2016** [1] | **554,868** | **29.45** |
| Granted | – | – |
| Vested | (163,210) | 29.95 |
| Forfeited | (49,905) | 29.07 |
| Performance adjustment | 29,869 | 30.09 |
| **Balance as of December 31, 2017** | **371,622** | **29.33** |

1) Opening balances were revised to reflect performance adjustment in prior year.

On December 31, 2017, an estimated total of EUR 11 million of unrecognized compensation costs related to non-vested performance shares was allocated to employees of Philips Lighting. These costs are expected to be recognized over a weighted-average period of 1.0 years.

### Royal Philips restricted shares

The fair value of restricted shares is equal to the share price at grant date.

Royal Philips issues restricted shares that, in general, have a 3-year cliff vesting period. 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, 2017, and changes during the year are presented below:

Philips Lighting
**Royal Philips restricted shares**
2017

| | Shares | Weighted average grant-date fair value |
|---|---|---|
| **EUR-denominated** | | |
| **Balance as of December 31, 2016** | **473,819** | **24.14** |
| Granted | – | – |
| Vested | (165,385) | 24.93 |
| Forfeited | (10,380) | 23.75 |
| **Balance as of December 31, 2017** | **298,054** | **24.02** |
| **USD-denominated** | | |
| **Balance as of December 31, 2016** | **124,348** | **27.36** |
| Granted | – | – |
| Vested | (25,628) | 27.40 |
| Forfeited | (20,085) | 27.21 |
| **Balance as of December 31, 2017** | **78,635** | **27.39** |

On December 31, 2017, an estimated total of EUR 3 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 1.1 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.

On December 31, 2017, there were no unrecognized compensation costs related to outstanding options.

Total share-based compensation costs for Philips Lighting amounted to EUR 36 million in 2017 and EUR 23 million in 2016. Out of EUR 36 million of share-based compensation costs for the period that ended on December 31, 2017, EUR 11 million costs related to the Philips Lighting LTI Plan with the remaining relating to the Royal Philips LTI Plan. The expense for the period that ended December 31, 2016 fully related to the Royal Philips LTI Plan.

## [29] Information on remuneration

Philips Lighting
**Remuneration costs of Key Management** in EUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Board of Management 1) | 4,677,059 4) | 6,034,313 |
| Supervisory Board 2) 3) | 221,979 | 585,291 |
| **Total** | **4,899,038** | **6,619,604** |

1) Remuneration costs shown for the full year.
2) Supervisory Board: 2 new members as of May 9, 2017 (allowances for observer period till May 9, 2017 included).
3) Supervisory Board in place since IPO in May 2016.
4) Comparatives were revised to reflect the forfeiture in 2016 of Royal Philips performance shares related to one specific grant, due to not meeting the performance targets. To correct for the error of not including this in 2016, the revised 2016 expense is lower for an amount of EUR 381,134. The grant was forfeited prior to the IPO of Philips Lighting.

**Remuneration of the Board of Management**

In 2017, the total remuneration costs relating to the members of the Board of Management amounted to EUR 6,034,313 (2016: EUR 3,725,472 for the period starting May 31, 2016, representing the time from which the current members of the Board of Management were formally in function).

At December 31, 2017, the members of the Board of Management held no options on Philips Lighting shares and held 46,125 (2016: 152,568) stock options related to shares in Royal Philips at a weighted average exercise price of EUR 22.46 (2016: EUR 19.83).

Philips Lighting
**Remuneration costs of Key Management - the Board of Management** in EUR
2016-2017

| | 2016 1) | 2017 |
|---|---|---|
| Salary/Base compensation | 1,510,726 | 1,952,000 |
| Annual incentive 2) | 1,641,621 | 1,492,033 |
| Long Term Equity-based Incentive 3) | 844,147 5) | 1,689,133 |
| Pension allowances | 521,418 | 621,503 |
| Pension scheme costs | 57,956 | 75,834 |
| Other compensation 4) | 101,191 | 203,810 |
| **Total** | **4,677,059** | **6,034,313** |

1) Remuneration costs shown for the full year. Costs for individual members of the Board of Management are disclosed further below for the period starting May 31, 2016, representing the time from which the current members of the Board of Management were formally in function, and for Mr. Rougeot as from September 1, 2016 when he was appointed as CFO of the company.
2) The annual incentives are related to the performance in the year reported which are paid out in the subsequent year.
3) Costs for 2016 relate to Royal Philips shares only. For 2017, costs for Philips Lighting shares granted under the Philips Lighting Long-term Incentive Plan are included. Costs of performance shares and restricted share rights (Royal Philips shares only) are based on accounting standards (IFRS) and do not reflect the value of the shares at the vesting/release date.
4) 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.
5) Comparatives were revised to reflect the forfeiture in 2016 of Royal Philips performance shares related to one specific grant, due to not meeting the performance targets. To correct for the error of not including this in 2016, the revised 2016 expense is lower for an amount of EUR 381,134. The grant was forfeited prior to the IPO of Philips Lighting.

Philips Lighting
**Remuneration costs of individual members of the Board of Management** in EUR
2016-2017

| | Base compen-sation/ salary | Annual incentive 1) | Perfor-mance shares 2) | Restricted share rights 2) | Pension allowances | Pension scheme costs | Other compen-sation 3) | Total costs |
|---|---|---|---|---|---|---|---|---|
| **2017** | | | | | | | | |
| E.H.E. Rondolat | 850,000 | 753,440 | 1,057,400 | 4,743 | 316,175 | 25,278 | 41,585 | 3,048,621 |
| S.L.A. Rougeot | 554,500 | 369,629 | 165,061 | – | 111,671 | 25,278 | 138,692 | 1,364,831 |
| C.L. van Schooten | 547,500 | 368,964 | 460,649 | 1,280 | 193,657 | 25,278 | 23,533 | 1,620,861 |
| **Total** | **1,952,000** | **1,492,033** | **1,683,110** | **6,023** | **621,503** | **75,834** | **203,810** | **6,034,313** |
| **2016 4)** | | | | | | | | |
| E.H.E. Rondolat | 499,053 | 973,844 | 441,067 | 4,772 | 185,901 | 14,489 | 26,712 | 2,145,838 |
| S.L.A. Rougeot 5) | 183,333 | 144,086 | – | – | 37,373 | 8,280 | 37,806 | 410,878 |
| C.L. van Schooten | 308,239 | 523,691 | 190,748 6) | 2,068 | 113,964 | 14,489 | 15,557 | 1,168,756 |
| **Total** | **990,625** | **1,641,621** | **631,815** | **6,840** | **337,238** | **37,258** | **80,075** | **3,725,472** |

1) 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 (cash) Incentive, of this Annual Report.
2) Costs for 2016 relate to Royal Philips shares only. For 2017 costs for Philips Lighting shares granted under the Philips Lighting Long-term Incentive Plan are included. Costs of performance shares and restricted share rights (Royal Philips shares only) are based on accounting standards (IFRS) and do not reflect the value of the shares at the vesting/release date.
3) 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.
4) For 2016, 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 function, and for Mr. Rougeot as from September 1, 2016 when he was appointed as CFO of the company.
5) Appointed as CFO as of September 1, 2016; appointed as a member of the Board of Management in AGM 2017.
6) Comparatives were revised to reflect the forfeiture in 2016 of Royal Philips performance shares related to one specific grant, due to not meeting the performance targets. To correct for the error of not including this in 2016, the revised 2016 expense is lower for an amount of EUR 381,134 on a full year basis. The grant was forfeited prior to the IPO of Philips Lighting.

For further information on remuneration costs, see chapter 9, Remuneration report, of this Annual Report.

The tables below give an overview of the performance shares of Philips Lighting and 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 Philips Lighting and Royal Philips performance shares (holdings)** in number of shares
2017

| | January 1, 2017 | Awarded 2017 | Awarded dividend shares 2017 | Realized 2017 | December 31, 2017 | Vesting date |
|---|---|---|---|---|---|---|
| E.H.E. Rondolat | 33,124 [1)] | – | – | 35,276 | – | 04.28.2017 |
| | 30,149 [1)] | – | 760 | – | 30,909 | 05.05.2018 |
| | 37,327 [1)] | – | 940 | – | 38,267 | 04.29.2019 |
| | – | 31,253 [2)] | – | – | 31,253 | 02.29.2020 |
| S.L.A. Rougeot | – | 16,355 [2)] | – | – | 16,355 | 02.29.2020 |
| C.L. van Schooten | 16,562 [1)] | – | – | 17,638 | – | 04.28.2017 |
| | 10,396 [1)] | – | 262 | – | 10,658 | 05.05.2018 |
| | 16,331 [1)] | – | 411 | – | 16,742 | 04.29.2019 |
| | – | 16,325 [2)] | – | – | 16,325 | 02.29.2020 |
| **Performance shares (holdings)** | **143,889** | **63,933** | **2,373** | **52,914** | **160,509** | |

1) Awarded under Royal Philips Long-term Incentive Plan before date of appointment as a member of the Board of Management.
2) Awarded under the Philips Lighting Long-term Incentive Plan.

Royal Philips restricted shares all vested prior to January 1, 2016. However, members of the Board of Management are entitled to receive premium shares if shares from restricted share rights release are kept for another 3 years. As at December 31, 2017, awarded Royal Philips premium shares amounted to 2,041 (2016: 3,320) for E.H.E. Rondolat and 191 (2016: 620) for C.L. van Schooten.

Philips Lighting
**Royal Philips Stock options (holdings)** in number of shares
2017

| | January 1, 2017 | Granted | Exercised | Expired | December 31, 2017 | Grant price (in EUR) | Share (closing) price on exercise date | Expiry date |
|---|---|---|---|---|---|---|---|---|
| E.H.E. Rondolat [1)] | 72,000 | – | 72,000 | – | – | 14.82 | 33.16 | 04.23.2022 |
| S.L.A. Rougeot | – | – | – | – | – | – | – | – |
| C.L. van Schooten [1)] | 15,840 | – | – | 15,840 | – | 30.96 | – | 04.16.2017 |
| | 2,403 | – | 2,403 | – | – | 24.18 | 31.93 | 01.22.2018 |
| | 16,200 | – | 16,200 | – | – | 23.11 | 31.93 | 04.15.2018 |
| | 18,000 | – | – | – | 18,000 | 24.90 | – | 04.19.2020 |
| | 28,125 | – | – | – | 28,125 | 20.90 | – | 04.18.2021 |
| **Stock options (holdings)** | **152,568** | **–** | **90,603** | **15,840** | **46,125** | | | |

1) Awarded before date of appointment as a member of the Board of Management.

See note 28, Share-based compensation, for further information on the Long-term Incentive Plans of Philips Lighting and Royal Philips.

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
2016-2017

| | Age at December 31, 2017 | Accumulated annual pension as of December 31, 2016 [1] | Total pension related costs 2016 [2) 3)] | Accumulated annual pension as of December 31, 2017 [1] | Total pension related costs 2017 [2] |
|---|---|---|---|---|---|
| E.H.E. Rondolat | 51 | 30,367 | 200,390 | 32,023 | 341,453 |
| S.L.A. Rougeot | 49 | 542 | 45,653 | 2,199 | 136,949 |
| C.L. van Schooten | 58 | 204,344 | 128,453 | 206,001 | 218,935 |
| **Pension costs** | | | **374,496** | | **697,337** |

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 Board of Management was formally in function, and for Mr. Rougeot as from September 1, 2016 when he was appointed as CFO of the company.

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 2017, 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 585,291 (2016: EUR 221,979).

At December 31, 2017, the members of the Supervisory Board held no (2016: nil) stock options, performance-, conditional-, and restricted shares of Philips Lighting.

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
2016-2017

| | Membership | Committees | Other compensation [5] | Total |
|---|---|---|---|---|
| **2017 [1]** | | | | |
| A.P.M. van der Poel | 110,000 | 25,000 | – | 135,000 |
| G. van der Aast [3] | 81,250 | 28,141 | – | 109,391 |
| C.J.A. van Lede | 75,000 | 34,275 | – | 109,275 |
| R.S. Lane | 75,000 | 18,625 | 35,000 | 128,625 |
| J. Lee [3] | 75,000 | 13,000 | 15,000 | 103,000 |
| F.A. van Houten [4] | – | – | – | – |
| A. Bhattacharya [4] | – | – | – | – |
| **Total** | **416,250** | **119,041** | **50,000** | **585,291** |
| **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] | – | – | – | – |
| **Total** | **152,651** | **44,328** | **25,000** | **221,979** |

1) The amounts mentioned in this table are excluding VAT.
2) Supervisory Board in place since IPO in 2016.
3) Appointment as a member of the Supervisory Board in AGM 2017. The remuneration includes the observer period.
4) Unsalaried.
5) The amounts mentioned under other compensation relate to the fee for intercontinental travel, inter-European travel.

### 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
2016-2017

| | December 31, 2016 | December 31, 2017 |
|---|---|---|
| E.H.E. Rondolat | 25,000 | 25,000 |
| S.L.A. Rougeot | 5,000 | 5,000 |
| C.L. van Schooten | 12,500 | 12,500 |

1) Reference date for board membership is December 31, 2017. At December 31, 2017, the members of the Supervisory Board held no Philips Lighting shares.

## [30] Details of treasury and other financial risks

Philips Lighting is exposed to several types of financial risks. This note further analyzes these financial risks.

Philips Lighting enters 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 31, 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, 2017, Philips Lighting had outstanding interest-bearing debt of EUR 1,309 million (2016: 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 derivative financial instruments to fix interest rates for a certain period of time. As of December 31, 2017, Philips Lighting had a ratio of fixed-rate debt to total outstanding debt of approximately 2% (2016: 5%).

The sensitivity of changing interest rates for this reporting period is low as the underlying EUR interest rates are negative.

A sensitivity analysis conducted as of January 2018 shows that if interest rates were to increase instantaneously by 1% from their level of December 31, 2017, with all other variables held constant, the annualized net interest expense would decrease by approximately EUR 2 million. This impact was based on the outstanding net floating debt position as of December 31, 2017.

### 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 with strong investment grade financial institutions, and 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. 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. The table below shows details of cash and cash equivalents and bank overdrafts as of the reporting date:

Philips Lighting
**Cash and cash equivalents and bank overdrafts**
in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Cash at banks and in hand | 434 | 390 |
| Short-term deposits | 578 | 495 |
| Other cash equivalents | 28 | 57 |
| **Cash and cash equivalents** | **1,040** | **942** |
| Bank overdrafts | – | (17) |
| **Cash and cash equivalents and bank overdrafts** | **1,040** | **925** |

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, 2017, Philips Lighting did not have any amounts outstanding under this facility (2016: nil).

