KONINKLIJKE PHILIPS ELECTRONICS NV
Form 20-F
February 19, 2008

As filed with the Securities and Exchange Commission on February 19, 2008

**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**WASHINGTON, D.C. 20549**
**Form 20-F**

(Mark one)

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

**For the fiscal year ended December 31, 2007**

**OR**

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

**For the fiscal year ended December 31, 2007**

**OR**

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

**OR**

o **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**Commission file number 001-05146-01**

**KONINKLIJKE PHILIPS ELECTRONICS N.V.**
(Exact name of Registrant as specified in charter)

**ROYAL PHILIPS ELECTRONICS**
(Translation of Registrant s name into English)

**The Netherlands**
(Jurisdiction of incorporation or organization)

**Breitner Center, Amstelplein 2, 1096 BC Amsterdam, The Netherlands**
**(Address of principal executive office)**

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

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

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

**None**

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

**Common Shares par value Euro (EUR) 0.20 per share**
(Title of class)

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

| Class | Outstanding at December 31, 2007 |
|---|---|
| **Koninklijke Philips Electronics N.V.** | 1,064,893,254 shares |

Common Shares par value EUR 0.20 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

þ Yes o No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934.

o Yes þ No

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

þ Yes o No

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark which financial statement item the registrant has elected to follow.

o Item 17 þ Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

o Yes þ No

**Table of contents**
**Introduction**


| | | Page |
|---|---|---|
| **Part I** | | |
| Item 1. | Identity of directors, senior management and advisors | 4 |
| Item 2. | Offer statistics and expected timetable | 4 |
| Item 3. | Key information | 4 |
| Item 4. | Information on the Company | 8 |
| Item 4A. | Unresolved Staff Comments | 26 |
| Item 5. | Operating and financial review and prospects | 27 |
| Item 6. | Directors, senior management and employees | 78 |
| Item 7. | Major shareholders and related party transactions | 79 |
| Item 8. | Financial information | 79 |
| Item 9. | The offer and listing | 80 |
| Item 10. | Additional information | 81 |
| Item 11. | Quantitative and qualitative disclosures about market risk | 84 |
| Item 12. | Description of securities other than equity securities | 84 |
| **Part II** | | |
| Item 13. | Defaults, dividend arrearages and delinquencies | 84 |
| Item 14. | Material modifications to the rights of security holders and use of proceeds | 84 |
| Item 15. | Controls and procedures | 84 |
| Item 16A. | Audit Committee Financial Expert | 84 |
| Item 16B. | Code of Ethics | 84 |
| Item 16C. | Principal Accountant Fees and Services | 85 |
| Item 16D. | Exemptions from the Listing Standards for Audit Committees | 85 |
| Item 16E. | Purchases of Equity Securities by the Issuer and Affiliated Purchasers | 85 |
| **Part III** | | |
| Item 17. | Financial statements | 86 |
| Item 18. | Financial statements | 86 |
| Item 19. | Exhibits | 86 |

Exhibit 4(a)
Exhibit 4(c)
Exhibit 4(g)
Exhibit 8
Exhibit 12(a)
Exhibit 12(b)
Exhibit 13(a)
Exhibit 13(b)
Exhibit 15(a)
Exhibit 15(b)
Exhibit 15(c)
Exhibit 15(d)
Exhibit 15(e)

**Table of Contents**

In this report amounts are expressed in euros ( euros or EUR ) or in US dollars ( dollars , US $ or $ ).

Introduction

Specific portions of Philips Annual Report 2007 to Shareholders (the 2007 Annual Report ) are incorporated by reference in this report on Form 20-F to the extent noted herein. Philips 2007 Annual Report (except for the omitted portions thereof identified in the following sentence) is attached hereto as Exhibit 15(d). The Annual Report to Shareholders for 2007 is furnished to the Securities and Exchange Commission for information only and the Annual Report to Shareholders is not filed except for such specific portions that are expressly incorporated by reference in this Report on Form 20-F. Furthermore, the International Financial Reporting Standards (IFRS) financial statements and related notes on pages 188 through 239 of the Annual Report to Shareholders, and the unconsolidated Company financial statements, including the Notes thereto, also prepared on the basis of IFRS, on pages 240 through 245 of the Annual Report to Shareholders, have been omitted from the version of such Report being furnished as an exhibit to this Report on Form 20-F. The IFRS financial statements and Company statements have been omitted because Philips primary consolidated accounts are prepared in accordance with accounting principles generally accepted in the United States and Philips is not required to include in this Report on Form 20-F the IFRS financial statements and Company statements.

In presenting and discussing the Philips Group s financial position, operating results and cash flows, management uses certain non-US GAAP financial measures like: comparable growth; adjusted income from operations; net operating capital; net debt and cash flow before financing activities. These non-US GAAP financial measures should not be viewed in isolation as alternatives to the equivalent US GAAP measure and should be used in conjunction with the most directly comparable US GAAP measure(s). Unless otherwise indicated in this document, a discussion of the non-US GAAP measures included in this document and a reconciliation of such measures to the most directly comparable US GAAP measure(s) is contained under the heading Reconciliation of non-US GAAP information in item 5.

Forward-looking statements

Pursuant to provisions of the United States Private Securities Litigation Reform Act of 1995, Philips is providing the following cautionary statement. This document, including the portions of the Philips 2007 Annual Report to Shareholders incorporated hereby, contains certain forward-looking statements with respect to the financial condition, results of operations and business of Philips and certain of the plans and objectives of Philips with respect to these items, in particular, among other statements, certain statements in Item 4 Information on the Company with regard to management objectives, market trends, market standing, product volumes and business risks, the statements in Item 8 Financial Information relating to legal proceedings, the statements in Item 5 Operating and Financial Review and Prospects with regard to trends in results of operations, margins, overall market trends, risk management, exchange rates and statements in Item 11 Quantitative and Qualitative Disclosures about Market Risks relating to risk caused by derivative positions, interest rate fluctuations and other financial exposure are forward-looking in nature.

Forward-looking statements can be identified generally as those containing words such as anticipates , assumes , believes , estimates , expects , should , will , will likely result , forecast , outlook , projects or similar exp nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements. These factors include but are not limited to domestic and global economic and business conditions, the successful implementation of our strategy and our ability to realize the benefits of this strategy, our ability to develop and market new products, changes in legislation, legal claims, changes in exchange and interest rates, changes in tax rates, pension costs, raw materials and employee costs, our ability to identify and complete successful acquisitions and to integrate those acquisitions into our business, our ability to successfully exit certain businesses or restructure our operations, the rate of technological changes, political, economic and other developments in countries where Philips operates, industry consolidation and competition. See also Item 3 Key information Risk factors . Statements regarding market share, including those regarding Philips competitive position, contained in this document are based on outside sources such as specialized research institutes, industry and dealer panels in combination with management estimates. Where full-year information regarding 2007 is not yet available to Philips, those statements may also be based on estimates and projections prepared by outside sources or management. Rankings are based on sales unless otherwise stated.

3

**Table of Contents**

Part I

Item 1. Identity of directors, senior management and advisors

Not applicable.

Item 2. Offer statistics and expected timetable

Not applicable.