### 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.
- Financing exposure arising from 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 committed and anticipated transaction exposure and related hedges**
in mEUR
2016-2017

| | Receivables | | Payables | |
|---|---|---|---|---|
| | Exposure | Hedges | Exposure | Hedges |
| **Balance as of December 31** | | | | |
| **Exposure currency** | | | | |
| CNY | 11 | (11) | (678) | 603 |
| GBP | 60 | (46) | – | – |
| EUR [1] | 76 | (60) | (27) | 11 |
| USD | 99 | (93) | (126) | 100 |
| SEK | 22 | (17) | – | – |
| CHF | 13 | (9) | – | – |
| AUD | 13 | (10) | – | – |
| HUF | – | – | (9) | 9 |
| PLN | 38 | (38) | (29) | 29 |
| Others | 24 | (16) | – | – |
| **Total 2017** | **356** | **(300)** | **(869)** | **752** |
| **Total 2016** | **646** | **(423)** | **(1,163)** | **792** |

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, 2017, a gain of EUR 1 million was deferred in equity as a result of these hedges (2016: EUR 4 million). The result deferred in equity will be released to earnings mostly during 2018 at the time when the related hedged transaction affects the Consolidated statements of income. During 2017, EUR nil million (2016 a net loss of 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, 2017 was an unrealized asset of EUR 8 million (2016: asset EUR 3 million). An instantaneous 10% increase in the value of the euro against all currencies, with all other variables held constant, would lead to a decrease of EUR 46 million in the value of the derivatives.

The EUR 46 million decrease includes a loss of EUR 19 million that would impact the income statement, which would largely offset the opposite revaluation effect on the underlying accounts receivable and payable, and the remaining loss of EUR 27 million would be recognized in equity to the extent that the cash flow hedges were effective.

Foreign exchange exposure also arises on intercompany loans and deposits. Where Philips Lighting enters into such arrangements the financing is generally provided in the functional currency of the subsidiary. The currency of Philips Lighting's 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. In certain cases, where Philips Lighting subsidiaries may also have external foreign currency debt or liquid assets, these exposures are also hedged using 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 could hedge certain commodity price risks using derivative instruments to minimize significant, unanticipated earnings fluctuations caused by commodity price volatility. As of December 31, 2017, Philips Lighting does not have any outstanding commodity derivatives (2016: nil).

**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 and enters into financial derivative instruments with various financial institutions and is exposed to credit risk with these counterparties. Philips Lighting does not enter into any financial derivative instruments to protect against default by financial institutions.

Where possible, Philips Lighting requires all financial institutions 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 generally accepted rating agencies. Philips Lighting also regularly monitors the development of the credit risk of its financial counterparties.

As of December 31, 2017, the company held 72% of cash at banks and at hand and short-term deposits in "A" rated banks based on Standard and Poor's rating (2016: 67%).

For an overview of the overall maximum credit exposure of the company's financial assets, please refer to note 31, Fair value of financial assets and liabilities, for details of carrying amounts and fair value.

Philips Lighting's policy is to provide guarantees only in writing. Philips Lighting does not stand by other forms of support. As at December 31, 2017, the total fair value of guarantees recognized on the Consolidated balance sheet amounted to EUR nil million (2016: EUR nil million). Remaining off-balance-sheet business and credit-related guarantees provided on behalf of third-parties and associates as per December 31, 2017 amounted EUR 8 million (2016: EUR 8 million). These guarantees will mature between 2018 and 2022.

**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 per country 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. Country risk is monitored and international developments such as the exit of the United Kingdom from the European Union are closely monitored.

As of December 31, 2017, Philips Lighting had country risk exposure of EUR 1.6 billion in the United States and EUR 908 million in the Netherlands. Countries where the risk exceeds EUR 200 million but was less than EUR 500 million are Belgium (EUR 484 million), Poland (EUR 459 million), China (including Hong Kong EUR 275 million) and Saudi Arabia (EUR 218 million). Countries where the risk exceeded EUR 50 million but was less than EUR 200 million are Spain, Canada, Mexico, India, Indonesia, France and Singapore. The degree of risk of a country 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 thousand 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 2017 retained EUR 1.5 million per occurrence and EUR 3 million in the aggregate per year for specific property damage and business interruption losses. For general and product liability claims, the captive retention during 2017 is EUR 1.5 million per claim and EUR 3 million in the aggregate. New insurance contracts were signed on December 31, 2017, for the coming year.

## [31] 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 debt, 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 has not been disclosed.

As of December 31, 2017, long-term loans and receivables included in other non-current financial assets in the Consolidated balance sheet amounted to EUR 9 million (2016: EUR 7 million) and held to maturity investments amounted to EUR less than 1 million (2016: EUR 1 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
2016-2017

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Balance as of December 31, 2017** | | | | |
| Derivative financial instruments - assets | – | 16 | – | 16 |
| Fair value through profit and loss - non-current | – | – | 1 | 1 |
| Available-for-sale financial assets | – | – | 2 | 2 |
| **Total** | **–** | **16** | **3** | **19** |
| Derivative financial instruments - liabilities | – | (8) | – | (8) |
| **Total** | **–** | **(8)** | **–** | **(8)** |
| **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)** |

During 2017 under Level 3, an impairment loss on available-for-sale financial assets of EUR 1 million was recognized in the Consolidated statements of income, EUR 1 million has been transferred from other captions of the Consolidated balance sheet and EUR 1 million fair value loss has been recognized in relation to financial assets at fair value through profit or loss.

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 sheet and EUR 2 million fair value gain has been recognized in relation to financial assets at fair value through profit or loss.

In addition, 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
2017

| | 2016 | 2017 |
|---|---|---|
| **Derivatives** | | |
| Gross amounts of recognized financial assets | 29 | 16 |
| 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** | **16** |
| Related amounts not offset in the statement of financial position | | |
| • Financial instruments | (12) | (6) |
| • Cash collateral received | – | – |
| **Net amount** | **17** | **10** |

Philips Lighting
**Financial liabilities subject to offsetting, enforceable master netting arrangements with financial counterparties or similar agreements**
in mEUR
2017

| | 2016 | 2017 |
|---|---|---|
| **Derivatives** | | |
| Gross amounts of recognized financial liabilities | (26) | (8) |
| 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)** | **(8)** |
| Related amounts not offset in the statement of financial position | | |
| • Financial instruments | 12 | 6 |
| • Cash collateral received | - | - |
| **Net amount** | **(14)** | **(2)** |

## [32] Events after the balance sheet date

**Share repurchases and cancellation**

On February 12, 2018, the Company cancelled the 2.8 million shares that it repurchased on November 28, 2017. As a result of this cancellation, Royal Philips' stake in the issued share capital of Philips Lighting N.V. became 29.59%. On February 26, 2018, the Company announced its intention to repurchase further shares. The repurchase is part of an accelerated bookbuild offering by Royal Philips to institutional investors, the details of which are included in the related press releases by the Company and Royal Philips.

**Restructuring**

After December 31, 2017, several restructurings projects have been announced. The costs for these projects are expected to be approximately EUR 30 million.

**Changes in financial reporting**

As the market trend of both professionals and consumers switching from buying lamps and luminaires to integrated LED luminaires is accelerating, the company has decided to modify the current portfolios of its business groups. As of January 1, 2018, Philips Lighting has implemented the following changes to the following portfolios:

- Consumer and professional trade downlights, the recessed spots portfolio and the LED Light strips will move from Home and Professional to LED;
- Consumer LED functional ceiling products will move from Home to LED;
- LED battens will move from Home to Professional; and
- Consumer and professional trade LED panels will move from Home and LED to Professional.

Therefore, with effect from the first quarter of 2018, Philips Lighting plans to report and discuss its financial performance based on the above portfolio changes.

In March 2018, the company will provide an update to show the effect of changes to the business portfolio as well as changes to the allocation methods of centrally-managed costs and expenses and threshold for other incidental items as adjusting items when presenting certain non-IFRS measures such as Adjusted EBITA.

# 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').

A description of the activities of the Company, its subsidiaries and Company structure are 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.

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.

The Lighting business was transferred by Royal Philips to Philips Lighting N.V. as at May 31, 2016, therefore the income statement of the Company in 2016 only includes the Lighting business results from this date.

**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, of the Consolidated financial statements and are deemed incorporated and repeated herein by reference. Investments in subsidiaries in the Company financial statements are accounted for using the equity method.

The balance sheet included in these Company financial statements has been prepared before the appropriation of result.

## 15.1 Balance sheets before appropriation of results

Philips Lighting N.V.
**Balance sheets before appropriation of results** in mEUR
As of December 31

| | | 2016 | | 2017 | |
|---|---|---|---|---|---|
| | **Non-current assets** | | | | |
| [C] | Financial fixed assets | | 3,448 | | 3,458 |
| | **Total non-current assets** | | **3,448** | | **3,458** |
| | **Total assets** | | **3,448** | | **3,458** |
| [D] | **Shareholders' equity** | | | | |
| | Share capital | 2 | | 1 | |
| | Share premium | 2,173 | | 1,975 | |
| | Legal reserve: currency translation differences | 190 | | (87) | |
| | Legal reserve: cash flow hedges | 4 | | 1 | |
| | Legal reserve: other | 196 | | 187 | |
| | Other reserve: treasury shares | - | | (124) | |
| | Other reserve: retained earnings | (7) | | (6) | |
| | Net income | 146 | | 294 | |
| | **Total shareholders' equity** | | **2,704** | | **2,242** |
| | **Current liabilities** | | | | |
| [E] | Short-term debt | | 743 | | 1,214 |
| | Other current liabilities | | 1 | | 3 |
| | **Total current liabilities** | | **744** | | **1,217** |
| | **Total liabilities and shareholders' equity** | | **3,448** | | **3,458** |

## 15.2 Statements of income

Philips Lighting N.V.
**Statements of income** in mEUR
2016-2017

| | | 2016 [1)] | 2017 |
|---|---|---|---|
| | Other expenses | (1) | (3) |
| | Financial expenses | (3) | (5) |
| | Share in results of subsidiaries | 150 | 301 |
| [A] | **Net income** | **146** | **294** |

1) The Company was incorporated in February 2016, therefore year 2016 is for the period February to December.

## 15.3 Statements of changes in equity

Philips Lighting N.V.
**Statements of changes in equity** in mEUR
2016-2017

| | | | Legal reserves | | | Other reserves | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium | Currency translation differences | Cash flow hedges | Other | Treasury shares | Retained earnings | Net income | Total share-holders' equity |
| **Balance as of February 1, 2016** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** |
| Share issuance and formation of the Company | 2 | 2,169 | 84 | (3) | 200 | – | – | – | 2,452 |
| Net income | – | – | – | – | – | – | – | 146 | 146 |
| Other comprehensive income (loss) | – | – | 106 | 7 | – | – | (7) | – | 106 |
| **Total comprehensive income (loss)** | **–** | **–** | **106** | **7** | **–** | **–** | **(7)** | **146** | **252** |
| Legal reserves reclassifications | – | 4 | – | – | (4) | – | – | – | – |
| **Balance as of December 31, 2016** | **2** | **2,173** | **190** | **4** | **196** | **–** | **(7)** | **146** | **2,704** |
| | | | | | | | | | |
| **Balance as of January 1, 2017** | **2** | **2,173** | **190** | **4** | **196** | **–** | **(7)** | **146** | **2,704** |
| Appropriation of prior year result | – | – | – | – | – | – | 146 | (146) | – |
| Net income | – | – | – | – | – | – | – | 294 | 294 |
| Other comprehensive income (loss) | – | – | (277) | (3) | – | – | 1 | – | (280) |
| **Total comprehensive income (loss)** | **–** | **–** | **(277)** | **(3)** | **–** | **–** | **147** | **147** | **14** |
| Legal reserves reclassifications | – | 9 | – | – | (9) | – | – | – | – |
| Dividend distributed | – | (11) | – | – | – | – | (146) | – | (157) |
| Purchase of treasury shares | – | – | – | – | – | (307) | – | – | (307) |
| Cancellation of treasury shares | (0) | (183) | – | – | – | 183 | – | – | – |
| Re-issuance of treasury shares | – | (1) | – | – | – | 1 | – | – | – |
| Share-based compensation plans | – | 10 | – | – | – | – | – | – | 10 |
| Income tax share-based compensation plans | – | 2 | – | – | – | – | – | – | 2 |
| Funding by (distribution to) Royal Philips [1)] | – | (24) | – | – | – | – | – | – | (24) |
| **Balance as of December 31, 2017** | **1** | **1,975** | **(87)** | **1** | **187** | **(124)** | **(6)** | **294** | **2,242** |

1) Includes a negative adjustment of EUR 30 million related to the re-measurement of deferred taxes following the reduction of the US federal income tax rate.

## 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 its affiliated companies. Other expenses mainly relate to the remuneration of the directors of the Company and the supervisory board. These costs are partly recharged to the subsidiaries of the Company. Financial expenses mostly relate 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.
**E&Y Audit fees** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Audit fees [1] | 5.6 | 5.3 |
| • Consolidated financial statements | 3.6 | 3.5 |
| • Statutory financial statements | 2.0 | 1.8 |
| Audit-related fees | 0.3 | 0.3 |
| • Sustainability assurance | 0.3 | 0.3 |
| **Fees E&Y in millions of EUR [2]** | **5.9** | **5.6** |

1) The audit fees included represent the fees in relation to the audit of the 2017 financial statements.
2) Fees charged by the Dutch organization of EY were EUR 2.7 million (2016: 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.

Philips Lighting N.V.
**Financial fixed assets** in mEUR
2016-2017

| | 2016 | 2017 |
|---|---|---|
| **Balance as of January 1** | **-** | **3,448** |
| Acquisitions/additions | 3,192 | - |
| Share in results of subsidiaries | 150 | 301 |
| Translation differences | 106 | (277) |
| Other movements | - | (14) |
| **Balance as of December 31** | **3,448** | **3,458** |

### [D] Shareholders' equity

**Share capital**

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.

On December 31, 2017, 29.01% (2016: 71.23%) of the issued share capital is held by Royal Philips, 68.31% (2016: 28.78%) is publicly traded at the Euronext Stock Exchange in Amsterdam and 2.68% (2016: Nil) are held as treasury shares.

**Ordinary shares**

On December 31, 2017, the issued and fully paid share capital consisted of 143,000,000 ordinary shares with a nominal value of EUR 0.01 per share (December 31, 2016: 150,000,000).

**Preference shares**

As a defense measure, Philips Lighting, a foundation organized under the laws of the Netherlands, has been granted the right to acquire preference shares in the Company. As of December 31, 2017, this right had not been exercised therefore no preference shares have been issued.

**Dividend distribution**

In May 2017, the Company settled a dividend of EUR 1.10 per ordinary share, representing a total value of EUR 157 million including costs.

A proposal will be submitted to the 2018 Annual General Meeting of Shareholders to pay a dividend of EUR 1.25 per ordinary share, in cash, from the 2017 net income.

**Restricted and performance shares**

The Company has granted rights to receive common shares in the future (see note 28, Share-based compensation).

**Treasury shares**

Shares which have been repurchased and are held in Treasury for (i) delivery of shares under the Company's long-term incentive performance share plan and other employee share plans, and (ii) capital reduction purposes, are accounted for as a reduction of shareholders' equity. Treasury shares are recorded at cost, representing the market price on the acquisition date.
When issued, shares are removed from treasury shares on a first-in, first-out (FIFO) basis.

When treasury shares are delivered under the Company's share plans, the difference between the market price of the shares delivered and the cost is recorded in retained earnings, the market price is recorded in share premium.

The following table shows the movements in the outstanding number of shares over the last two years:

Philips Lighting
**Outstanding number of shares** in number of shares
2016-2017

| | 2016 | 2017 |
|---|---|---|
| **Balance as of January 1** | **-** | **150,000,000** |
| Formation of the Company | 150,000,000 | - |
| Purchase of treasury shares | - | (10,850,000) |
| Delivery of treasury shares | - | 24,079 |
| **Balance as of December 31** | **150,000,000** | **139,174,079** |

In May 2017, the Company started a share buyback program to cover obligations arising from its long-term incentive performance share plans and other employee share plans. In 2017, the following transactions took place:

Philips Lighting
**Employee share plan transactions**
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Shares acquired | - | 1,050,000 |
| Average market price | - | EUR 33.23 |
| Amount paid | - | EUR 35 million |
| Shares delivered | - | 24,079 |
| Average price (FIFO) | - | EUR 31.73 |
| Cost of delivered shares | - | EUR 1 million |
| **Total shares in treasury at year-end** | **-** | **1,025,921** |
| **Total cost** | **-** | **EUR 34 million** |

In January 2017, the Company announced that it intended to return up to EUR 300 million to its shareholders over the period 2017-2018, by participating in share disposals by its main shareholder. To reduce the share capital, the following transactions took place:

Philips Lighting
**Share capital transactions**
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Shares acquired | - | 9,800,000 |
| Average market price | - | EUR 27.79 |
| Amount paid | - | EUR 272 million |
| Reduction of capital stock (shares) | - | 7,000,000 |
| Reduction of capital stock | - | EUR 183 million |
| **Total shares in treasury at year-end** | **-** | **2,800,000** |
| **Total cost** | **-** | **EUR 90 million** |

In February 2018, the 2.8 million shares in treasury were cancelled reducing the issued share capital to 140,200,000 shares. After cancellation, Royal Philips' shareholding in the issued share capital of Philips Lighting increased to 29.59%.

In 2018, the Company intends to repurchase shares for an amount up to EUR 150 million, by participating in share disposals by its main shareholder.

**Funding by (distribution to) Royal Philips**
Funding by (distribution to) Royal Philips includes a negative adjustment of EUR 30 million related to the re-measurement of deferred taxes following the reduction of the US federal income tax rate. For further information, refer to note 11, Income taxes.

**Legal reserves**
As of December 31, 2017, legal reserves related to currency translation losses of EUR 87 million, unrealized gains related to cash flow hedges of EUR 1 million and included in other, the 'affiliated companies' reserve of EUR 184 million and other reserves of EUR 3 million.

The item 'affiliated companies' reserve 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

As of December 31, 2016, legal reserves related to unrealized currency translation gains of EUR 190 million, unrealized gains related to cash flow hedges of EUR 4 million and included in other, the 'affiliated companies' reserve of EUR 196 million.

**Limitations in the distribution of shareholders' equity**
As at December 31, 2017, certain limitations existed relating to the distribution of shareholders' equity of EUR 103 million. Such limitations relate to ordinary shares of EUR 1.4 million, included in other, the 'affiliated companies' reserve of EUR 184 million and other reserves of EUR 3 million, unrealized currency translation losses of EUR 87 million and unrealized gains related to cash flow hedges of EUR 1 million.

The unrealized losses related to currency translation differences of EUR 87 million, although qualifying as a legal reserve, reduce the distributable amount by their nature.

As at December 31, 2016, these limitations in distributable reserves were EUR 392 million, related to ordinary shares of EUR 1.5 million, 'affiliated companies' reserve of EUR 196 million, unrealized currency translation gains of EUR 190 million and 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 (2016: EUR 740 million) with an interest rate equal to the higher of 6 months EURIBOR or 0% plus 0.65% with a maturity date of May 31, 2018 and other debt to subsidiaries of EUR 474 million (2016: EUR 3 million).

In February 2018, the intercompany loan agreement of EUR 740 million was extended to May 12, 2021, with a variable interest rate equal to the higher of 6 months EURIBOR or 0% plus a margin subject to semi-annual adjustment.

### [F] Employees

The number of persons employed by the Company at year-end 2017 was three (2016: three), all were employed in The Netherlands. For the remuneration of past and present members of both the Board of Management and the Supervisory Board, please refer to note 29, 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 1,171 million as of December 31, 2017, (2016: EUR 1,115 million).

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. For additional information, please refer to note 26, 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 32, Events after the balance sheet date.

On February 27, 2018, 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 15, 2018.

February 27, 2018

**Board of Management**
Eric Rondolat
Stéphane Rougeot
René van Schooten

**Supervisory Board**
Arthur van der Poel
Gerard van de Aast
Abhijit Bhattacharya
Rita Lane
Kees van Lede
Jill Lee

# 16. Sustainability statements

## 16.1 Approach to sustainability reporting

Sustainability is central to our company strategy and purpose. We strive to balance economic, social and environmental considerations. Our aim is to maximize long-term value creation along these three dimensions.

We have made our approach towards long-term value creation more transparent by preparing this Annual Report with key elements of the International Integrated Reporting Council's (IIRC) Integrated Reporting framework, while continuing to report in accordance with the GRI Standards.

At the core is the value creation model. This model shows how our business activities depend on various financial, environmental, and social resources that get converted to outputs. Our activities and its outputs lead to outcomes in terms of the impact made on our stakeholders and society at large.

By expressing these impacts in monetary terms in 2017, it enables us to consider the indirect economic, social, and environmental effects of our business. This allows for more effective and efficient decision making and gives a holistic view on our most prominent risks and opportunities. It also provides further transparency to our stakeholders on company performance.

By publishing the results of our analysis and being transparent on the methodology, we strive to contribute to developing a global standard for impact analysis, together with our active participation in the Impact Valuation Roundtable.

As part of our continuing commitment to the United Nations Sustainable Development Goals (SDGs), we report on our progress towards four 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. With this, Philips Lighting is a frontrunner in this field. To read the combined assurance statement, please refer to chapter 17, Combined independent auditor's report, of this Annual Report.

### 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 Responsible Business Alliance (RBA), and the European Partnership for Responsible Minerals (EPRM). For more information on the work we perform with stakeholders, refer to sub-section 16.2.10 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<br>Satisfaction rates<br>ESG-performance |
| Employees | Regular meetings, quarterly TEAM Surveys, bi-annual employee development process, quarterly update webinars | Strategic alignment sessions<br>Training & Development<br>Engagement |
| Investors | Roadshows, investor conferences, Capital Markets Day, investor relations email address, investor surveys | Strategic alignment sessions<br>ESG-performance |
| Suppliers | Supplier development and quality activities (including topical training sessions) (4 times per week), supplier forums, industry working groups like EPRM and RBA (4 times per year), and the commodity management, supplier quality and procurement engineering functions | Sustainability performance,<br>Peer-learning |
| Governments, municipalities | Issues meetings, annual innovation experience, research projects, policy and legislative developments, business development | Sustainable cities<br>Sustainable innovation |
| Civil society | Partnerships with NGOs (several times per week), cross-sector (multi-stakeholder) projects, supplier sustainability stakeholder day, our social investment program, and the Philips Foundation | Access to light<br>Sustainable operations<br>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.

**Materiality matrix**


**Environmental**
1 Products: energy efficiency
2 Operational carbon footprint
3 Carbon footprint of our supply chain
4 Products: hazardous substances
5 Products: circularity
6 Waste management
7 Regulated substances in production processes
8 Products: packaging
9 Water usage
10 Products: weight & materials

**Social**
11 Product stewardship
12 Human rights in our operations
13 Social responsibility in our supply chain
14 Occupational Health & Safety
15 Living wages
16 Employee engagement
17 Diversity & inclusion
18 Conflict minerals
19 Products: human centric lighting
20 Talent management
21 Access to light
22 Products: basic needs

**Governance**
23 Business ethics
24 Sustainable innovation
25 Big data and customer privacy
26 Procurement practices
27 Share-performance & pay-out policy
28 Responsible tax policy

The materiality assessment process uses many sources of information. These include media-search, trend analyses, and structured and unstructured stakeholder dialogues. In 2017, Philips Lighting asked a diverse group of internal and external stakeholders to rank a comprehensive list of topics relevant to them and our organization. The results from external stakeholders are reflected on the vertical axis of the materiality matrix. The scores on the horizontal axis are based on Philips Lighting's internal stakeholders. Our materiality assessment was conducted in line with the GRI Standards Reporting Framework.

Philips Lighting
**Key material topics**

| | Reference | Boundary |
|---|---|---|
| **Environmental** | | |
| Products: energy efficiency | Sub-section 16.3.1 Sustainable revenues | Use phase |
| Operational carbon footprint | Sub-section 16.3.3 Carbon footprint and energy | Own operations |
| Carbon footprint of our supply chain | Sub-section 16.2.8 Supply chain sustainability | Supply chain |
| Products: Hazardous substances | Sub-section 16.3.1 Sustainable revenues | Use phase |
| Products: Circularity | Sub-section 16.3.2 Sustainable innovation | Use phase |
| Waste management | Sub-section 16.3.4 Waste | Own operations |
| Regulated substances in production processes | Sub-section 16.3.5 Chemical substances in production processes | Own operations |
| Products: packaging | Sub-section 16.3.2 Sustainable innovation | Use phase |
| Water usage | Sub-section 16.3.6 Water | Own operations |
| Products: Weight & materials | Sub-section 16.3.2 Sustainable innovation | Use phase |

| | Reference | Boundary |
|---|---|---|
| **Social** | | |
| Product stewardship | Sub-section 16.3.1 Sustainable revenues | Use phase |
| Human rights in our operations | Sub-section 16.2.2 Human rights | Own operations |
| Social responsibility in our supply chain | Sub-section 16.2.8 Supply chain sustainability | Supply chain |
| Occupational Health & Safety | Sub-section 16.2.6 Safe and healthy workplace | Own operations |
| Living wages | Sub-section 16.2.2 Human rights | Own operations |
| Employee engagement | Sub-section 16.2.3 Employee engagement | Own operations |
| Diversity & Inclusion | Sub-section 16.2.4 Diversity & Inclusion | Own operations |
| Conflict minerals | Sub-section 16.2.8 Supply chain sustainability | Supply chain |
| Products: Human centric lighting | Sub-section 16.3.2 Sustainable innovation | Use phase |
| Talent management | Sub-section 16.2.5 Leadership & development | Own operations |
| Access to light | Sub-section 16.2.9 Access to light | Use phase |
| Products: Basic needs | Sub-section 16.3.2 Sustainable innovation | Use phase |

| | Reference | Boundary |
|---|---|---|
| **Governance** | | |
| Business ethics / acting with integrity | Sub-section 16.2.7 General Business Principles | Own operations |
| Sustainable innovation | Sub-section 16.3.2 Sustainable innovation | Own operations |
| Big data and customer privacy | Section 12.3 Strategic risks | Use phase |
| Share-performance & pay-out policy | Sections 11.1 Stock performance, 11.3 Capital allocation | Own operations |
| Procurement practices | Sub-section 16.2.8 Supply chain sustainability | Own operations |
| Responsible tax policy | Section 14.6, note 11, Income taxes | Own operations |

This materiality analysis shows how our world is changing. Key global mega trends, such as population growth, resource challenges, 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. This is a company-wide effort. In the sections that follow we explain how we manage 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 the Board of Management and the leadership. 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 implement sustainability programs include innovation, manufacturing, sourcing, and logistics. Targets on sustainability are set both at a corporate level and at a Business Group 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. Changes in targets, policies, definitions or scope are specified annually. There are no changes in targets, policies, definitions or scope to be reported in 2017.

Philips Lighting
**Program targets**
2017

| Program | Baseline | Target 2020 |
|---|---|---|
| Sustainable revenues | N/A | 80% of revenues |
| LED lamps & luminaires | 2015 | >2 billion LED lamps & luminaires 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 | Zero waste to landfill |
| Health & Safety | N/A | Total recordable injury case rate of <0.35 |
| Sustainable Supply Chain | N/A | Minimum performance rate of 90% |

### 16.1.5 Reporting standards

The sustainability information in this report is presented in accordance with the GRI Standards comprehensive option. We also developed additional company specific indicators.
An overview of the information on data definitions, measurements and any uncertainties inherent to measurements can be found in the supplement to the 2017 sustainability statements, available on our Sustainability webpage: http://www.lighting.philips.com/main/company/about/sustainability/downloads.html.

This supplement also provides an overview of the GRI Comprehensive Indicators, and a mapping to the recommendations of the Taskforce on Climate-related Financial Disclosures.

New Philips Lighting ventures are included in environmental and social disclosures to the extent that the integration process of these ventures has sufficiently been finalized.
The normative integration period is two years. Divestures completed before December 31 of the book-year are excluded from environmental and social reporting.

In 2017, Philips Lighting re-committed itself to the United Nations Global Compact 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.