Item 3. Key information

Selected consolidated financial data

| | Selected financial data as at and for the years ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2003[1)] | 2004[1)] | 2005[1)] | 2006[1)] | **2007** | **2007**(a) |
| in millions, except per share data and ratio data | EUR | EUR | EUR | EUR | **EUR** | **US $** |
| **Income statement data:** | | | | | | |
| Sales | 23,614 | 24,488 | 25,445 | 26,682 | **26,793** | **39,459** |
| Income from Operations (IFO) | 924 | 1,733 | 1,558 | 1,201 | **1,852** | **2,728** |
| Financial income and expenses-net | (245) | 216 | 104 | 28 | **2,613** | **3,848** |
| Income from continuing operations and before cumulative effect of a change in accounting principles | 219 | 3,164 | 2,879 | 901 | **4,601** | **6,776** |
| Income (loss) from Discontinued operations | 490 | (328) | (11) | 4,482 | **(433)** | **(638)** |
| Cumulative effect of a change in accounting principles, net of tax | (14) | | | | | |
| Net income | 695 | 2,836 | 2,868 | 5,383 | **4,168** | **6,138** |
| Weighted average number of common shares outstanding (in thousands) | 1,277,174 | 1,280,251 | 1,249,956 | 1,174,925 | **1,086,128** | |
| **Basic earnings per Common Share:** | | | | | | |
| Income from continuing operations | 0.17 | 2.47 | 2.30 | 0.77 | **4.24** | **6.24** |
| Net income | 0.54 | 2.22 | 2.29 | 4.58 | **3.84** | **5.65** |
| Weighted average number of common shares outstanding on a diluted basis (in thousands) | 1,281,227 | 1,283,716 | 1,253,330 | 1,182,784 | **1,097,435** | |
| **Diluted earnings per Common Share:** (b) | | | | | | |
| Income from continuing operations | 0.17 | 2.46 | 2.30 | 0.76 | **4.19** | **6.17** |
| Net income | 0.54 | 2.21 | 2.29 | 4.55 | **3.80** | **5.59** |
| **Balance sheet data:** | | | | | | |
| Total assets | 28,989 | 30,739 | 33,905 | 38,497 | **36,343** | **53,524** |
| Short-term debt | 1,684 | 961 | 1,167 | 863 | **2,345** | **3,454** |
| Long-term debt | 4,193 | 3,552 | 3,320 | 3,006 | **1,212** | **1,785** |
| Short-term provisions (c) | 885 | 731 | 769 | 876 | **377** | **555** |
| Long-term provisions (c) | 1,761 | 1,905 | 1,865 | 2,417 | **2,727** | **4,016** |
| Minority interests | 67 | 59 | 58 | 40 | **42** | **62** |
| Stockholders equity | 12,763 | 14,860 | 16,666 | 22,997 | **21,684** | **31,935** |
| Capital stock | 263 | 263 | 263 | 228 | **228** | **336** |
| **Cash flow data:** | | | | | | |
| Net cash provided by operating activities | 1,413 | 1,392 | 1,147 | 330 | **1,519** | **2,237** |

| | | | | | | |
|---|---|---|---|---|---|---|
| Net cash (used for) provided by investing activities | (202) | 1,337 | 1,694 | (2,802) | **3,930** | **5,788** |
| Net cash used for financing Activities | (1,355) | (2,145) | (2,589) | (3,715) | **(2,368)** | **(3,487)** |
| Cash provided by (used for) continuing Operations | (144) | 584 | 252 | (6,187) | **3,081** | **4,538** |

1) Restated to present the MedQuist business as a discontinued operation.

4

Table of Contents

| | 2003 1) | 2004 1) | 2005 1) | 2006 1) | **2007** |
|---|---|---|---|---|---|
| **Key Ratios:** | | | | | |
| Income from operations (in millions of euros) | 924 | 1,733 | 1,558 | 1,201 | **1,852** |
| as a % of sales | 3.9 | 7.1 | 6.1 | 4.5 | **6.9** |
| Turnover rate of net operating capital | 4.48 | 5.27 | 4.92 | 3.09 | **2.59** |
| Inventories as a % of sales | 10.5 | 10.2 | 11.0 | 10.8 | **12.0** |
| Outstanding trade receivables (in days sales) | 43 | 41 | 44 | 45 | **44** |
| Net income as a % of stockholders equity | 5.3 | 20.3 | 18.3 | 25.8 | **19.2** |
| Income from continuing operations as a % of stockholders equity (ROE) | 1.7 | 22.7 | 18.4 | 4.3 | **21.0** |
| Ratio net debt : group equity | 19:81 | 2:98 | (4):104 | (10):110 | **(32):132** |

1) Restated to present the MedQuist business as a discontinued operation.

**Definitions:**

Turnover rate of net operating capital : sales divided by average net operating capital (calculated on the quarterly balance sheet positions)

Net operating capital* : total assets excluding assets from discontinued operations less (a) cash and cash equivalents, (b) deferred tax assets, (c) other non-current financial assets, (d) investments in equity accounted investees, and after deduction of (e) provisions excluding deferred tax liabilities, (f) accounts and notes payable, (g) accrued liabilities and (h) current/non-current liabilities.

Philips believes that an understanding of the Philips group s financial condition is enhanced by the disclosure of net operating capital, as this figure is used by Philips management to evaluate the capital efficiency of the Philips group and its operating segments. Net operating capital is computed as follows:

| | 2003 1) | 2004 1) | 2005 1) | 2006 1) | 2007 |
|---|---|---|---|---|---|
| Intangible assets | 2,579 | 2,307 | 3,541 | 5,536 | 6,289 |
| Property, plant and equipment | 2,843 | 2,768 | 2,999 | 3,084 | 3,180 |
| Remaining assets* | 7,928 | 8,776 | 9,681 | 10,712 | 11,333 |
| Provisions** | (2,534) | (2,445) | (2,347) | (2,684) | (2,417) |
| Other liabilities*** | (6,292) | (7,140) | (8,435) | (8,130) | (7,799) |
| Net operating capital | 4,524 | 4,266 | 5,439 | 8,518 | 10,586 |

1)

Restated to present the MedQuist business as a discontinued operation.

* Remaining assets includes all other current and non-current assets on the balance sheet, except for intangible assets and property, plant and equipment and excludes deferred tax assets, cash and cash equivalents and securities

** Excluding deferred tax liabilities

*** Other liabilities includes other current and non-current liabilities on the balance sheet, except for short-term and long-term debt

| | | |
|---|---|---|
| ROE | : | income from continuing operations as a % of average stockholders equity |
| Net debt* | : | long-term and short-term debt net of cash and cash equivalents |
| Group equity | : | stockholders equity and minority interests |
| Net debt: group equity ratio* | : | the % distribution of net debt over group equity plus net debt |

* See under the heading Reconciliation of non-US GAAP information in item 5

incorporated herein by reference for a reconciliation of non-US GAAP measures to the most directly comparable US GAAP measure(s).

(a) For the convenience of the reader, the euro amounts have been converted into US dollars at the exchange rate used for balance sheet purposes at December 31, 2007 (US $1 = EUR 0.6790).

(b) See Note 8 of Notes to the Consolidated Financial Statements on page 159 of the 2007 Annual Report incorporated herein by reference for a discussion of net income per common share on a diluted basis.

(c) Includes provision for pensions, severance payments, restructurings, Asbestos related claims and taxes among other items; see Note 19 of Notes to the Consolidated Financial Statements on page 163 of the 2007 Annual Report incorporated herein by reference.

**Table of Contents**

*Cash dividends and distributions paid per Common Share*

The following table sets forth in euros the gross dividends and cash distributions paid on the Common Shares in the financial years indicated (from prior-year profit distribution) and such amounts as converted into US dollars and paid to holders of Shares of New York registry:

| | 2003 | 2004 | 2005 | 2006 | **2007** |
|---|---|---|---|---|---|
| In EUR | 0.36 | 0.36 | 0.40 | 0.44 | 0.60 |
| In US $ | 0.38 | 0.44 | 0.51 | 0.54 | 0.80 |

A proposal will be submitted to the 2008 Annual General Meeting of Shareholders to declare a dividend of EUR 0.70 per Common Share, which dependent on the amount of shares purchased in the current share repurchase program, we currently estimate a dividend of approximately EUR 715 million. In 2007, a dividend was paid of EUR 0.60 per common share (EUR 659 million) in respect of the financial year 2006.

Pursuant to article 33 of the Articles of Association of Royal Philips Electronics, and with the approval of the Supervisory Board, the remainder of the income for the financial year 2007 has been retained by way of reserve. The balance sheet in the consolidated financial statements presented in the 2007 Annual Report for the period ended and as at December 31, 2007 in accordance with IFRS, is before the dividend which is subject to shareholder approval after year-end.

The dollar equivalent of this cash distribution to be paid to shareholders in the year 2008 will be calculated at the euro/dollar rate of the official Amsterdam daily fixing rate (transfer rate) on the date fixed and announced for that purpose by the Company, expected to be April 2, 2008. The dollar equivalents of the prior year profit distributions paid to shareholders have been calculated at the euro/dollar rate of the official Amsterdam daily fixing rate (transfer rate) on the date fixed and announced for that purpose by the Company.