## 16.2 Social statements

**Gordana Landen, Chief HR Officer Philips Lighting:** “At 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. 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. 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 32,130 at the end of 2017, compared to 34,256 at year-end 2016. Approximately 64% of our employees were employed by one of our four Business Groups, focusing on manufacturing and research & development. 22% are employed in one of our markets, focusing on sales & marketing. The remaining 14% work in corporate functions. Compared to 2016, the number of employees decreased by 6%. This reduction is primarily related to the rationalization of our industrial footprint and our focus on reducing indirect costs. In line with our expectations, most leavers are from the factory and warehouse environment.

Philips Lighting
**Employees**
2015-2017

| | 2015 | 2016 | 2017 |
|---|---|---|---|
| Philips Lighting total | 37,399 | 34,256 | 32,130 |

In 2017, employee turnover amounted to 22% (of which 15% was voluntary) which is comparable to 2016.

### Top sources of talent

Our approach to talent is to build and develop employees' functional and leadership skills continuously, while attracting new talent where critical capabilities need to be strengthened for us to achieve our strategic objectives. In 2017, we recruited talent internally and externally, which involved more than 4,000 people.

At the executive level, 60% of the vacancies were filled with planned successors in line with our talent philosophy to promote talent within the organization; this has been the highest percentage of succession conversion in the last six years. At levels below executives, around one-third of our vacancies were filled with internal candidates, which is in line with the targets we aim for.

### A strong global employer brand with local relevance in the digital age

In 2017, we continued to strengthen our global employer brand through our Employee Value Proposition. We focused our strategic recruitment marketing investments on the most critical talent segments, to drive our transformation and growth. For example: Special focus was given within Home, where we attracted and hired more than 150 talents worldwide within a few months to enable the growth plan.

Philips Lighting
**Employee turnover** in %
2017

| | Staff | Professional | Management | Executives | Total |
|---|---|---|---|---|---|
| Involuntary turnover | 8% | 4% | 6% | 12% | 7% |
| Voluntary turnover | 19% | 7% | 5% | 8% | 15% |

As part of our global talent acquisition strategy, we continue to attract talent from proven high-quality sources. In 2017, the main sources of hire were:

- **Internal hire** - We fill approximately 30% of our vacancies internally each year.
- **Employee referral** – Historical data has shown that our top-performing hires are those referred by our own employees. Therefore, we encourage them to share their network through a formal employee referral program, which generates close to 30% of our total hires each year.
- **Proactively sourced by recruiter** – Our dedicated in-house sourcing function focuses on proactively building talent pipelines and identifying of passive talent.
- **Digital career channel (employee review sites, social media sites, online community groups, etc.)** – Channel-specific indicators showed 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 Lighting global career website can be found at www.lighting.philips.com/main/careers.

## 16.2.2 Human rights

Acting with integrity is at the heart of Philips Lighting's culture and is part and parcel of our company's mission and vision. Respecting human rights is a central foundation of the way we work. Our commitment to respecting and promoting human rights extends beyond our own operations, across our wider sphere of influence, including our supply chain. To that end, we integrate human rights considerations into our policies, processes, and practices.

On December 10, 2017, during the international day of human rights, Philips Lighting issued its new policy on Human Rights. This policy was not created from scratch but is an updated reflection of the values reflected in our General Business Principles. This policy is based on the International Bill of Human Rights, the United Nations Global Compact norms, and the International Labour Organization's declaration on Fundamental Principles and Rights at work. Philips Lighting carried out due diligence research to identify the most salient ethical and social principles that govern our relationship with stakeholders worldwide.

The table below shows, in random order, the salient issues identified and the stakeholders they affect, as well as references to the sub-sections that contain the progress that Philips Lighting made in addressing these issues

Philips Lighting
**Salient human rights issues**

| | Salient human rights issues | Rights holders covered in our programs | | | Reference to our disclosures |
|---|---|---|---|---|---|
| | | (3rd party) employees | Direct suppliers | Indirect suppliers | |
| 1 | Freedom of association and collective bargaining | • | • | | 16.2.7: General Business Principles<br>16.2.8: Supply chain sustainability |
| 2 | Safe & Healthy workplace | • | • | | 16.2.6: Safe and healthy workplace<br>16.2.8: Supply chain sustainability |
| 3 | Working hours | • | • | | 16.2.7: General Business Principles<br>16.2.8: Supply chain sustainability |
| 4 | Equal employment opportunities and respect | • | • | | 16.2.4: Diversity & Inclusion<br>16.2.7: General Business Principles |
| 5 | Recognition and reward | • | • | | 16.2.2: Human Rights<br>16.2.7: General Business Principles<br>16.2.8: Supply chain sustainability |
| 6 | Forced and child labor | | • | • | 16.2.8: Supply chain sustainability |
| 7 | Employee development | • | | | 16.2.5: Leadership & development<br>16.2.7: General Business Principles |

**Human rights risk assessment**
Compliance to the Human Rights policy is governed through our GBP processes, combined with dedicated steps that help ensure adherence.

In 2017, employees were requested to complete e-learnings or to participate in face-to-face trainings that helped interpret GBP. Dedicated communication campaigns urged everyone to speak-up and report concerns of possible violations. In those campaigns, the availability of our Ethics hotline was also brought to the attention.

Based on a country risk assessment, multiple manufacturing locations were considered to have an increased likelihood of policy violations. These locations are subject to a 3-year audit and are requested to periodically fill in a dedicated self-assessment on human rights. In 2017, 50% of the locations were also audited by an external company. No systemic violations were identified at any of the sites.

**Living wages**
At Philips Lighting, our people make the difference between good and great results, whether it is in day-to-day operations or year-to-year performance. By ensuring good working conditions, Philips Lighting does not only aim to provide a fair, safe, and respectful environment, but also an inspiring place to work and grow.
Fair remuneration is considered a pre-condition for our employees to flourish. It is our company policy to offer remuneration that meets or exceeds the provisions of all applicable wage laws, including those relating to minimum wages, overtime hours and legally mandated benefits.

In 2017, Philips Lighting investigated its rewards approach to ensure remuneration packages meet the fair living wage definition. We found we provide remuneration that exceeds minimum wage standards, and fair living wage standards were met on average for the lowest pay-grades. Going forward, Philips Lighting will review its salary ranges annually, not only to be market-competitive, but also to ensure fair living wage standards are met across the globe for all employees.

## 16.2.3 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 and managers 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 quarterly survey currently known as the Team Survey, with the accompanying promotion of Team Dialogues with People Managers and their teams. This proved to be a positive driver of employee engagement to increase team effectiveness, and, as a result, we continue to run the Team Survey on a quarterly basis to monitor engagement.

In 2017, we upgraded the Team Survey in line with our purpose and values. This allowed us to gain valuable new insights into how our employees shape and are at the heart of our culture. A year after implementing these new survey questions, we came back with the following results: 85% of our employees underline that we truly put our Customer First; 86% of our employees acknowledge that we are Greater Together; 87% of our employees feel that we are considered a Game Changer and 79% of our employees agree that we have Passion for Results.

We have noted that we need to continue to improve in effectiveness and recognition. Initiatives to address our improvement areas are driven at a team level via our Team Dialogues, and in addition we continue to drive progress on these questions during our Quarterly Performance Reviews.

To measure employee satisfaction, the Net Promoter Score (NPS) methodology was adopted with the introduction our Team Survey. 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. In 2017, Team Survey had an average employee response rate of 78%, and we recorded an overall NPS score of 14 across the Philips Lighting population (2016: 8).

### 16.2.4 Diversity & Inclusion

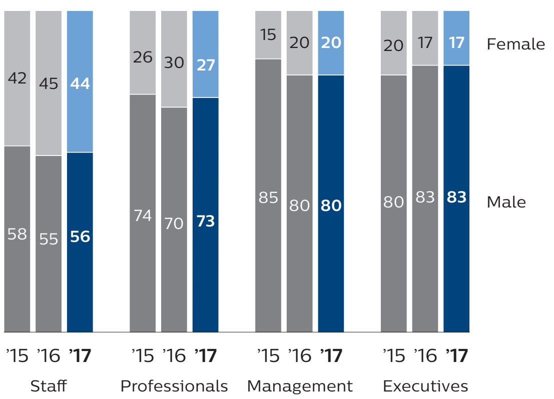
At Philips Lighting, we believe in building a diverse and inclusive workplace. This means we celebrate and foster an environment in which all people's ideas, knowledge, perspectives, experiences and styles are highly valued. It also means that all individuals are treated fairly and respectfully, have 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.

In 2017, we created a network of Diversity & Inclusion champions in our organization consisting of a variety of employees across grades, gender, nationalities, and age representing the different markets, businesses and functions. This network will promote our inclusive culture, by creating more awareness on local initiatives and sharing best practices around the world.

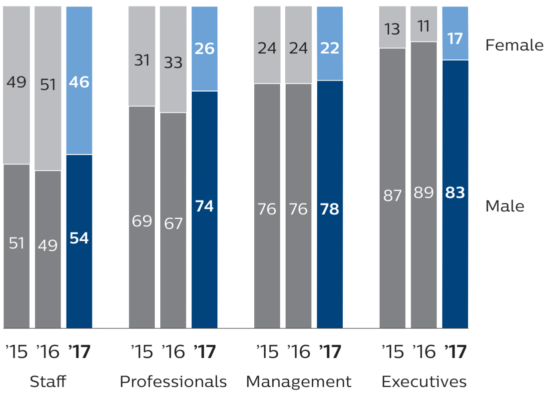
We continually monitor our gender diversity numbers and strive to have a healthy balance in our organization. In 2017, 17.4% of executives across the company were female. We aspire to maintain a healthy pipeline of female talent at approximately 35% of our overall employee population (2017: 29%). Overall, 38% of Philips Lighting employees in 2017 were female.

Our internal and external hiring process, as well as our succession planning process, foster a rigorous focus on the broader sense of diversity (background, ethnicity, race, gender, age, education, religion). We aim to build a diverse workforce and an inclusive work environment to continuously improve our capabilities for the future success of Philips Lighting. We foster this culture by actively promoting our open internal job market, where all vacancies are posted, and all our employees can apply.

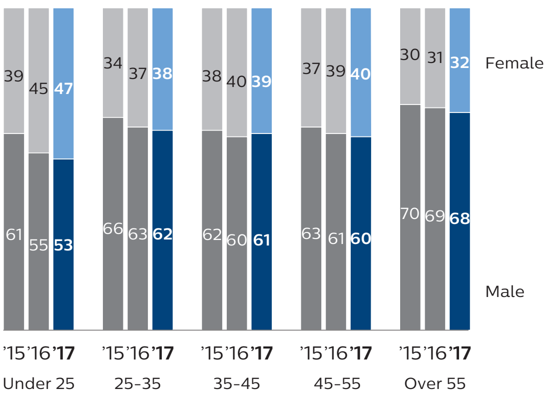
Philips Lighting
**Gender diversity** in %
2015 - 2017



Philips Lighting
**New hire diversity** in %
2015 - 2017




Philips Lighting
**Employees per age category** in %
2015 - 2017




**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.

## 16.2.5 Leadership & development

We consider continuous development to be 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 2017, the Philips Lighting University launched several new 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). In addition, we are extremely focused on building digital capability in learning which will accelerate and personalize learning. Digitization will leverage Personal Learning platforms, advanced and engaging software and mobile devices to make sure learning becomes more about performance support. Learners should be able to access tailored learning content and experiences when required augmented by components of Artificial Intelligence fitting their development needs (chatbots and virtual assistants to source and categorize information and augmented reality simulations to embed learning).

**Leadership development**
In 2017 we launched leadership development programs, focused on accelerating the development of our 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 in a more lean way, and strengthening 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 40 individual modules on personal development, business and management skills. In 2017, more than 2,450 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 2017 more than 156,000 e-learnings were booked through the Lighting University (2016: 90,000+), and more than 33,000 classroom trainings were scheduled (2016: 28,000+).

## 16.2.6 Safe and healthy workplace

**Health & Safety performance**

Since our founding, 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 one fatality in 2017. While on duty, one of our employees passed away after a traffic accident in the Netherlands. A thorough investigation and root-cause analysis were conducted. Our safe driving rules were strongly communicated through an awareness campaign and we further accelerated our injury prevention program to prevent such occurrences in the future.

In spite of this tragic event, it was encouraging to see the general improvement in safety performance. Significant progress was again made in further embedding our safety mind-set, through the revised safety program which was initiated in 2015. Activities in 2017 include a dedicated safety week with accompanying communications campaign. We held safety boot-camps at most of our manufacturing sites, deployed new safety programs for personal safety and turnkey project safety and increased the reporting of leading indicators related to unsafe situations and near-misses. We recorded 132 TRC cases, a year-on-year improvement of 19% versus the 162 cases in 2016. The TRC rate decreased to 0.41 per 100 FTEs, compared with 0.50 in 2016. Eleven of our industrial units went through 2017 without any recordable injuries. One of our sites in Brazil has been injury free since mid-2013.

Philips Lighting
**Recordable cases**
2015-2017

| | 2015 | 2016 | 2017 |
|---|---|---|---|
| Total recordable cases rate | 0.66 | 0.50 | 0.41 |
| Lost workday cases rate | 0.34 | 0.22 | 0.27 |
| Fatalities | – | 2 | 1 |

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. All our manufacturing sites have now 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 2017, 67% 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, several of our office spaces are using 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.

## 16.2.7 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. 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 2017, 198 GBP complaints were filed via the Philips Lighting Ethics Line and the GBP Compliance Officers. Compared with 2016 (164 complaints), this is an increase of 21%. This is a continuation of the upward trend reported since 2014, the year in which we completely overhauled the GBP and initiated a related communication campaign. We believe this demonstrates that our efforts to inform our employees via training sessions and encouraging them to speak up have paid off.

**Most commonly reported concerns**

Treatment of employees

As in previous years, the most commonly reported type of concern relates to the category Treatment of employees. Two subcategories, 'Respectful treatment' and 'Equal and fair treatment', make up 72% 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 favouritism and matters of discrimination and unfair treatment in the workplace.

We see a slight increase compared to 2016 in this segment. 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 in 2016 and the consequential increase in corporate activities.

Business integrity

The second most reported type of concern relates to Business integrity, which makes up 37% of the total cases reported. We believe the increase in number of cases reported in this segment is related to the company's attempt to focus its growth ambitions on growth geographies, where the legal and regulatory environment is less developed compared to mature geographies. The attention on business development in these geographies and the consequential increased awareness of the company's GBP and speak up procedure seem to have led to the increased number of reported cases in this segment.