**Exchange rates US $ : EUR**

The following two tables set forth, for the periods and dates indicated, certain information concerning the exchange rate for US dollars into euros based on the Noon Buying Rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate ).

| calendar period | | | | EUR per US $1 |
|---|---|---|---|---|
| | period end | average(1) | high | low |
| 2002 | 0.9537 | 1.0573 | 1.1636 | 0.9537 |
| 2003 | 0.7938 | 0.8782 | 0.9652 | 0.7938 |
| 2004 | 0.7387 | 0.8014 | 0.8474 | 0.7339 |
| 2005 | 0.8445 | 0.8046 | 0.8571 | 0.7421 |
| 2006 | 0.7577 | 0.7906 | 0.8432 | 0.7504 |
| 2007 | 0.6848 | 0.7259 | 0.7750 | 0.6729 |
| 2008 (through January) | 0.6738 | 0.6738 | 0.6862 | 0.6722 |

(1) The average of the Noon Buying Rates on the last day of each month during the period.

| | highest rate | lowest rate |
|---|---|---|
| August 2007 | 0.7462 | 0.7274 |
| September 2007 | 0.7350 | 0.7033 |
| October 2007 | 0.7096 | 0.6912 |
| November 2007 | 0.6928 | 0.6729 |
| December 2007 | 0.6972 | 0.6776 |
| January 2008 | 0.6862 | 0.6722 |

Philips publishes its financial statements in euros while a substantial portion of its net assets, earnings and sales are denominated in other currencies. Philips conducts its business in more than 50 different currencies.

6

**Table of Contents**

Unless otherwise stated, for the convenience of the reader the translations of euros into dollars appearing in this report have been made based on the closing rate on December 31, 2007 (US $1 = EUR 0.6790). This rate is not materially different from the Noon Buying Rate on such date (US $1 = EUR 0.6848).

The following table sets out the exchange rate for US dollars into euros applicable for translation of Philips financial statements for the periods specified.

| | EUR per US $1 | | | |
|---|---|---|---|---|
| | period end | average(a) | high | low |
| 2002 | 0.9543 | 1.0579 | 1.1497 | 0.9543 |
| 2003 | 0.7943 | 0.8854 | 0.9543 | 0.7943 |
| 2004 | 0.7350 | 0.8050 | 0.8465 | 0.7350 |
| 2005 | 0.8435 | 0.8053 | 0.8491 | 0.7613 |
| 2006 | 0.7591 | 0.7935 | 0.8375 | 0.7579 |
| 2007 | 0.6790 | 0.7272 | 0.7694 | 0.6756 |

(a) The average rates are based on daily quotations.

Risk factors

The information on risk factors required by this Item is incorporated by reference herein from pages 98 through 111 under the heading Risk Management and note 36 on page 185 of the 2007 Annual Report.

It describes some of the risks that could affect Philips businesses. The risk factors and the cautionary statements contained in the section entitled Introduction on page 3 should be considered in connection with any forward-looking statements contained in Philips Annual Report on Form 20-F. Forward-looking statements can be identified generally as those containing words such as anticipates , assumes , believes , estimates , expects , should , will , will lik forecast , outlook , projects or similar expressions. From time to time, Philips may also provide oral or written forward-looking statements in other materials Philips releases to the public. The cautionary statements contained in Introduction are deemed to apply to these statements.

The risks described are not the only ones that Philips faces. Some risks are not yet known to Philips and certain risks that Philips does not currently believe to be material could later turn out to be material. All of these risks could materially affect Philips business, its revenues, operating income, net income, net assets and liquidity and capital resources.

**Table of Contents**

## Item 4. Information on the Company

### The structure of the Philips group

The information under the heading Business Overview in this item 4, Discontinued Operations under the heading Operating and financial review and prospects in item 5, the information on capital expenditures under the headings Cash flows provided by continuing operations and Cash flows in Operating and financial review and prospects in item 5, pages 54 through 57 under the heading Acquisitions of the 2007 Annual Report and pages 250 through 257 under the heading Corporate governance of the 2007 Annual Report, is incorporated herein by reference. The registered office of Royal Philips Electronics is Groenewoudseweg 1, 5621 BA Eindhoven, The Netherlands. Our phone number is +31 20 5977777.

### Business Overview

The information on under the heading Operating and financial review and prospects in item 5 is incorporated herein by reference. The description of industry terms contained in Exhibit 15(e) to this Report on Form 20-F is also incorporated herein by reference.

**Philips Structure**

Koninklijke Philips Electronics N.V. (the Company ) is the parent company of the Philips Group ( Philips or the Group ). Its shares are listed on the stock markets of Euronext Amsterdam and the New York Stock Exchange. The management of the Company is entrusted to the Board of Management under the supervision of the Supervisory Board.

The businesses are the source of value creation. They are provided with effective and efficient support through shared service centers. Country management supports value creation, connecting Philips with key stakeholders, especially our employees, customers, government and society.

In 2007, Philips activities were organized on a divisional basis: Medical Systems, Domestic Appliances and Personal Care, Consumer Electronics, Lighting, Innovation & Emerging Businesses, and Group Management & Services.

As of January 2007, the following key portfolio changes have been applied to the Philips Group structure: Other Activities was renamed Innovation & Emerging Businesses; Unallocated was renamed Group Management & Services; GSU activities and Miscellaneous were transferred from Innovation & Emerging Businesses to Group Management & Services; Consumer Healthcare Solutions was moved from DAP to Innovation & Emerging Businesses. Also as of January 2007, certain Corporate/Regional/Country overhead and Corporate Intellectual Property costs were allocated to the operating divisions to further improve transparency of the total cost structure. As a consequence of the aforementioned, prior-year financials have been restated.

At the end of 2007, Philips had approximately 100 production sites in 29 countries, sales and service outlets in approximately 150 countries, and some 123,800 employees.

**Philips in 2008**

As of January 1, 2008, Philips activities are organized on a sectoral basis, with each operating sector Healthcare, Lighting and Consumer Lifestyle being responsible for the management of its businesses worldwide. The Healthcare sector brings together the former Medical Systems division and Home Healthcare Solutions formerly Consumer Healthcare Solutions which has been transferred from Innovation & Emerging Businesses group. The former Consumer Electronics and Domestic Appliances and Personal Care divisions have been integrated in the Consumer Lifestyle sector.

By leveraging Philips brand, technology base and distribution network, the Company aims, through the Innovation & Emerging Businesses sector, to invest in projects that are not currently part of Philips operating sectors, but which will lead to additional organic growth or create value through future spin-offs. Innovation & Emerging Businesses includes Corporate Research, Philips Incubators and Intellectual Property & Standards, as well as Philips Design. The sector Group Management & Services includes the global service units, corporate and regional centers, pensions and the global brand activities.

### Product sectors and principal products

The information under the heading Operating and financial review and prospects in item 5 is incorporated herein by reference.

**Table of Contents**

## Medical Systems

Philips Medical Systems is a global provider of innovative healthcare solutions, designed to address the needs of patients as well as healthcare professionals, with a particular focus on diagnostic imaging cardiology, oncology and women s health and critical care. Whether it is in the hospital or in the home, we seek to improve patient outcomes throughout the entire cycle of care from prevention and screening to diagnosis, treatment, monitoring and management.

In order to simplify healthcare for our customers and the patients they serve, innovation at Philips is driven by gaining insight into the needs of the people who use our products. Within healthcare, this human insight is combined with a solid clinical understanding to create integrated offerings across the cycle of care that truly support clinical excellence.

In 2007 we were comprised of four areas of business*:

Imaging Systems x-ray, computed tomography, magnetic resonance and nuclear medicine equipment, designed to create diagnostic images and to support minimally invasive therapy

Ultrasound and Monitoring Solutions ultrasound imaging, patient monitoring and cardiac systems

Healthcare Informatics picture archiving and communication systems (PACS), clinical decision-support information, cardiology IT and document services

Customer Services consultancy, clinical services, education, equipment financing, asset management, as well as equipment maintenance and repair; supports the optimization of workflow and maintenance in all markets served.

* *Following the announcement on November 2, 2007, of Philips intention to dispose of its majority stake in MedQuist, this business is presented as a discontinued operation in this Annual Report and not consolidated with the results of Medical Systems.*

Products and services are sold to healthcare providers around the world, including academic, enterprise and stand-alone institutions, clinics, physicians and consumer retailers. Marketing, sales and service channels are mainly direct.

Major drivers of the medical technology market include a growing and longer-living world population, the associated rising incidence of chronic diseases, insufficient staffing levels, and government funding and reimbursement. Healthcare reforms in some countries and increased price competition among major players may have a limiting impact on future market growth. In light of these factors, technology has a significant role to play, enabling new solutions for early and better diagnoses and less labor-intensive treatment. Therefore the technology share of the healthcare bill is set to increase more rapidly than overall healthcare spending. We believe that bridging the hospital and the home is going to be increasingly important in delivering better patient outcomes while containing costs. This conviction is driving Philips investment in building up a leading home healthcare business, as outlined in the Consumer Healthcare Solutions business description within Innovation & Emerging Businesses.

We intend to maintain our high level of product innovation and strengthen our sales and distribution channels. The United States is the largest healthcare market, currently representing close to 50% of the global market, followed by Japan and Germany.

The medical systems market is subject to some seasonality as a relatively large proportion of revenue is recognized in the fourth quarter, mainly reflecting public/governmental budget spending.

We employ approximately 27,000 employees worldwide, including 8,000 in services.

With regard to sourcing, please refer to the business description of Philips Supply Management within Group Management & Service.

**Progress against targets**

Philips Annual Report 2006 to Shareholders (the Annual Report 2006 ) set out a number of key targets for Medical Systems in 2007. The advances made in addressing these are outlined below.

**Continue to grow faster than the market**

We continued to grow slightly faster than the market by: intensifying the focus on emerging market growth, resulting in double-digit order intake growth in China, India and Latin America; maintaining the solid innovation rate and further increasing service-contract penetration by slightly more than 2%; and making strategically aligned acquisitions.

Table of Contents

In 2007 we continued to broaden our position in strategic growth areas and increased penetration into international markets through focused investments in products and channels.
The acquisition of XIMIS, a company that focuses on systems to help reduce medical errors and streamline workflow in hospitals, further expands our growing presence in the radiology informatics market. This was followed by the announcement, toward the end of the year, of the acquisitions of the US-based clinical IT specialists Emergin (closed in 2007) and VISICU (to be finalized in 2008), enhancing our capability to offer full monitoring solutions.
In line with the strategy to bolster our healthcare presence in emerging markets, we acquired Brazil s leading general X-ray manufacturer, VMI-Sistemas Medicos, thereby expanding our position in the Latin American market. We also entered into a number of strategic agreements, e.g. with Artemis Health Institute in Gurgaon, India, to supply medical equipment and undertake integrated medical technology planning as well as research and development, enabling Philips to capture real-time scientific data.

**Support care providers throughout the entire care cycle by developing disease-based product and service solutions**

**Cardiology**

Philips innovations are driving integration of cardiology products and services, bridging previously disparate cardiac patient events, from arrival at healthcare facilities, through transfers to non-invasive, interventional intensive care. This process is supported by one of the broadest cardiology portfolios on the market, encompassing multidisciplinary diagnoses and inclusive treatments, with fewer mistakes and repeated procedures. Our goal is the delivery of better, more efficient care through earlier diagnosis, fewer disabilities, faster recoveries and, in cases of long-term care, slower progression of disease.
By way of example, in 2007 Philips introduced its HeartStart MRx Monitor/Defibrillator, which enables paramedics to transmit patient data from the ambulance to the hospital s emergency department. By allowing a hospital to begin organizing its resources before the patient arrives, the MRx can help reduce the time to treatment.
Another example of how Philips optimizes timely delivery of diagnosis and treatment in the cardiac care cycle is the recently introduced ultrasound transducer for Live 3D transesophageal echocardiography (Live 3D TEE), which provides views of cardiac structure and function available for the first time. Along with new advanced software, this enables 2D imaging as well as real-time 3D visualization of the heart, in particular the heart s valves, giving clinicians the ability to carry out a complete analysis, which allows a faster, more precise diagnosis.

**Oncology**

Our commitment in oncology is to provide technologies and support that enable physicians to make effective treatment decisions for cancer patients at every point of care. As our collective understanding of how to detect, stage and treat cancer continues to evolve, so does our ability to detect disease earlier, to stage disease more accurately and to pursue image-guided interventional treatment techniques.
Clinical insights in the treatment of oncology patients led to the 2007 introduction of the GEMINI Big Bore PET-CT to complement the Brilliance Big Bore CT. This offering allows radiation oncologists to see both the biological cell intensity combined with anatomical tumor location in the treatment position, and where necessary to incorporate the effects of respiratory motion with 4D for the most accurate tumor targeting. For patients undergoing treatment, this means more targeted treatment that allows healthy tissue around the tumor to be spared.

**Women s health**

Advances in technology and medical science continue to transform women s healthcare, as our understanding of screening, prevention and education evolves in parallel to improvements in disease management.
Philips maintains its long-term commitment to introducing innovations for every season of a woman s health from adulthood through helping seniors maintain independence later in life. Whether it is in obstetrical care, where our technologies allow vigilant and reassuring surveillance before, during and after pregnancy, or alerting medical emergency services from home when needed, Philips offers women around the globe a sense of confidence and reliability.
For breast cancer, we developed important MR technologies in 2007 such as the Smart Exam as well as integrated MRI coils and the DynaCAD® Workstation to support optimal screening and early detection.

Table of Contents

**Customer loyalty**

We use the Net Promoter Score to measure customer loyalty. We are investing significantly to improve our patient-and-provider focus through products that address the care cycle, better communication from our customer-facing employees and improved service performance. These initiatives are intended to increase the bond of trust we have with our customers, a leading indicator of purchase and repurchase behavior. In 2007, we implemented customer-loyalty programs to better understand how our products and services are viewed in the marketplace.

**Cultivate leadership talent**

In order to support our business excellence we continued to build the strategic leadership capabilities of our people. It is our goal to be one of the best places to work. Therefore we must offer energizing challenges and development opportunities for our people to fully exploit their talent.

In 2007 we deployed employee recognition programs in different parts of the organization. We also enhanced our ability to recruit, develop and retain top talent, attracting 25 senior managers from outside the company.

**Focus on operational excellence**

Throughout 2007 we continued to focus on improving the key business processes.

By adopting one common logistics process for equipment and one global logistics partner for spare parts, we dramatically improved our customer delivery performance. We also deployed global project tools, resulting in more predictable and efficient installation activity. Harmonizing global order types is reducing the complexity of commercial and industrial transactions. Finally, by beginning to consolidate our industrial footprint, we have been able to focus on core competencies and on integrating acquisitions.

Process improvements remain a key focus as we simplify interfaces and gain leverage with our supply base. Initiatives built around supplier development and collaboration continue to yield improvements in the areas of early supplier involvement, accelerated time-to-market and supplier quality performance.

**Improve service satisfaction**

Service satisfaction continues to be a focal area for us. Serviceability features that allow quick problem resolution have been designed-in to all product lines using a new standardized process. The process has yielded a 30% improvement in serviceability features over the last three product release cycles.

We also implemented a robust business management system designed to take operational performance to world-class level. This system is founded upon the integrated application of Philips Business Excellence/Process Survey Tools, Six Sigma, Breakthrough Management (Hoshin) and, specifically, extensive benchmarking.

**Regulatory requirements**

Medical Systems is subject to extensive regulation. It strives for full compliance with regulatory product approval and quality system requirements in every market it serves by addressing specific terms and conditions of local ministry of health or federal regulatory authorities, including agencies like the US FDA, EU Competent Authorities and Japanese MLHW. Environmental and sustainability requirements like the European Union s Waste from Electrical and Electronic Equipment (WEEE) and the Restriction of Hazardous Substances (RoHS) directives are met with comprehensive EcoDesign and manufacturing programs to reduce the use of hazardous materials.