Philips Lighting
**Breakdown of alleged violations GBP**
2015-2017

| | 2015 | 2016 | 2017 |
|---|---|---|---|
| Health & Safety | 1 | 7 | 2 |
| Treatment of employees | 63 | 97 | 106 |
| • Collective bargaining | – | 2 | – |
| • Equal and fair treatment | 12 | 22 | 27 |
| • Employee development | – | 3 | – |
| • Employee privacy | 2 | 2 | 1 |
| • Employee relations | – | 4 | 10 |
| • Respectful treatment | 28 | 45 | 50 |
| • Remuneration | 4 | 6 | 5 |
| • Right to organize | – | – | – |
| • Working hours | 1 | 6 | 4 |
| • HR other | 16 | 7 | 9 |
| Legal | 14 | 5 | 6 |
| Business integrity | 48 | 47 | 73 |
| Supply management | 3 | 3 | 1 |
| IT | 2 | 2 | – |
| Other | 4 | 3 | 10 |
| **Total** | **135** | **164** | **198** |

Substantiated/unsubstantiated concerns

Of the 198 cases reported in 2017, 68 are open. Of the 130 reports investigated, 46 were ultimately closed having been found to be substantiated, which represents 35% of the closed cases.

## 16.2.8 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 4,000 product and component suppliers. 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.

In 2017 we organized a dedicated stakeholder-engagement day to get an outside-in view on our supply chain sustainability activities. During this day, the different programs were discussed in detail by the suppliers, NGOs, customers, peers and research institutes in attendance.

**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 and can be found through the following link www.philips.com/Lighting-SSD.

The SSD is derived from the Responsible Business Alliance (RBA, formerly Electronic Industry Citizenship Coalition) 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 RBA 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**
For selected suppliers in risk countries, full audits are performed in a three-year cycle by an independent audit firm. If non-conformances are identified, we require the supplier to draw up a corrective action plan. Our sustainability experts then support the supplier in correcting the non-conformances, for instance by providing training or sharing best practices. We monitor the execution of the corrective action plans until the supplier is compliant with our requirements.

Philips Lighting
**Summary of 2017 audit program (three-year cycle, third-party audit)**
2017

| | Greater China | Rest of the World | Americas | Europe | Total |
|---|---|---|---|---|---|
| **Total amount of risk suppliers** | **197** | **29** | **15** | **2** | **243** |
| Total no. of audits | 98 | 11 | 3 | 0 | 112 |
| Initial audits | 11 | 4 | 0 | 0 | 15 |
| Continued conformance audits | 87 | 7 | 3 | 0 | 97 |
| Workers employed at sites audited | 60,704 | 7,588 | 3,026 | 0 | 71,318 |

In 2017 we audited 112 of our current risk suppliers, including 97 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 71,318 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 RBA 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. 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 2017 the average audit score of our risk suppliers was 67 (2016: 63). Risk suppliers new to the audit program scored 64 (2016: 52). Dedicated follow-up to close the non-conformances was carried out for the lower scoring suppliers. After implementing the corrective action plans, the average overall audit score in 2017 was 91 out of 100.

The supplier sustainability performance rate represents the percentage of risk suppliers that have an audit score of at least 90 out of 100 points. Our 2017 target on supplier sustainability performance is 90%. In 2017 we achieved a supplier sustainability performance rate of 95% (2016: 92%).

The table on the next page shows the supplier sustainability performance and indicates the conformance level in the audits before suppliers have taken corrective actions. Two suppliers showed outstanding performance during the third-party audit, without any non-conformities found.

Philips Lighting
**Summary of 2017 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 80-100% | EICC code 80-100% |
| Child labor prohibition/ Young worker management 80-100% | Emergency preparedness 40-60% | 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% | |

**Additional audit efforts**
In addition to the audits with current risk suppliers, we also audited 12 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.

Since 2016, we perform 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. In 2017 we performed 39 annual verifications (2016: 41). The average initial score in these audits was 80.

**Supplier training and development**
To further improve the awareness and knowledge of our suppliers, in 2017 we introduced a new way of working in the audit program, including a few hours of on-site training at suppliers. This training is tailored towards the non-conformances that were found during the audit. By doing so we train supplier staff on the topics that are most important for them to improve on. We performed on-site training at 76 supplier sites, which were attended by in total 605 supplier employees.

We also provide classroom training sessions on the RBA Code of Conduct/SSD. Our sustainability experts perform these trainings, supported by training materials provided by RBA. To address emerging issues, we also provide in-depth capability building programs for our suppliers on specific topics. In 2017, we focused these extra trainings on carbon emissions and reduction, related to the CDP Supply Chain program.

We organized 12 training sessions which were attended by 154 suppliers globally, with a total of 332 attendees.

## Reducing water and air pollution levels in China

To reduce the environmental pollution in China, Philips Lighting teamed up with the Chinese Institute of Public & Environmental Affairs (IPE), leveraging their work to engage with our suppliers.

Periodically IPE publishes a list of Chinese factories associated with concerning environmental pollution levels. Philips Lighting engages with any suppliers on the IPE list to resolve environmental non-conformances. Initially 30 direct suppliers were flagged on IPE's list, which was reduced to 15 by year-end. We have also requested direct suppliers to engage their own direct suppliers that appear on IPE's list for them to also resolve non-conformances.

Based on inputs obtained during our stakeholder-engagement meeting, Philips Lighting is reinvestigating its approach towards supplier audits. To further improve our engagement and audit effectiveness, we are expecting to incorporate further improvements in our 2018 approach.

**Responsible sourcing of minerals**
Our commitment to sustainable development extends to issues further down in our supply chains, to prevent and human rights abuses and financing of conflicts 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 (full text of our policy on 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). 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 through the following website: http://www.lighting.philips.com/main/company/about/s=uppliers/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). We carefully review the information received via the CMRT from each supplier against our Philips Lighting requirements. After having identified the smelters in our supply chain, we publish our Philips Lighting Conflict Minerals Declaration, including our smelter list on the company website: 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.

We are an active member of the Responsible Mineral Initiative (RMI) which runs the audit program to verify the smelters conflict-free status (www.responsiblemineralsinitiative.org). During 2017, significant progress was made in validating additional conflict-free smelters. Since the program's inception, we have started to actively direct our supply chain towards these smelters.

In 2017 we invited 130 priority suppliers to fill in the CMRT. We had a 100% supplier response and approved 91% of the CMRTs against the Philips Lighting requirements. We had a total amount of 274 smelters in our supply chain. We took a firmer stand on having validated smelters in the supply chain than in previous years, and the result shows, as we rose from 77% validated smelters in 2016 to 91% validated smelters in our supply chain in 2017.

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 Responsible Minerals Initiative (before Conflict Free Sourcing Initiative).

Philips Lighting
**Results of the RCOI (Reasonable Country of Origin Inquiry)**
2017

| | Gold | Tantalum | Tin | Tungsten | Total |
|---|---|---|---|---|---|
| Smelters known to source from the DRC and/or adjoining countries | 0 | 29 | 5 | 5 | 39 |
| Smelters known to process only recycled or scrap materials | 14 | 2 | 3 | 2 | 21 |
| Smelters known to source from outside the DRC or adjoining countries | 13 | 10 | 61 | 34 | 118 |
| Smelters that disclosed mineral country of origin to auditors only | 71 | 0 | 0 | 0 | 71 |
| Smelters with unknown minerals origin | 0 | 0 | 0 | 0 | 0 |

**European Partnership for Responsible Minerals**
We are a partner of the European Partnership for Responsible Minerals (EPRM), a public-private partnership initiative. 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. Philips Lighting is a member of the EPRM working group that is investigating the expansion of scope of EPRM to other minerals, like cobalt and mica.

**Responsible sourcing of cobalt**
To ensure Philips Lighting does not indirectly contribute to human rights abuses in cobalt mining, we investigated our batteries supply chain in 2017. We use batteries for emergency lighting and remote controls, making up less than 0.5% of our bill of material spend. Despite this, we decided to put our leverage in the industry to good use. We have investigated our full battery supply chain and engaged on responsible sourcing standards.

## Laura Gerritsen, Value chain program manager Fairphone:

"To improve the labor conditions at artisanal cobalt mines, it is crucial to move beyond the identification of risks and focus on improvements and formalization of the sector. We found a great partner in Philips Lighting to join forces and to drive actual impact together."

**Responsible sourcing of mica**
To ensure Philips Lighting does not indirectly contribute to child labor practices in mica mining, we performed the first phase of our due diligence in 2017. Based on initial analyses and inquiries of suppliers, we have thus far identified five direct-suppliers that provide components or parts which contain mica. In 2018, Philips Lighting plans to extend the due diligence to a bigger group of suppliers.

**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.

Our target for 2020 is to have at least 250 strategic suppliers annually reporting on scope 1 and scope 2 emissions (direct and indirect greenhouse gas emissions), and 200 strategic suppliers annually reporting on emission reduction activities. In 2017, we invited 200 of our strategic suppliers to the program, with148 submitting the CDP questionnaire. This equals 49% of our total spend, a good improvement compared to 2016 in which we had a coverage of 27% of total spend.

Similar to 2016, we asked 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 2017, we also provided classroom trainings for our Chinese suppliers in Shanghai and Shenzhen. The training program was a joint effort of CDP, CQC (a Chinese consultancy firm) and Philips Lighting. Of the 23 suppliers (47 attendees) that participated in the trainings, 20 suppliers submitted the CDP questionnaire.

In total, our suppliers undertook 30 carbon emission-savings projects in 2017, with a total of 5 million metric tonnes of $CO_2$ emissions saved.

Philips Lighting
**CDP reporters per region and topics reported**
2016-2017

| | Greater China | | Rest of the World | | Europe | | Americas | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2016 | 2017 | 2016 | 2017 | 2016 | 2017 | 2016 | 2017 | 2016 | 2017 |
| Scope 1 | 62% | 70% | 69% | 94% | 71% | 76% | 50% | 75% | 64% | 75% |
| Scope 2 | 60% | 56% | 62% | 94% | 60% | 67% | 56% | 75% | 59% | 66% |
| Scope 1 & 2 | 56% | 57% | 62% | 88% | 60% | 76% | 50% | 71% | 57% | 76% |
| Have a reduction target | 40% | 52% | 69% | 88% | 46% | 71% | 39% | 63% | 45% | 63% |
| Have on-going reduction activities | 50% | 43% | 77% | 75% | 54% | 56% | 56% | 50% | 55% | 51% |
| Climate change opportunities | 80% | 84% | 85% | 81% | 74% | 73% | 72% | 71% | 78% | 78% |
| Climate change risks | 80% | 86% | 85% | 81% | 71% | 71% | 61% | 71% | 75% | 79% |
| Integrated climate change in business strategy | 58% | 62% | 62% | 75% | 74% | 84% | 56% | 63% | 63% | 70% |
| Integrated climate change in risk management | 42% | 49% | 62% | 50% | 51% | 67% | 39% | 58% | 47% | 56% |
| **Total amount of reporters** | **50** | **63** | **13** | **16** | **35** | **45** | **18** | **24** | **116** | **148** |

### 16.2.9 Access to light

Today, more than one in seven people worldwide live without access to electricity, more than half of those living in rural communities in developing economies. For these communities, the productive day ends at sunset. Mobility after dark is limited and simple activities like accessing sanitation can be dangerous. Children cannot study. Shops cannot do business. Emergency relief workers cannot help people.

Lighting is a catalyst for equitable development, improving access to healthcare, education and livelihood opportunities. As a responsible company, we aim to use our expertise and knowledge of lighting to give back to the communities in which we operate. We do this through the Philips Lighting CSR program and by supporting the newly established Philips Lighting Foundation. The Philips Lighting Foundation is an independent, non-profit organization with a mission to provide sustainable access to light to people in communities that are underserved by electricity.

The Philips Lighting CSR program leverages our ability to innovate relevant lighting technology to address the specific needs of underserved communities. This is done through the Base of the Pyramid social venture, which works outside of the commercial framework of the organization with the objective of understanding and responding to the specific lighting needs of underserved communities. This has led to the design of a range of solar lanterns and home lighting systems that provide off-grid communities with access to safe, renewable lighting after dark. These are managed within the Base of the Pyramid social venture, that re-invests profits back into research and innovation based on the insights and feedback from the end-users of the solar technology.

With energy efficiency as core to our business, our volunteering program promotes and enables employees to volunteer their time and skills to inspire the next generation on the importance of energy efficiency as a climate change solution. Philips Lighting has developed training modules that can be used globally for employees to be a guest teacher in a local school. By reaching out to young students and embedding energy awareness in their school's curriculum, we seek to inspire the change makers of the future.
Our volunteering program offers all employees globally the right to one day of paid leave per year, spent on volunteering activities.

**Raj Dev Narula, Marketing Manager Philips Lighting:** "In the fight against climate change, it is essential to inspire the next generation on the importance of energy efficiency, as well as on the risks we could create by doing nothing. In 2017, the Asia Pacific teams reached 1616 students across 35 schools with 324 Philips Lighting volunteers involved."

**Philips Lighting Foundation**
In a world where more than 1 billion people have no reliable access to power, electric light is a distant dream for many. The Philips Lighting Foundation is committed to ending this imbalance through Philips Lighting's vision *to unlock the extraordinary potential of light for brighter lives and a better world*. The mission of the Foundation is to enable sustainable access to light in underserved communities.

Our projects promote the use of clean technology-based lighting systems that address the entire spectrum of lighting needs of a community. These could be home lighting, institutional lighting, public lighting and lighting for emergency relief. By mapping the access-to-light value chain and identifying barriers in key activities like manufacturing, distribution, affordability and sustainability, we inform our strategy and choice of partners and projects. Working with NGOs and communities around the world, we're bringing electric light to the places it is needed the most. And by sharing our expertise on the role of lighting in accelerating energy efficiency, we're helping to protect our environment.

The Foundation has three main focus areas for projects.

**Lighting Lives:** Enabling access to relevant, affordable and sustainable lighting technology for off-grid and partial grid communities to help extend the productive day.

In 2017, Philips Lighting provided 925,000 people with access to light through 13 different projects, exceeding our year-target of reaching 500,000 people without access to electricity.

David Tikah, an adult literacy teacher in Ghana "The attendance in my evening classes has increased from only 15 learners to over 45 learners, thanks to the solar home lighting kit provided by Philips Lighting."

**Lighting Entrepreneurs:** Better lighting stimulates productivity and entrepreneurship through technical training. In addition to technical training, the Philips Lighting Foundation helps entrepreneurs develop business skills to enable the development and strengthening of channels of last mile distribution. We train local people to become proficient in various aspects of the access-to-light value chain, from lighting distribution to post-delivery maintenance. By delivering training in light maintenance and business, we give entrepreneurs the skills they need to become independent.

To do this, Philips Lighting teamed-up with Barefoot College. Their signature training course focusses on solar engineering for women. This enables participants to contribute to the sustainable development of their communities, irrespective of barriers to literacy or formal education.

Anu Jain, Director of Enriche - Enterprise, Empowerment and Education, by and for Rural Women: "Phillips Lighting is supporting various Barefoot projects, thereby creating pathways to more sustainable, self-sufficient and resilient rural communities."

In 2017, 2,163 people were trained, with the majority following the solar electricians training. This exceeded our target of 1,200 by 80%.

**Humanitarian Lighting:** When a humanitarian crisis strikes, light plays a critical role in delivering emergency assistance. Without adequate illumination, aid workers cannot deliver care or supplies after nightfall. In these situations, light doesn't just assist relief efforts – it saves lives. By supplying technology and supporting lighting infrastructure for humanitarian projects, we help aid workers and engineers to see clearly while increasing safety and security of those who are made even more vulnerable in disaster contexts.

### 16.2.10 Working with stakeholders

In 2017, several important events took place in the areas of sustainable development and climate change. Philips Lighting further expanded existing initiatives and partnerships. Some of the events and conferences included the World Economic Forum in Davos, the third UN Environmental Assembly in Nairobi, the eighth Clean Energy Ministerial (CEM8) in San Francisco, Climate Week NYC in New York (CWNYC), and COP23, the UN Climate Change Conference in Bonn, Germany.

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 the World Economic Forum in Davos, our CEO Eric Rondolat was one of the global business leaders urging businesses and governments to act on climate risks, while walking the talk through our carbon neutral commitment by 2020 and reporting on climate-related performance. At Philips Lighting we believe it is critical for the stability of the economy and the global financial system to disclose information about the material financial risks and opportunities that climate change creates.

At CWNYC, Philips Lighting formally committed itself to integrate the Taskforce on Climate change related Financial Disclosure recommendations into its Annual Report by 2019.

At COP23, we announced the milestone of delivering one billion LED lamps & luminaires, as part of our commitment to deliver two billion by 2020. This initiative is part of the Global Lighting Challenge (a global program aimed at supporting market penetration of 10 billion LEDs by 2020).

At the UN Environmental Assembly in Nairobi the UN Science-Business-Policy initiative was launched which intends to accelerate sustainable development by driving technology deployment. Philips Lighting is an invited member of the governing consortium which oversees this initiative.

## 16.3 Environmental statements

Since the 1970s, we have focused on minimizing the environmental impact of our operations. This integrated report serves as our nineteenth 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.

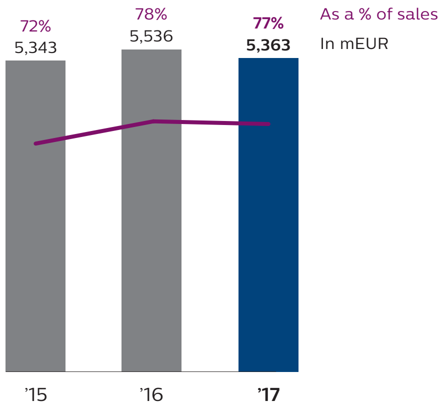
All our environmental policies and management framework are based on the international ISO-14001 standard. In 2017, 85% of our manufacturing sites were certified to ISO-14001.

### 16.3.1 Sustainable revenues

Sustainable revenues come from products, systems, and services that outperform annually updated benchmarks on energy efficiency by 10% or more. The environmental performance is measured quantitatively through the lifecycle assessment approach.

In 2017, Philips Lighting increased the stringency of its energy efficiency baseline in terms of lumens per watt. As a result, our sustainable revenues remained at comparable levels as 2016. In 2017, the energy efficiency of our product portfolio and sales has again reached a record level for Philips Lighting.

Philips Lighting
**Sustainable revenues** in mEUR
2015 - 2017




**TrueForce LED range supports the transition from HID to LED**

In May 2017 Philips Lighting launched the Philips TrueForce LED, a range of LED lamps intended to facilitate a simple switch from High Intensity Discharge lamps to LED technology. Offered as replacement lamps, there is no requirement to change light fixtures or sacrifice light effects. The range provides energy savings of up to 75% compared to conventional lamps.

**Two billion LED lamps & luminaires**
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 lamps & luminaires by 2020. When combined with digitally connected systems, we can 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.

In November 2017, we were the first company to break through the one billion LED milestone. Considering the environmental impact of avoided carbon emissions, our LED lamps & luminaires delivered thus far have already saved 29,794 kilotonnes in $CO_2$, equaling EUR 2,979 million in societal costs.

Philips Lighting
**LED lamps & luminaires delivered** in millions of units
2015-2017

| | 2015 | 2016 | 2017 | Total |
|---|---|---|---|---|
| LED lamps & luminaires delivered | 257 | 371 | 568 | 1,196 |

**Product quality**
Philips Lighting has a strong commitment to responsible product stewardship. The Philips Lighting quality management system is ISO 9001:2015 certified, covering all business activities. When it comes to quality, we believe prevention of defects is better than cure. This is reflected in our structured approach towards the selection and qualification of suppliers, manufacturing, installation and service of our products and services. In those rare cases where defects are found in our products that have been brought to market, Philips Lighting does not hesitate to respond and take the appropriate action which may include a product recall, especially if health and safety are of concern. Philips Lighting has a robust process in place to ensure impacted constituents are informed. In 2017, no product safety issues were found that resulted in a fine or penalty.

**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) and REACH regulations. Guided by the precautionary principle, 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 2017, we continued to engage with our suppliers, further rolling out the publicly available BOM check tool, in which components and substances can be registered.

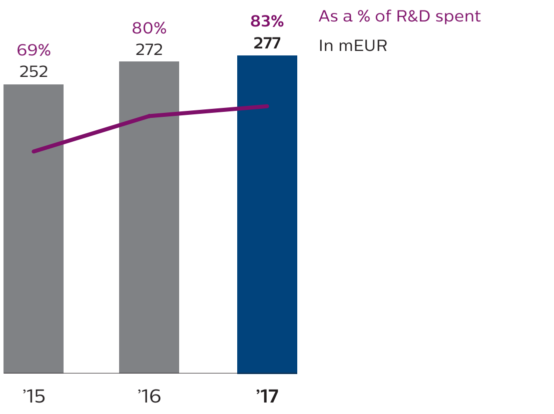
## 16.3.2 Sustainable innovation

Through sustainable innovation we create sustainable lighting solutions that help contribute to the 17 United Nations Sustainable Development Goals (SDG's). We have a clear focus on SDG 7 Affordable and clean energy, SDG 11 Sustainable cities and communities, SDG 12 Responsible consumption production, and SDG 13 Climate action. Our sustainable products and systems must demonstrate proven measurable benefits in one or more of the eight sustainable focal areas (SFAs) compared to the relevant annually updated benchmark.

- energy
- packaging
- substances
- weight & materials
- circularity
- access to light
- basic needs
- human centric lighting.

With a 2017 investment of EUR 277 million in sustainable innovation, we invested a higher amount compared to 2016 (EUR 272 million), and the relative amount also increased by three percentage points. 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 (circularity). At the same time, sustainable innovation also addresses social needs such as access to light, basic needs and Human Centric Lighting.

Philips Lighting
**Sustainable innovation** in mEUR
2015 - 2017




**Circular economy**
At Philips Lighting, we consider the transition to a circular economy as 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. 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 this fifth year of our circular economy program, the design of our 'Circular Economy ready' luminaires was finalized and brought to market.

### Circular lighting in the High-Tech Campus parking garages

The High-Tech Campus in Eindhoven has engaged in a 10-year Circular lighting contract. Philips Lighting will retain responsibility for the lighting performance and for optimal use and reuse of products and materials. Philips Lighting applied its Pacific LED first-of-a-kind 'Circular Economy ready' luminaires, which were designed for traceability, serviceability, recycling, upgrade options, as well as parts harvesting. The High-Tech Campus opted to combine this lighting with a lighting system, which helps ensure the lights only switch on where and when it is needed. The combination of these types of luminaires and the accompanying system will save at least 70% on energy consumption in their parking garages.

Scientific evidence proves that lighting does much more than provide illumination. Researchers have found that light has the potential to provide visual, biological and emotional benefits. At Philips Lighting, these insights help us innovate commercial lighting solutions to target enhanced vision, well-being, and performance, supporting our mission to bring light beyond illumination.

In 2017, we further enhanced the internal evidence-based-classification-system, to identify products that meet our Human Centric Lighting requirements - helping people to see, feel, and function better.

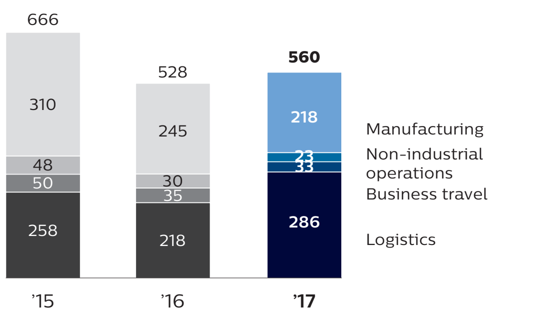
### Deloitte's London office achieves the WELL standard through our lighting

The WELL Building standard focuses on the health and wellness of building occupants. In 2017, Philips Lighting provided Deloitte's London office with a human centric lighting solution that met all WELL lighting requirements. With it, the light output is automatically catered to the circadian rhythm, thereby ensuring the brightness and tone of office lighting aligns with energy patterns and needs.

## 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.

Philips Lighting
**Operational carbon footprint** in kilotonnes $CO_2$-equivalent
2015 - 2017




In 2017, our $CO_2$ emissions increased by 6% year-on-year, resulting in a total of 560 kilotonnes in $CO_2$ emissions. This was especially due to an increase in emissions from logistics.

Through our partnership with the South Pole Group, we initiated several strategic projects that target forest conservation in Colombia and increased the availability of renewable electricity through wind farms in India, and small-scale hydro plants in China. These projects enabled us to prevent 235 kilotonnes of $CO_2$ being emitted into the atmosphere, thereby offsetting 42% of our own emissions, resulting in a net carbon footprint of 325 kilotonnes which is 20% lower than our net $CO_2$ footprint in 2016.

### Engaging employees on carbon emissions

To increase employee engagement on our carbon neutral commitment, Philips Lighting organized an employee vote to select a project to invest in. Three projects were proposed, with each offering a different choice in terms of carbon reduction mechanism, scale, and location. In the end a reforestation project in Colombia won, which is now in our portfolio of carbon offsetting projects.

### Manufacturing

Accounting for 39% of our operational carbon footprint, $CO_2$ emissions from manufacturing decreased 11%. This was achieved mainly due to operational changes and efficiency improvements, for instance relating to optimized heating systems.

### Non-industrial operations

$CO_2$ emissions from non-industrial operations (offices, warehouses) represent 4% of our total emissions. In 2017 our emissions decreased by 21% year-on-year, primarily through increased renewable electricity usage.

### Logistics

Overall, $CO_2$ emissions from logistics, which make up 51% of our total, increased by 31%. This was due to a changed modality mix and an overall increase in freight.

Philips Lighting
**Operational carbon footprint for logistics**
in kilotonnes $CO_2$-equivalent
2015-2017

| | 2015 | 2016 | 2017 |
|---|---|---|---|
| Air transport | 121 | 77 | 143 |
| Road transport | 53 | 50 | 49 |
| Ocean transport | 84 | 91 | 94 |
| **Total Philips Lighting** | **258** | **218** | **286** |

### Business travel

Our $CO_2$ emissions relating to business travel account for 6% of our operational carbon footprint. The $CO_2$/km ratio of our car fleet improved again year-on-year. Due to a more stringent travel policy, air travel has also come down by 11%. This resulted in an overall decrease of 6% year-on-year.

Philips Lighting
**Operational carbon footprint by GHG**
in kilotonnes $CO_2$-equivalent
2015-2017

| | 2015 | 2016 | 2017 |
|---|---|---|---|
| Scope 1 | 221 | 187 | 185 |
| Scope 2 (market based) | 137 | 88 | 56 |
| Scope 3 | 308 | 253 | 319 |
| **Total Philips Lighting** | **666** | **528** | **560** |
| **Scope 2 (location based)** | **284** | **236** | **242** |

### Energy use in operations

Total energy usage amounted to 4,408 terajoules in 2017. This is a decrease of 1% year-on-year. This minor decrease was caused by energy efficiency improvements in our factories, offset by reporting changes. In 2017, environmental results from our manufacturing activities in Saudi Arabia came into scope for the first time.

### Electricity

As a proud member of the RE100 since 2015, we are committed to using only 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 have been fully powered through renewable sources since December 2016.

In 2017, our electricity used across Europe came from renewable sources. In addition, we were the first international company to secure renewable energy consumption in the Gulf region using the pioneering International REC Standard (I-REC).

## Operations in the Gulf region powered by renewable electricity

In July 2017, Philips Lighting announced it was the first major international company to purchase traceable renewable electricity in the Gulf region using the pioneering International REC Standard (I-REC). Through collaboration with ECOHZ, I-RECs were purchased from Dubai Electricity and Water Authority (DEWA's) Mohammed bin Rashid Al Maktoum Solar Park in Dubai. Living up to the commitments outlined in our company's sustainability vision, Brighter Lives, Better World, this first of its kind transaction added to the growing number of Philips Lighting operations fully powered by renewable electricity.

In 2017, we procured 80% of our electricity from renewable sources. Approximately 55% of our renewable electricity is contracted via our energy providers. The remaining 45% was sourced through the procurement of renewable energy certificates, of which 56% came from our participation in power-purchase agreements.

Philips Lighting
**Ratios relating to carbon emissions and energy use**
2015-2017

| | 2015 | 2016 | 2017 |
|---|---|---|---|
| Operational $CO_2$ emissions in kilotonnes $CO_2$-equivalent | 666 | 528 | 560 |
| Operational $CO_2$ efficiency in tonnes $CO_2$-equivalent per million euro sales | 89 | 74 | 80 |
| Operational energy use in terajoules | 5,213 | 4,460 | 4,408 |
| Operational energy efficiency in terajoules per million euro sales | 0.70 | 0.63 | 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 2016, we launched a five-year program that targets all our manufacturing sites to send zero waste to landfill by 2020. In 2017, we were able to effectively reduce the amount of waste sent to landfill by 26% compared to 2016, thereby ensuring that the waste from daily operations is recycled, re-used or incinerated.