Continuous clinical innovation and breakthroughs, in combination with collaborative customer relationships, drive growth and profitability. However, the success of clinical innovation is often dependent upon appropriate reimbursement. In the US, concern over rapid and sustained growth in imaging services has attracted increased scrutiny by the Federal government and commercial payers. This has resulted in the adoption of new strategies designed to curb growth that could continue to impact Philips Healthcare in 2008 and beyond. The Deficit Reduction Act of 2005 came into effect in February 2006 and included substantial reductions in Medicare payments for imaging services performed in nonhospital settings. Commercial payers are also implementing several types of utilization management strategies designed to curb growth. Philips will continue to work closely with legislators, payers and providers to avoid further unwarranted reimbursement reductions and to ensure a more rational approach to payment for innovative technologies, particularly advanced imaging services.

Table of Contents

### Strategy and 2008 objectives

Following the announcement of Vision 2010 in September 2007, the former Medical Systems division and Consumer Healthcare Solutions business now renamed Home Healthcare Solutions have been integrated effective January 1, 2008, and going forward will be reported as the Healthcare sector.

Philips Healthcare will play an important role in the realization of Philips Vision 2010 ambition. For 2008 and beyond, Healthcare has put in place a number of specific value-creating initiatives which it will drive through a framework of Growth, Talent and Simplicity:

- Extract value from acquisitions through successful integration
- Expand presence in emerging markets
- Cultivate leadership talent and recognize and reward top talent
- Deliver on care cycle solutions from the hospital to the home.

The information on the financial performance of the sector Medical Systems under the heading Operating and financial review and prospects in item 5 is incorporated herein by reference.

## Domestic Appliances and Personal Care

Philips Domestic Appliances and Personal Care (DAP) empowers consumers with a wide range of technologically advanced yet easy-to-use products that enhance their sense of well-being and appearance, as well as helping them to prepare food and beverages and take care of their homes and garments.

We are engaged in the development, manufacturing and marketing of innovative propositions through our three businesses:

- Shaving & Beauty electric shavers, female depilation appliances, haircare and male grooming products
- Domestic Appliances kitchen appliances, floor care, garment care, water and air purifiers and beverage appliances
- Health & Wellness oral health care and mother and child care.

We also partner with leading companies from other fields, like Sara Lee/Douwe Egberts and Nivea Beiersdorf, in order to deliver exciting appliance/consumable combinations.

With our extensive product portfolio, we are able to service traditional and emerging distribution channels, e.g. general retailers, electronic retailers, mass merchants, retailer specialists, online retailers, distributors/wholesalers.

The domestic appliances and personal care retail landscape continues to evolve, with major emerging markets such as Brazil, Russia, China and India maintaining their strong growth, and retailers driving their expansion, both into new geographies, as well as into the online sector.

DAP has a host of top 3 positions across its portfolio and across key markets in Europe, North America and Asia. For example, the global No. 1 position in male dry shaving, as well as top 3 positions for Garment Care in Europe, Female Depilation and Oral Healthcare in Asia Pacific, and Kitchen Appliances and Floorcare in Europe.

We have a strong global presence with manufacturing sites in nine countries and sales organizations in more than 60. Our Centers of Competence, located in four different countries, play an important role in the development of our products. In total, DAP employs nearly 10,000 people.

DAP complies with all relevant regulatory requirements, most notably the EU WEEE (Waste from Electrical and Electronic Equipment) Directive and the RoHS (Restriction of Hazardous Substances) Directive.

With regard to sourcing, please refer to the business description of Philips Supply Management under the heading Group Management & Services in this Item 4.

**Progress against objectives**
The Annual Report 2006 set out a number of key targets for DAP in 2007. The advances made in addressing these are outlined below.

**Increase customer focus: category management, international key account management and channel strategy**
While upgrading its key account management teams and implementing innovative customer intimacy programs, DAP significantly intensified its focus on global customers. We deepened our strategic alignment with international key accounts by holding strategy review meetings designed to involve key retail partners in our product creation process with the aim of gaining direct feedback. This new approach towards our retailers, based on trust and open communication, helped to accelerate profitable growth while providing better value to both our retailers and consumers. We are now executing common 3-year global business plans with our largest international key accounts across all product categories and countries. In 2007, DAP accelerated growth with key accounts via the successful introduction of ground-breaking products such as the Arcitec shaver.

Building on the successful healthy living positioning, the Domestic Appliances business completed its juicer range in 2007, with the Alu model becoming a global image carrier for the appliances business. Continuing the Senseo success story, Domestic Appliances also introduced a range of Espresso makers in Europe, thereby entering the high-value coffee category with the highest growth rate 13% within the small appliances segment. In the Home environment segment Domestic Appliances extended its scope with its newly introduced water purification products, addressing the global need for safe drinking water. These products are initially available in India and Brazil, but are to be rolled out to other markets in 2008.

Growth of the Domestic Appliances business in 2007 was strongly supported by a dedicated program to develop business jointly with the trade. Cooperation on marketing campaigns led to significant category growth, e.g. through the healthy living positioning, especially in juicing and blending. Good relationships have been developed with key international distribution chains. The dedicated program resulted in three-quarters of market share growth in Western Europe being achieved with DAP s top 10 international retailers.

DAP further expanded its global leading position in electric dry- and wet male shaving and grooming products in 2007. The Shaving & Beauty business celebrated the milestone of producing its 500 millionth shaver and achieved record sales and earnings for the second consecutive year. 2007 also saw the global introduction of two innovative shaver ranges, Arcitec and the Moisturizing Shaving System, which offer a much improved shaving performance combined with an innovative design.

The Beauty business continued its rapid expansion by offering a range of female depilation, haircare and male grooming products, among which the Bodygroom for males was particularly successful. The Bodygroom was further rolled out in Eastern Europe, Middle East and Africa and reached more than one million new consumers in Europe and North America.

In the Oral Healthcare category, the September 2007 launch of Flexcare firmly established Philips Sonicare as the world leader in the sonic power toothbrush category, according to GfK.

**Focus resource allocation on mission-critical initiatives**
The successful launches of Arcitec, the Moisturizing Shaving System and the FlexCare toothbrush are proofpoints of organizational emphasis on mission-critical initiatives.

The initiative to develop business jointly with the trade in the field of domestic appliances is recognized by retail partners as a positive change agent. This program is gaining momentum and will be rolled out beyond Domestic Appliances in 2008.

**Ensure functional leadership to maximize cost efficiencies and speed**
2007 saw the deployment of a sector-wide cost-reduction initiative Earn-to-Invest , which is designed to free up and redirect resources toward drivers of growth. In R&D, for example, this resulted in over 100 local initiatives to reduce costs (e.g. by moving prototype testing to lower cost locations) and increase speed (e.g. by reducing rework required on models and moulds).

**Further develop consumer-centric innovation competence**
DAP enhanced its innovative capability by leveraging (online) external networks and knowledge more intensely during the early phases of innovation (e.g. via the YourEncore online experts network). Posting the right technology

questions in expert communities outside Philips increases the chances of getting better answers faster.

In June 2007, the Health & Wellness business organized the Avent Innovation Wave, at which all DAP employees worldwide were triggered to think as consumers for Mother & Childcare products. The event gathered over 1,200 validated consumer insights and over 500 product solutions, ensuring distinctive new propositions for the Philips AVENT portfolio as well as for expansion into new value spaces.

Table of Contents

**Focus on talent by securing engagement and internationalizing the talent pipeline**

An Engagement Master Class has been introduced for all senior managers, and employee engagement data are used in leadership assessment/development and promotions.

Diversity is vital. To reflect DAP s global business, our leaders need to have broad, multifunctional and international experience. For teams with global/regional reach, DAP requires that a minimum of 50% of the employees on each team originate from the markets in question.

**Simplify the organization by creating a direct link between markets and the business**

As of January 1, 2007, DAP removed the regional management layer between its global business units and country sales organizations, simplifying its organization and processes to facilitate maximum growth and realize untapped potential.

**Redesign and simplify the innovation process towards Open Innovation**

Building on the increasing application of the Value Proposition House methodology for arriving at a unique and discriminating positioning for a product, the marketing and R&D communities simplified the process to translate a Value Proposition House into a technical product specification. In addition, dedicated research was done on returned products to better understand consumer requirements, thereby augmenting the consumer insight knowledge base from which new products will be developed.