Our recycling programs address waste arising from manufacturing activities and offices, such as glass or canteen waste, as well as from suppliers, such as packaging materials.

In 2017, total waste amounted to 42.7 kilotonnes. This is an increase of 7% compared to 2016. The increase is mainly due to reporting changes, as the environmental impact from our manufacturing activities in Saudi Arabia came into scope for the first time in 2017.

Total waste consists of waste that is delivered for landfill, incineration or recycling. 87% of total waste was recycled (2016: 85%).

Philips Lighting
**Total waste**
2015-2017

| | 2015 | 2016 | 2017 |
|---|---|---|---|
| Kilotonnes | 45 | 40 | 43 |
| % recycled | 85% | 85% | 87% |

## 16.3.5 Chemical substances in production processes

We prioritize the safe management of chemicals to ensure that we minimize the risks of the use of these substances related to the environment, society and our employees in their daily work. If there are threats of harm to human safety or the environment, we proactively search for effective alternatives.

We have a robust approach to identify and manage 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 hazardous substances.

Total emissions from Mercury and Mercury compounds totaled 6 kilograms in 2016. The target to achieve emissions As Low As Reasonably Achievable (ALARA) was met in 2015. Philips Lighting continues to closely monitor usage, emissions and exposure, to determine if further improvement opportunities are possible.

**Emissions from Mercury**
Since 2012 we have been able to drastically decrease the emissions from mercury by changing our production processes and through replacing liquid mercury by solid state mercury. Since then, the emissions from mercury have remained stable.

Philips Lighting
**Emissions from Mercury** in kilograms
2015-2017

| | 2015 | 2016 | 2017 |
|---|---|---|---|
| Mercury and Mercury compounds | 7 | 6 | 5 |

**Emissions from volatile organic compounds (VOCs) in lacquering processes**
Due to improvements in operations relating to the coating of products, the application of targeted VOCs was extensively reduced and is now limited to small quantities of hand-sprayed, customized order batches. Philips Lighting continues to phase out styrene in resins, used for impregnation.

Philips Lighting
**Emissions of VOCs in lacquering processes**
2015-2017

| | 2015 | 2016 | 2017 |
|---|---|---|---|
| Lead and lead compounds | 6 | 3 | 2 |
| Styrene | 1,231 | 1,119 | 909 |
| Toluene | 132 | 99 | 92 |
| Xylene | 1,339 | 695 | 644 |
| **Emissions from category 2 substances** | **2,708** | **1,916** | **1,645** |

### 16.3.6 Water

As we expand our portfolio of 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 was 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 2017 was 1,321 million $m^3$, compared to 1,451 million $m^3$ in 2016.
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 a rationalization of our industrial footprint.

Philips Lighting
**Water intake** in thousands of $m^3$
2015-2017

| | 2015 | 2016 | 2017 |
|---|---|---|---|
| Total water | 1,751 | 1,451 | 1,321 |

### 16.3.7 Environmental incidents

In 2017, Philips Lighting experienced no significant environmental incidents. However, three instances of non-compliance were reported, of which two related to waste water disposal. These incidents were resolved in a satisfactorily manner and did not result in any fine.

# 17. Combined independent auditor's report

## Combined independent auditor's report on the 2017 financial statements and sustainability information

To: the Annual General Meeting of Shareholders and Supervisory Board of Philips Lighting N.V.

**Our conclusions**
We have audited the financial statements 2017 of Philips Lighting N.V. (hereinafter the Company) 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, 2017 and of its result and its cash flows for 2017 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, 2017 and of its result for 2017 in accordance with Part 9 of Book 2 of the Dutch Civil Code

We have audited the sustainability information in the annual report for the year 2017 of Philips Lighting N.V. based in Eindhoven, the Netherlands. The scope is described in section Our Scope. An audit engagement is aimed at obtaining reasonable assurance.

In our opinion, the sustainability information presents, in all material respects, a reliable and adequate view of:
- the policy and business operations with regard to sustainability;
- the thereto related events and achievements for the year 2017.

in accordance with the Sustainability Reporting Standards (option Comprehensive) of the Global Reporting Initiative (GRI) and the applied supplemental reporting criteria as disclosed in section 16.1 Approach to sustainability reporting of the annual report 2017 of Philips Lighting N.V. (hereafter: the annual report).

## Basis for our conclusions

We performed our assurance engagements in accordance with Dutch law, including the Dutch Standards on Auditing and the Dutch Standard 3810N, "Assurance engagements relating to sustainability reports", which is a specified Dutch Standard that is based on the International Standard on Assurance Engagements (ISAE) 3000, "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information". Our responsibilities under those standards are further described in the section Our responsibilities in this report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our conclusions.

**Our independence**
We are independent of Philips Lighting N.V. in accordance with the EU Regulation on specific requirements regarding statutory audit of public-interest entities, the Wet toezicht accountantsorganisaties (Wta, Audit firms supervision act), 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. This includes that we do not perform any activities that could result in a conflict of interest with our independent assurance engagements. Furthermore, we have complied with the "Verordening gedrags- en beroepsregels accountants (VGBA, Dutch Code of Ethics)".

## Our scope

**Our engagements scope**
The Consolidated financial statements comprise:
- The Consolidated balance sheet as at December 31, 2017
- The following statements for 2017: the Consolidated statements of income, comprehensive income, changes in equity and cash flows
- 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, 2017
- The company statements of income and changes in equity for 2017
- The notes comprising a summary of the accounting policies and other explanatory information

The sustainability information is included in chapter 3 Our strategic focus, section 4.2 Sustainability performance and chapter 16 Sustainability statements, in the annual report.

**Limitations to the scope of our audit engagement comprising the sustainability information**

### Unexamined prospective information

The sustainability information includes prospective information, such as ambitions, strategy, plans, expectations and estimates. Inherently, the actual future results are uncertain. We do not provide any assurance on the assumptions and achievability of prospective information in the sustainability information.

### Unaudited references to external sources

The references to external sources or websites in the sustainability information, with the exception of the Methodology for calculating societal impact and the Supplement to the 2017 sustainability statements (supplement 1 and 2), are not part of the sustainability information as audited by us. We therefore do not provide assurance on this information.

### Unaudited corresponding information

We do not provide assurance on the corresponding sustainability figures related to 2015.

## Materiality

**General**

The scope of our audit procedures is influenced by the application of materiality. Our assurance engagements aim to provide assurance about whether the financial statements and the sustainability information are free from material misstatement. Misstatements may arise due to fraud or error. They are considered to be 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 financial statements and the sustainability information. The materiality affects the nature, timing and extent of our assurance procedures and the evaluation of the effect of identified misstatements on our conclusions.

**Financial statements**

For the audit of the financial statements our considerations regarding the materiality are as follows:

| | |
|---|---|
| Materiality | € 26 million (2016: € 17 million) |
| Benchmark used | 5.0% of adjusted income before taxes |
| Additional explanation | Based on our professional judgment we consider earnings-based measures as the most appropriate basis to determine materiality. |

We have also taken into account misstatements 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 € 1.1 million, which are identified during the audit, would be reported to them, as well as smaller misstatements that in our view must be reported on qualitative grounds.

**Sustainability information**

Based on our professional judgment we determined materiality levels for each part of the sustainability information and for the sustainability information as a whole. When evaluating our materiality levels, we have taken into account quantitative and qualitative considerations as well as the relevance of information for both stakeholders and the organization.

## Our scope for the group audit of the financial statements

Philips Lighting N.V. is parent of a group of entities. The financial information of this group is included in the Consolidated financial statements of Philips Lighting N.V.

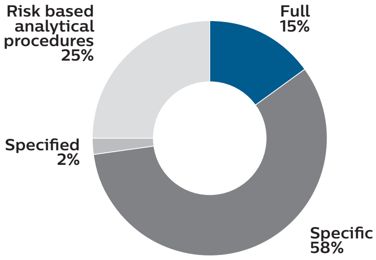
Following our assessment of the risk of material misstatement to Philips Lighting N.V.'s Consolidated financial statements, we have selected 2 components which required an audit of the complete financial information (Full Scope Components) and 29 components requiring audit procedures on specific account 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.

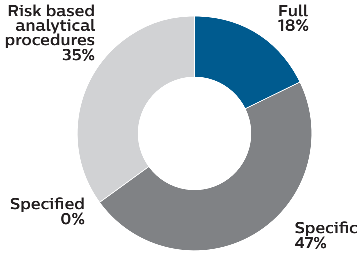
Of the remaining components, we performed risk based analytical procedures to respond to any potential risks of material misstatements to the financial statements.

Accordingly, our audit coverage of the group's sales and total assets can be summarized as follows:

**Assets**




**Sales**




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 about the Consolidated financial statements.

## Our key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our assurance procedures for the financial statements and the sustainability information. We have communicated the key audit matters to the supervisory board. The key audit matters are not a comprehensive reflection of all matters discussed.

These matters were addressed in the context of our audit procedures for the financial statements and the sustainability information as a whole and to conclude thereon, and we do not provide a separate opinion on these matters.

For the audit of the financial statements we identified the following key audit matters.
The key audit matter "initial audit engagement" which was included in our 2016 audit, is not a key audit matter in the 2017 audit because 2017 is not an initial audit. The operations in the Kingdom of Saudi Arabia (KSA) resulted in increased audit risks, we therefore have added "operations in KSA" as a key audit matter in 2017.

### Improper revenue recognition and risk of management override

| | |
|---|---|
| **Key audit matter** | Sales are recognized when the risks and rewards of goods 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.<br><br>We assessed that improper revenue recognition, specifically related to cut-off, represents a significant risk. The recognition of revenues of transactions that have separately identifiable components are dependent on fulfillment of the contractual sales conditions. These transactions mainly occur in the Professional business. |
| **How our audit addressed the matter** | Our audit procedures included the assessment of the appropriateness of the Company's revenue recognition accounting policies and the compliance with IFRS as endorsed by the EU. 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 and revenues of transactions that have separately identifiable components in the Professional business.<br><br>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, and note 5. |
| **Key observations** | Based on the procedures performed, we did not identify any evidence of material misstatement in the revenue recognized relating to the sales of goods or revenues of transactions that have separately identifiable components in the year nor in amounts deferred as of December 31, 2017. |

### Valuation of goodwill

| | |
|---|---|
| **Key audit matter** | At December 31, 2017, the total carrying value of goodwill amounted to € 1,694 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. The determination of the carrying value of goodwill is based on significant judgement and a complex valuation method. 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 impairment test to support the recoverable amount of goodwill as disclosed in note 14. |
| **How our audit addressed the matter** | As part of our audit, we assessed and tested the assumptions, methodologies, and data used by the company in their impairment test, 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.<br><br>We specifically focused on the sensitivity of the headroom in the CGU Professional and whether a reasonably possible change in assumptions could cause the carrying amount to exceed its recoverable amount.<br><br>We assessed the adequacy of the company's disclosure around goodwill as included in note 14 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. |
| **Key observations** | We consider management's assumptions to be within a reasonable range.<br><br>We note that the Company concluded from its impairment tests that headroom for the CGU Professional increased compared to 2016.<br><br>We concur with management's conclusion that no impairment of goodwill is required as at December 31, 2017. |

### Valuation of deferred tax assets and liabilities for uncertain tax positions

| | |
|---|---|
| **Key audit matter** | The accounting for deferred tax assets and tax risk liabilities was 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.<br><br>At December 31, 2017, the net deferred tax assets are valued at € 440 million and the other tax liability related to tax uncertainties is valued at € 97 million. Further reference is made to note 11 to the Consolidated financial statements. |
| **How our audit addressed the matter** | 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.<br><br>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.<br><br>We evaluated and challenged the Company's judgments in respect to estimates of tax exposures in consideration of ongoing local tax authority audits, legislative developments, and relevant historical and recent judgements.<br><br>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 11 in respect to deferred tax assets and other tax liabilities related to tax uncertainties. |
| **Key observations** | The reduction of the federal income tax rate in the United States and foreign currency translation differences resulted in a decrease of the deferred tax assets relating to Pensions and other postretirement benefits and Tax loss carryforwards of € 30 million recognized in equity.<br><br>We did not identify any evidence of material misstatement of deferred tax assets and uncertain tax positions as recorded in the year-end balance sheet. |

### Organizational change

| | |
|---|---|
| **Key audit matter** | During 2017 Philips Lighting N.V. continued the process to disentangle from Royal Philips by tailoring corporate functions and IT systems. In addition, a finance transformation program was initiated to review the various finance departments.<br><br>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 transition 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. |
| **How our audit addressed the matter** | Our audit procedures included, amongst others, discussions with management and various departments within the Company to corroborate that the post separation process took place in an orderly fashion and that no internal control or IT performance issues occurred as a result of the process.<br><br>Together with our IT audit specialists we have obtained an understanding of the post separation IT landscape and tested the effectiveness of the IT related internal controls.<br><br>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. |
| **Key observations** | We did not identify any evidence of material misstatement on the charges for restructuring and the valuation of related assets and liabilities as at December 31, 2017. |

**Operations in KSA**

| | |
|---|---|
| **Key audit matter** | The Company's business in the Kingdom of Saudi Arabia (KSA) has been acquired in 2014 and has a minority shareholder. The business is not yet fully integrated from a system and process perspective, and the internal control environment requires improvement. Due to the continued poor market conditions in KSA, the ageing of receivables has special attention from management. |
| **How our audit addressed the matter** | Together with our local team, we have performed additional substantive audit procedures in respect of the valuation of receivables and revenue recognition. In addition, we have reviewed the procedures performed by the Company's internal audit department and the other procedures performed by the Company to address these risks. |
| **Key observations** | Based on the procedures performed, we did not identify any evidence of material misstatement in the revenue recognized in the year in respect of the Company's KSA operations nor in the related receivables as of December 31, 2017. |

For the audit of the sustainability information, we identified the following key audit matters:

**Reporting criteria for sustainable revenues**

| | |
|---|---|
| **Key audit matter** | Sustainable revenues is an important key performance *indicator (KPI) in the sustainability strategy*. This KPI is based on reference products which are continuously improving in time. |
| **How our audit addressed the matter** | Our audit procedures focused on evaluating whether the self-developed reporting criteria for this indicator are suitable and consistently applied, and assessing whether the disclosure of the reporting criteria in the annual report is sufficient for a proper understanding by the reader. |
| **Key observations** | We concur with the criteria, its application by management and the disclosures made by management. |

**Estimates and assumptions for calculating the environmental and social impact of the value creation model**

| | |
|---|---|
| **Key audit matter** | Inherent to the nature of calculation environmental and social impact is that these calculations are to a large extent based on estimates and assumptions. |
| **How our audit addressed the matter** | Our audit procedures focused on evaluating whether the methodology is suitable and assessing the reasonableness of estimates and assumptions. Furthermore we reviewed whether the related disclosures in the annual report and in the additional methodology document are adequate. |
| **Key observations** | We concur with the methodologies applied, the estimations and assumptions made by management and the sufficiency of the related disclosures. |

## 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 or the sustainability information.

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 initially engaged as the auditor of Koninklijke Philips N.V. 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.