**Strategy and 2008 objectives**

Following the announcement of Vision 2010 in September 2007, the former Consumer Electronics and Domestic Appliances and Personal Care divisions have been integrated effective January 1, 2008, and going forward will be reported as the Consumer Lifestyle sector.

Philips Consumer Lifestyle will play an important role in the realization of Philips Vision 2010 ambition.

For 2008 and beyond, Consumer Lifestyle has put in place a number of specific value-creating initiatives which it will drive through a framework of Growth, Talent and Simplicity:

- Leverage post-integration synergies, particularly with regard to customers, markets and key account management, as well as in supply chain optimization and the sector s relationships with third-party suppliers and partners; synergies will also be realized across all operational processes, through the organizational blueprint and way-of-working design
- Open up new value spaces in the consumer lifestyle field to further strengthen our business portfolio and to deliver upon our growth ambition
- Create a unified, engaged and high-performance organization in which growth and diversity can be nurtured within our leadership community and talent pipeline
- Maximize our structure to be fully market-driven, in terms of our customer relationships and our business portfolio.

The information on the financial performance of the sector Domestic Appliances and Personal Care under the heading Operating and financial review and prospects in item 5 is incorporated herein by reference.

## Consumer Electronics

Placing consumers needs at the very heart of its strategy and activities. Philips Consumer Electronics (CE) is dedicated to providing consumers with lifestyle entertainment experiences and services whenever and wherever they want.

Applying relevant innovation powered by simplicity-led design to address the twin consumer desires of wellness and pleasure, Philips has a distinctive position in the consumer electronics space offering applications with ambient benefits that support both the individual s desire for entertainment content as well as differentiated sensorial experiences.

Income is derived principally from two sources: products (including product/service combinations) and licensing activities.

Table of Contents

In 2007, CE consisted of the following areas of business:

Connected Displays including FlatTVs such as the new Aurea and the Ambilight range, the Perfect Pixel HD Engine picture quality platform, LCD PC monitors, and professional and business display solutions, such as Hotel TV and public signage displays

Entertainment Solutions, consisting of Video & Multimedia Applications including the Cineos SoundBar DVD Home Theater with Ambisound technology, Hard Disk/DVD Recorders and Blu-ray Disc players and Audio & Multimedia Applications including GoGear portable audio and video players, Streamium Wireless Music Systems, entertainment docks for portable audio/video players such as Philips GoGear range and Apple s iPod

Peripherals & Accessories including Prestigo remote controls, Philips-Swarovski Active Crystal fashion accessories, the PhotoFrame range, amBX PC gaming peripherals, DECT and VoIP cordless phones, webcams and USB PC add-on drives

Home Networks including a complete range of digital set-top boxes such as HDTV receivers, along with Streamium wireless audio-video links.

The license activities offer third parties access to new and inventive Philips technologies by making licenses available under Philips intellectual property relevant to these technologies. Licenses can be obtained for various products, like DVD/Blu-ray players, recorders and discs.

CE products are channeled towards the consumer primarily through national and international retailers. The division offers a broad range of products from high to low price/value quartiles, necessitating a diverse distribution model that includes mass merchants, retail chains, independents and small specialty stores often represented by buying groups. In order to work in the most effective way with these retail channels, Philips has created an organization designed around its retail customers, with Global Key Account Managers and Country Ambassadors.

The consumer electronics retail landscape continues to evolve, with the major emerging markets like Russia, China and India maintaining their strong growth, and retailers driving their expansion, both into new geographies, as well as into the online sector. Price pressure remains a key challenge for the industry.

The CE business experiences seasonality, with higher sales in the fourth quarter resulting from the holiday sales.

CE employs approximately 14,000 people worldwide, with a global sales and service organization embracing more than 50 mature and emerging markets in Europe, North America, Latin America, Asia Pacific, the Middle East and Africa. In addition, we operate manufacturing and business creation organizations in the Netherlands, France, Belgium, Hungary, Mexico, Argentina and Brazil, as well as overseeing licensed manufacturing activities in China.

CE complies with all relevant regulatory requirements, most notably the EU WEEE (Waste from Electrical and Electronic Equipment) Directive and the RoHS (Restriction of Hazardous Substances) Directive.

With regard to sourcing, please refer to the business description of Philips Supply Management under the heading Group Management & Services , in this item 4.

**Progress against targets**

With value creation and margin management our main objective, our 2007 activities centered on leveraging the strength of our asset-light operating model, as well as driving differentiation in the marketplace.

**Growth**

We achieved 1% comparable sales growth (nominal 2%), with 9% comparable growth in the second half of the year (nominal + 6%). This overall growth was supported by double-digit growth with our top eight retail accounts. We maintained our strong relationships with major retailers, driving greater customer intimacy and dedication through a combination of more efficient distribution models, increased application of category management, and closer cooperation on supply chain management.

Overall, the consistent delivery of solid financial results has supported the strategic ambitions of sustainable performance through CE s asset-light operating model (including minimal to negative net operating capital levels) and an adjusted IFO of around 3%.

Our Peripherals & Accessories business grew further with the acquisition of the US-based Digital Lifestyle Outfitters (DLO), a leading supplier of computer and digital music player accessories. Over the past years the Peripherals & Accessories organization has established a successful track record of integrating such acquisitions quickly and effectively. Along with its acquisition program, Peripherals & Accessories organic growth has benefited from the application of innovative brand alliances, such as the Philips-Swarovski Active Crystals range and the assortment of accessories for Nokia mobile phones.

Continuing our active portfolio management, in line with our growth strategy, we completed the sale of our remaining Mobile Phone activities to China Electronics Corporation (CEC) in March 2007. This transaction included the transfer of the Xenium product brand and the granting of an exclusive license to market and sell mobile phones under the Philips brand for the coming five years. In December 2007, Philips announced that it has reached an agreement to sell its Set-Top Boxes and Connectivity Solutions activities, part of the Home Networks business unit, to Pace Micro Technology of the UK. Upon completion of the deal, Philips will become a shareholder of some 23% in the combined business.

Relevant innovation continues to be a key driver of our business. Major 2007 product launches included the Aurea FlatTV, which we unveiled at IFA 2007 in Berlin. Taking Ambilight a dramatic step further, Aurea creates a halo of dynamic light within the frame and around the TV for an immersive viewing experience. The Cineos SoundBar with Ambisound technology simplifies the home entertainment experience, delivering real 5.1-channel surround sound from a single unit, reducing the need for multiple speakers and cabling. In PC gaming, we introduced a range of accessories applying Philips amBX technology for even more immersive gaming.

Simplicity-led design is a key differentiator in the consumer electronics marketplace. Its application together with relevant innovation and deep consumer insight has enabled CE to create unique and compelling lifestyle propositions. Early in 2007, CE appointed a dedicated Chief Design Officer to ensure a more structural and consistent implementation of a differentiating design strategy throughout the business creation process.

CE also continues to harness Philips recommended brand status, driving Net Promoter Scores across all key categories, processes, functions and consumer touchpoints, in particular delivering consistent top-tier results above 60% levels for the Ambilight Flat TV category.

**Talent**

Transformational leadership was reinforced by the launch, in April, of a strategic initiative to apply consumer and customer-centric behavior throughout the organization. This initiative was underpinned by a new structural framework entailing key changes simplifying the way CE operates designed to engender greater outside-in thinking. This initiative was carried further into the project to integrate CE and DAP in the Consumer Lifestyle sector, which commenced in September following the Philips Vision 2010 announcement.

CE s People Leadership ranking showed a score of 76% in 2007, clearly above the high-performance benchmark.

**Simplicity**

CE has contributed significantly to the increase in Philips brand value by applying simplicity to products, services and the way we interact and communicate with our customer base.

CE has also worked directly with retailers in addressing the environmental impact of electrical consumer appliances. Major retail partners have sought Philips expertise in this area, leveraging the company s EcoVision product creation strategy. Furthermore, the launch, in 2007, of a green logo on CE s most environmentally friendly products provided clear and easy in-store guidance to consumers about the environmental impact of Philips products they wish to purchase.

**Strategy and 2008 objectives**

Following the announcement of Vision 2010 in September 2007, the former Consumer Electronics and Domestic Appliances and Personal Care divisions have been integrated effective January 1, 2008, and going forward will be reported as the Consumer Lifestyle sector.