**No prohibited non-audit services**
We have not provided prohibited non-audit services as referred to in Article 5(1) of the EU Regulation on specific requirements regarding statutory audit of public-interest entities.

## Responsibilities

**Responsibilities of management and the supervisory board**
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.

Management is also responsible for the preparation of the sustainability information in accordance with the Sustainability Reporting Standards (option Comprehensive) of GRI and the applied supplemental reporting criteria as disclosed in section 16.1 Approach to sustainability reporting of the annual report, including the identification of stakeholders and the determination of material issues. The choices made by management regarding the scope of the sustainability information and the reporting policy are summarized in section 16.1 Approach to sustainability reporting of the annual report.

Furthermore, management is responsible for such internal control as management determines is necessary to enable the preparation of the financial statements and the sustainability information that are free from material misstatement, whether due to fraud or errors.

As part of the preparation of the financial statements, management is responsible for assessing the company's ability to continue as a going concern. Based on the financial reporting frameworks mentioned, management should prepare the financial statements using the going concern basis of accounting unless management either intends to liquidate the company or to cease operations, or has no realistic alternative but to do so. 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**
Our responsibility is to plan and perform the assurance engagements in a manner that allows us to obtain sufficient and appropriate assurance evidence for our conclusions.

Our audit of the financial statements and our audit of the sustainability information have 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 the financial statements and 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 conclusions.

We apply the 'Nadere voorschriften kwaliteitssystemen' (Regulations for Quality management systems) and accordingly maintain a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and other applicable legal and regulatory requirements.

A further description of our responsibilities is included in the Annex to the combined auditor's report.

Amsterdam, The Netherlands,
February 27, 2018

Ernst & Young Accountants LLP

O.E.D. Jonker

## Annex to the combined independent auditor's report

**Work performed**
We have exercised professional judgement and have maintained professional skepticism throughout the assurance engagements performed by a multi-disciplinary team, in accordance with Dutch Standards on Auditing and the Dutch Standard 3810N, "Assurance engagements relating to sustainability reports", ethical requirements and independence requirements.

Our audit to obtain reasonable assurance about the financial statements (Consolidated and corporate) included the following:
- 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 the 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.

Our audit to obtain reasonable assurance about the sustainability information included the following:
- Performing an external environment analysis and obtaining insight into relevant social themes and issues and the characteristics of the organization.
- Obtaining an understanding of the value creation model of the Company.
- Evaluating the appropriateness of the reporting criteria used, their consistent application and related disclosures in the sustainability information, including the evaluation of the results of the stakeholders' dialogue and the reasonableness of estimates made by management.
- Obtaining an understanding of the systems and processes for collecting, reporting and consolidating the sustainability information, including obtaining an understanding of internal control relevant to our audit;
- Reconciling the relevant financial information with the financial statements.
- Identifying and assessing the risks of material misstatement of the sustainability information, whether due to errors or fraud, designing and performing further 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. These further procedures consisted amongst others of:
  - Interviewing management and relevant staff at corporate and local level responsible for the sustainability strategy, policies and results.
  - Interviewing relevant staff responsible for providing the information as disclosed in the sustainability information, carrying out internal control procedures on the data and consolidating the data in the sustainability information.
  - Visits to production sites in China (PETEC), Poland (Pila) and United States (Salina) aimed at, on a local level, validating source data and to evaluate the design, implementation and operation of control validation procedures.
  - Evaluating relevant internal and external documentation, on a test basis, to determine the reliability of the information in the sustainability information; and
  - An analytical review of the data and trends submitted for consolidation at corporate level.
  - Evaluating the presentation, structure and content of the sustainability information as a whole, including the disclosures, in relation to the reporting criteria used.

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. Decisive were the size and/or the risk profile of the group entities or operations. On this basis, 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 assurance procedures and significant findings, including any significant findings in internal control that we identify during our assurance engagements. In this respect we also submit an additional report to the audit committee in accordance with Article 11 of the EU Regulation on specific requirements regarding statutory audit of public-interest entities. The information included in this additional report is consistent with our audit opinion in this auditor's report.

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 and the audit of the sustainability information of the current period and are therefore the key audit matters. We describe these matters in our combined auditor's report and assurance 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.

# 18. 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 items such 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, changes in consolidation (second order effects) and regulatory changes 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 %
2017

| | Comparable growth | Currency effects | Consolidation changes | Nominal growth |
|---|---|---|---|---|
| Lamps | (18.6) | (1.2) | (2.1) | (22.0) |
| LED | 13.8 | (1.8) | 0.3 | 12.2 |
| Professional | 4.6 | (1.8) | (0.1) | 2.7 |
| Home | 26.5 | (1.9) | (2.3) | 22.3 |
| Other | (83.7) | (1.9) | - | (85.6) |
| **Total** | **0.5** | **(1.6)** | **(1.0)** | **(2.1)** |

Philips Lighting
**Sales growth composition per market** in %
2017

| | Comparable growth | Currency effects | Consolidation changes | Nominal growth |
|---|---|---|---|---|
| Europe | 4.5 | (0.7) | (0.1) | 3.8 |
| Americas | (2.3) | (1.6) | (0.3) | (4.2) |
| Rest of the World | (0.8) | (3.0) | (0.4) | (4.2) |
| Global businesses | 1.0 | (0.3) | (10.7) | (10.0) |
| **Total** | **0.5** | **(1.6)** | **(1.0)** | **(2.1)** |

## EBITA and Adjusted EBITA

The company discloses EBITA, Adjusted EBITA and Adjusted EBITA ratio as supplemental non-IFRS financial measures, as the company believes these 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 and impairment of acquisition related intangible assets and goodwill, which arises when acquisitions are consolidated by the company. In the case of Adjusted EBITA and Adjusted EBITA ratio, the company believes that these measures 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
2016-2017

| | Philips Lighting | Lamps | LED | Profes-sional | Home | Other |
|---|---|---|---|---|---|---|
| **2017** | | | | | | |
| Adjusted EBITA | 699 | 370 | 174 | 225 | 36 | (106) |
| Restructuring | (125) | (41) | (5) | (45) | (4) | (29) |
| Acquisition related charges | – | – | – | – | – | – |
| Incidental items | (3) | 21 | – | – | – | (24) |
| **EBITA** | **571** | **350** | **169** | **181** | **31** | **(160)** |
| Amortization [1] | (130) | (1) | (4) | (119) | (5) | (2) |
| **Income from operations (or EBIT)** | **441** | **349** | **165** | **62** | **27** | **(161)** |
| **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 [1] | (110) | (2) | (4) | (102) | (2) | – |
| **Income from operations (or EBIT)** | **369** | **433** | **136** | **(9)** | **(48)** | **(143)** |

1) Amortization and impairment of acquisition related intangible assets and goodwill.

## Adjusted gross margin

The company discloses adjusted gross margin as a supplemental non-IFRS financial measure. 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. The measure factors out restructuring costs, acquisition related charges and incidental charges attributable to cost of sales which are not directly related to the operational performance of the company. Adjusted gross margin is also used by the company as a key financial measure to assess the operating performance of the company.

Philips Lighting
**Adjusted gross margin** in mEUR unless otherwise stated
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Sales | 7,115 | 6,965 |
| Cost of sales | (4,438) | (4,264) |
| **Gross margin** | **2,677** | **2,701** |
| Restructuring | 85 | 51 |
| Acquisition related charges | – | – |
| Incidental items | 1 | 1 |
| **Adjusted gross margin** | **2,763** | **2,752** |
| Adjusted gross margin % | 38.8% | 39.5% |

## 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. 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. The measure factors out restructuring costs, acquisition related charges and incidental charges attributable to SG&A and R&D costs which are not directly related to the operational performance of the company. Adjusted SG&A costs and adjusted R&D costs are 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
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Selling expenses | (1,750) | (1,738) |
| G&A expenses | (248) | (221) |
| **SG&A expenses** | **(1,998)** | **(1,959)** |
| Restructuring | 17 | 58 |
| Acquisition related charges | 3 | – |
| Incidental items | 61 | 44 |
| **Adjusted SG&A expenses** | **(1,917)** | **(1,857)** |
| Adjusted SG&A expenses % | (26.9%) | (26.7%) |

In 2017, restructuring includes a EUR 4 million and incidental items a EUR 20 million impairment of acquisition related intangible assets which are not part of Adjusted EBITA. In 2016, no such impairment was included.

Philips Lighting
**Adjusted R&D costs** in mEUR unless otherwise stated
2016-2017

| | 2016 | 2017 |
|---|---|---|
| R&D expenses | (353) | (354) |
| **R&D expenses** | **(353)** | **(354)** |
| Restructuring | 13 | 20 |
| Acquisition related charges | - | - |
| Incidental items | - | - |
| **Adjusted R&D expenses** | **(340)** | **(334)** |
| Adjusted R&D expenses % | (4.8%) | (4.8%) |

Philips Lighting
**Adjusted indirect costs** in mEUR unless otherwise stated
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Selling expenses | (1,750) | (1,738) |
| G&A expenses | (248) | (221) |
| R&D expenses | (353) | (354) |
| **Indirect costs** | **(2,351)** | **(2,313)** |
| Restructuring | 30 | 78 |
| Acquisition related charges | 3 | - |
| Incidental items | 61 | 44 |
| **Adjusted indirect costs** | **(2,257)** | **(2,191)** |
| Adjusted indirect costs % | (31.7%) | (31.5%) |

## Other adjusted EBITA items

Other adjusted EBITA items are other business income (expenses) which exclude incidental items. The information is presented for the reconciliation of Adjusted EBITA.

Philips Lighting
**Adjusted other business income (expenses)** in mEUR unless otherwise stated
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Other business income | 60 | 72 |
| Other business expenses | (15) | (18) |
| **Other business income (expenses)** | **45** | **54** |
| Restructuring | - | - |
| Acquisition related charges | - | - |
| Incidental items | (14) | (22) |
| **Adjusted other business income (expenses)** | **31** | **32** |
| Adjusted other business income (expenses) % | 0.4% | 0.5% |

## 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
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Cash flows from operating activities | 505 | 435 |
| Cash flows from investing activities | (62) | (26) |
| **Cash flows before financing activities** | **443** | **409** |
| | | |
| Cash flows from operating activities | 505 | 435 |
| Net capital expenditures: | | |
| • Additions of intangible assets | (30) | (20) |
| • Capital expenditures on property, plant and equipment | (79) | (76) |
| • Proceeds from disposal of property, plant and equipment | 22 | 64 |
| **Free cash flow** | **418** | **403** |

## 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 unless stated otherwise
2016-2017

| | 2016 | 2017 |
|---|---|---|
| Short-term debt | 155 | 140 |
| Short-term loans payable to Royal Philips | 2 | - |
| Long-term debt | 1,224 | 1,170 |
| **Gross debt** | **1,381** | **1,309** |
| Cash and cash equivalents | 1,040 | 942 |
| **Net debt (cash)** [1] | **341** | 367 |
| | | |
| Shareholders' equity | 2,704 | 2,242 |
| Non-controlling interests | 104 | 79 |
| **Total equity** | **2,808** | **2,321** |
| | | |
| Net debt and total equity | 3,149 | 2,688 |
| Net debt divided by net debt and total equity (in %) | 11% | 14% |
| Total equity divided by net debt and total equity (in %) | 89% | 86% |

1) Gross 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
2016-2017

| | 2016 | 2017 |
|---|---|---|
| **Working capital** | **662** | **557** |
| Eliminate liabilities comprised in the working capital | | |
| • Accounts and notes payable | 1,024 | 1,001 |
| • Accrued liabilities | 502 | 475 |
| • Derivative financial liabilities | 26 | 8 |
| • Income tax payable | 57 | 79 |
| • Other current liabilities | 346 | 309 |
| Include assets not comprised in working capital | | |
| • Non-current assets | 3,795 | 3,306 |
| • Cash and cash equivalents | 1,040 | 942 |
| • Assets classified as held for sale | 3 | 1 |
| **Total assets** | **7,455** | **6,678** |

# 19. 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 other 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 other incidental items attributable to cost of sales.

**Adjusted indirect costs**
Indirect costs, excluding restructuring costs, acquisition related charges and other incidental items attributable to indirect costs.

**Adjusted research and development (R&D) expenses**
Research and development expenses, excluding restructuring costs, acquisition related charges and other 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 other 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 specific 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 and other changes.

**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).

**EBIT**
Income from operations.

**EBITA**
Income from operations excluding amortization and impairment of acquisition related intangible assets and goodwill.

**EBITDA**
Income from operations excluding depreciation, amortization and impairment 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. Other changes include regulatory changes and changes originating from new accounting standards.

**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 debt**
The sum of short-term debt and long-term debt

**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. Other 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 consolidated adjusted 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 (the "Company") 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.

**Responsible Business Alliance (RBA)**
The Responsible Business Alliance (RBA, formerly known as 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 RBA now includes more than 100 global companies and their suppliers.

**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). 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 income tax rate**
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 is the aggregation of the result before tax multiplied by the applicable statutory tax rate without adjustment for losses, divided by the company 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 waste to landfill, only regular operational non-hazardous waste is considered. When more than 99% of the total operational waste generated of a site is diverted from landfill, a site is considered to qualify as sending 'zero waste to landfill'.

# 20. 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, of this Annual Report 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. 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, 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 18, 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

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.

### Regulated information

This document contains regulated information within the meaning of the EU Transparency Directive.