Philips Consumer Lifestyle will play an important role in the realization of Philips Vision 2010 ambition. For 2008 and beyond, Consumer Lifestyle has put in place a number of specific value-creating initiatives which it will drive through a framework of Growth, Talent and Simplicity:

- Leverage post-integration synergies, particularly with regard to customers, markets and key account management, as well as in supply chain optimization and the sector s relationships with third-party suppliers and partners; synergies will also be realized across all operational processes, through the organizational blueprint and way-of-working design
- Open up new value spaces in the consumer lifestyle field to further strengthen our business portfolio and to deliver upon our growth ambition
- Create a unified, engaged and high-performance organization in which growth and diversity can be nurtured within our leadership community and talent pipeline
- Maximize our structure to be fully market-driven, in terms of our customer relationships and our business portfolio.

The information on the financial performance of the sector Consumer Electronics under the heading Operating and financial review and prospects in item 5 is incorporated herein by reference.

## Lighting

Philips Lighting is the global market leader, with recognized expertise in the development, manufacturing and application of innovative lighting solutions. Philips pioneered many of the key breakthroughs in lighting technology, creating a solid basis for both its present activities and future aspirations. Through its expertise and in-depth understanding of the customer and the end-user, the division is a market-driven innovator in lighting and a shaper of the lighting industry landscape. As stated in its mission, Philips Lighting understands people and improves their lives with lighting.

Lighting s products are found throughout the home and in professional applications at work, on the move, in shops, in the city, hospitals, sports stadiums, etc. The division consists of the following businesses:

- Lamps incandescent; halogen; (compact) fluorescent; high-intensity discharge
- Consumer Luminaires functional; decorative; lifestyle
- Professional Luminaires city beautification; road lighting; sports lighting; office lighting; shop/hospitality lighting; industry lighting
- Lighting Electronics electronic gear; electromagnetic gear; controls
- Automotive and Special Lighting Applications car headlights; car signaling; other transport vehicles; optical lighting; infrared; ultraviolet; projection
- Solid-State Lighting Components and Modules retrofits; modules; flashlight; display; LUXEON.

Two key trends are shaping the global lighting market: the need for energy efficiency and the emergence of solid-state lighting.

Lighting presents a clear opportunity to save energy and slow climate change. It accounts for some 19% of global electricity consumption. Innovative lighting solutions can realistically save up to 40% energy on today s installed base, while also improving the quality of the light.

Solid-state or LED lighting represents the most significant development in lighting since the discovery of electric light well over a century ago. Offering unprecedented design freedom in terms of color, dynamics, miniaturization, architectural integration and energy efficiency, it is opening up exciting new possibilities, e.g. for ambience creation.

Our customers are mainly in the professional market. The Lamps business operates its sales and marketing activities through the professional, OEM and consumer channels, the latter also being used by our consumer luminaires business. Professional Luminaires is organized in a Trade business (commodity products) and a Projects business (project luminaires); for the latter, the main focus is on lighting designers, architects and urban planners. Automotive Lighting is organized in two businesses: OEM and After-market. Special Lighting and solid-state lighting components and modules are OEM businesses, while Lighting Electronics sales and marketing are conducted through both the OEM and wholesale channels.

The division has manufacturing facilities in 25 countries, and sales organizations in more than 60. Commercial activities in other countries are handled via dealers working with the International Sales organization. Lighting has some 54,000 employees worldwide.

Lighting complies with all relevant regulatory requirements, most notably the EU WEEE (Waste from Electrical and Electronic Equipment) Directive and the RoHS (Restriction of Hazardous Substances) Directive.

With regard to sourcing, please refer also to the business description of Philips Supply Management under the heading Group Management & Services in this item 4.

17

**Progress against targets**

In the Annual Report 2006, Lighting identified a number of key objectives for 2007. The progress made in addressing these is discussed below.

**Emerging markets**

We continue to build on our strong position in key emerging, fast-growth markets, such as Latin America, China, the Indian subcontinent, Central and Eastern Europe and the ASEAN zone, which together now account for 37% of Lighting sales. In these markets, our comparable and nominal growth in 2007 was 16%.

Developing our distribution networks in these countries continues to receive our full attention. In China, for example, we are expanding our distribution network to second and third-tier cities, of which there are some 660 with populations of between half a million and two million. In 2007, we added 8,000 outlets (or 30 per day), giving a total of 11,600. We expect this figure to rise to 18,700 by the end of 2008. Our China Sourcing Group, formed in 2004 as a Lighting entity to facilitate our businesses sourcing from China through one window, is on course to deliver USD 1 billion supply value by 2010.

**Energy-efficient lighting solutions**

In 2007, Lighting built on its strong position in the value chain towards professional end-users and consumers, especially by drawing attention to the worldwide energy and climate-saving opportunity offered by our energy-efficient lighting. Our new innovative lighting solutions can realistically save up to 40% energy on all today s installed lighting, whether outdoors, in offices or shops, or in the home. At the same time they offer a clear improvement in the quality of the light.

Saving 50% on energy costs and creating a safer environment, over 50,000 Philips CosmoPolis street lighting systems have already been installed in 50 cities in Europe, and interest is increasing in Asia, and particularly China, where energy-efficient products already represent 44% of our total Lighting sales.

The switch-over rate to energy-efficient lighting, however, is still too low given the energy-saving opportunity. We are working hard to remove the obstacles to accelerating this switch-over via awareness campaigns (public and private), supporting new legislation (e.g. energy certification for buildings) and partnerships (public, private, non-government organizations and utilities). In 2007, sales of our Green products rose further and now account for 48% of Lighting sales.

**Solid-state lighting**

In 2007 we strengthened our position as the leader in solid-state lighting and are the only company covering the whole value chain from LED components via modules to luminaires and systems. Over the past few years we have invested nearly EUR 4 billion in acquiring high-growth businesses in the areas of solid-state lighting and luminaires. This figure includes the sum of EUR 1.8 billion agreed in November 2007 for the acquisition of Genlyte Group Incorporated, a leading North American luminaire manufacturer, which we completed on January 22, 2008.

Besides growing our presence in North America, this transaction deepens our contacts to end-users, such as wholesalers, contractors, architects and lighting designers, helping us speed up the market roll-out of more energy-efficient lighting and the introduction of new lighting technologies, like solid-state lighting.

Early in 2007 we closed the acquisition of Partners in Lighting International (PLI), the leading European manufacturer of home luminaires. This acquisition strengthens our presence in the home lighting market, where solid-state lighting will bring major benefits in terms of creating atmospheres and reducing energy consumption. Successfully integrated, PLI is now organized as a global business in its own right and is running well ahead of its business plan.

Next came our acquisition of TIR Systems, based in Vancouver, Canada, a leading company in solid-state lighting technology for products that generate high-quality white light and a leader in SSL modules. TIR has a sizeable intellectual property portfolio.

In September we completed the acquisition of Color Kinetics, a recognized innovator and leading player in the SSL luminaire business with a strong presence in the USA and a broad technology and intellectual property portfolio (controls and intelligent technology).

In this way we are building a strong position through the complete SSL value chain for future growth in energy-efficient lighting solutions using LED sources. These acquisitions strengthen our technology base and intellectual property position, and provide us with a strong presence in all continents. At the same time we continue to develop and invest in new OLED (Organic LED) and solid-state laser activities.

Table of Contents

**Talent**

Under the heading *Building competence*, we have been driving the quality of our leadership, training more than half our marketing people in the past two years on using end-user insights to drive innovation, the Value Proposition House methodology and marketing planning and execution. We have hired around 20 executive potentials per year over the past four years.

Under the heading *Building a strong culture of excellence*, we have been establishing a growth culture and have seen our progress reflected in, for example, a considerable advance in our Employee Engagement Survey score towards the high-performance benchmark and over 40% employee participation in our annual Quality Improvement Competition.

**Simplicity**

To bring ourselves closer to our customers, we have shifted our focus from product management to market segments. This move toward added value is reflected in the lighting solutions we offer in the various segments.

For example, in the home environment, we let people create the atmosphere to suit their mood by choosing the color of their light with LivingColors. And our flexible AmbiScene lighting concept lets retailers tailor the instore ambience at the touch of a button, to offer consumers an inspiring shopping experience.

In line with this, we have organized our country sales groups around the customer channels wholesale, projects, OEM and mass retail and leveraged our back office activities across our businesses as shared service departments.

We made significant progress in 2007 in our drive for supply chain excellence specifically in the area of organizing the China supply chain, where volume doubled in the last year thanks to several initiatives to improve processes and ways of working (e.g. direct shipments and planning).

**Strategy and 2008 objectives**

Philips Lighting will play an important role in the realization of Philips Vision 2010 ambition. For 2008 and beyond, Lighting has put in place a number of specific value-creating initiatives which it will drive through a framework of Growth, Talent and Simplicity:

- Accelerate growth, both organically and through the successful integration of acquisitions, on the basis of strength in emerging markets and in energy-efficient lighting solutions
- Expand in the direction of system solutions, closely connected to the applications in the market, in the areas of professional luminaires and consumer luminaires
- Continue to build on the leading position in solid-state lighting
- Strengthen the leadership bench via proactive talent recruitment
- Continue to build on the strong culture of excellence, while creating a learning organization focused on continuous improvement
- Streamline ways of working by implementing segment marketing, strengthening customer focus and driving for supply excellence.

The information on the financial performance of the sector Lighting under the heading Operating and financial review and prospects in item 5 is incorporated herein by reference.

## Innovation & Emerging Businesses

In 2007 this sector comprised Corporate Technologies, Corporate Investments, Design and Consumer Healthcare Solutions. The latter renamed Home Healthcare Solutions became part of the Healthcare sector as of January 1, 2008. In 2007 this sector previously reported under the heading Other Activities was positioned as Innovation & Emerging Businesses, reflecting Philips ambition for future growth. By leveraging its brand, technology, IP base and distribution network, Philips invests, through this sector, in projects that are not currently part of the operating divisions, but which will Philips believes lead to additional organic growth or value creation through future spin-offs.

**Corporate Technologies**

Corporate Technologies feeds the innovation pipeline, enabling its business partners Philips divisions and external businesses to improve their time-to-market and innovation effectiveness, and thus achieve profitable growth.

Table of Contents

It includes Corporate Research, Philips Incubators, Intellectual Property & Standards, campuses in India and China, as well as Applied Technologies.

Corporate Technologies supports Philips operating divisions in turning innovations into advanced products, creating company-wide technology synergies through its shared labs and competencies. The High Tech Campus in Eindhoven, Netherlands, and the Philips Innovation Campus in Bangalore, India and Shanghai, China are prime examples of this approach.

Innovations are developed in close interaction with endusers and partners, in order to ensure that as well as being advanced, they are designed around users needs and are easy to experience. Corporate Technologies reaches out to others in the innovation eco-system through relationships with institutes, academia and industrial partners, as well as via European and regional projects and presence at clinical sites. By adopting an Open Innovation strategy, Corporate Technologies also leverages the joint innovation power of its partners to bring more innovations to market faster and more effectively.

Corporate Technologies invests in new business opportunities as well as in building world-class competencies and technologies that are essential for the Philips businesses, but also provides these to external customers, in order to realize maximum return on investment. Technologies and applications are made available in the form of patent and technology licenses, software and hardware components, prototypes, competencies and services (design, system integration, product introduction services and testing). Where appropriate, emerging businesses are incubated until they are ready for transfer to a sector or spin-out, in part or in whole, to a third-party investor.

In total, Corporate Technologies employs around 4,200 professionals at some 20 locations worldwide.

**Research**

Philips Research supports Philips operating divisions with innovations, inventions and long-range vision. It employs approximately 1,800 professionals around the globe. Founded in 1914, Philips Research is one of the world s major private research organizations, with main laboratories in the Netherlands, Germany, the United Kingdom, the United States, China and India. The activities are driven by user insights, and Philips Research runs an ExperienceLab, consisting of HomeLab, ShopLab and CareLab, in order to obtain continuous feedback on how well its concepts meet end-user expectations.

**Incubation and emerging businesses**

In line with its strategy, Philips has established three corporate venturing organizations: the Healthcare, Lifestyle and Technology Incubators, employing close to 200 professionals. Their charter is to identify new growth opportunities for Philips and to help business teams transform ideas into new business, by matching unmet market needs with a unique value proposition. The necessary capabilities can be sourced internally, or acquired externally, e.g. in the start-up community. These initiatives are governed by boards which are chaired by a member of the Board of Management. In 2007 an external financing round was successfully structured for Silicon Hive, diluting Philips stake in this venture into that of the largest minority shareholding. In addition to the Incubator activities, a Molecular Healthcare business initiative has been created.

**Philips Intellectual Property & Standards (IP&S)**

Philips IP&S proactively pursues the creation of new Intellectual Property (IP) in strategic areas and uses this IP to support the growth and competitiveness of Philips businesses. IP&S manages the Philips IP portfolio, which currently consists of about 60,000 patent rights, 29,000 trademarks, 43,000 design rights and 2,000 domain name registrations. By participating in the creation of new standards, IP&S also facilitates market adoption of new innovations.

Employing close to 450 people, IP&S has a strong global presence with offices in the major countries, which allows it to create and exploit the Philips IP portfolio close to its internal and external customers.

Philips believes its business as a whole is not materially dependent on any particular patent or license, or any particular group of patents and licenses.

**Applied Technologies**

Philips Applied Technologies supports its customers by providing technology and developing first-of-a-kind products and applications. Approximately 850 professionals working at six locations across Europe, Asia and the US create new technologies and transform ideas into competitive products. In addition, customers are served through New Product Introduction Services.

**Progress against targets**

In the Annual Report 2006, Corporate Technologies defined a number of key focal areas for 2007 and beyond. The progress made in these is outlined below.

20

Developing advanced technologies to create meaningful innovations

Corporate Technologies contributed to a host of meaningful innovations in 2007. In healthcare, for example, the concept of SmartExam was introduced to MRI, leading to simpler procedures and an improved workflow for high-quality scans. For CT, a totally new hardware architecture has been developed, including an air-bearing gantry and new x-ray optics, allowing extremely highspeed multiple-slice scanning, which yields much sharper heart images. In solid-state lighting, Lumiramics technology has been transferred to Philips Lighting, providing the business with a breakthrough in color consistency for white LED products, a key component in the solid-state lighting revolution.

Generating patents

Philips filed approximately 1,625 patents in 2007. Currently, Philips is in the process of reshaping its intellectual property portfolio in line with its new strategic focus on Healthcare, Lighting and Consumer Lifestyle.

Incubating new businesses

The Philips Incubators are separate business units within Corporate Technologies. In 2007 there was public presence for 3D Solutions, amBX, Handshake Solutions, Lumalive, Content Identification, Beatbrew, Care Servant and Handheld Diagnostics, including a commercialization agreement with Cozart on drugs-of-abuse testing. The combined incubator pipelines contain more than 25 ventures. To ensure more effective management of the ventures in the pipeline, Bell-Mason stage gating was introduced in 2006, with preceding phases added in Philips Research. In 2007, more than 500 people across Philips were trained in this methodology.

Stimulating end-user focus

Philips has introduced the Value Proposition House methodology to capture end-user insights and create meaningful innovations. Marketing, supply management and R&D have worked closely together to create a process for value propositions and how to translate them into successful innovations.

**Strategy and 2008 objectives**

Corporate Technologies strategy for 2008 and beyond will focus on:

- Developing advanced technologies and applications to create meaningful innovations
- Generating patents to protect these innovations, particularly in key areas of growth
- Incubating new businesses as a driver of sustainable growth
- Improving innovation effectiveness by stimulating enduser focus and cross-functional collaboration with marketing and supply management
- Establishing closer links to the business sectors by reinforcing the account management function. This will ensure sharing of user insights, roadmap continuity and awareness of business options.

**Corporate Investments**

**Divested activities**

In line with Philips strategy to reduce its portfolio of noncore, strategically unaligned activities, most of the remaining activities within Corporate Investments were divested in the course of 2007.

Philips Power Solutions Supplies

Philips Power Solutions Supplies develops and markets integrated modules for electronic power conversion and has some 85 employees; sold to Bobinados de Transformadores S.L.

Ommic

Ommic develops, produces and markets Low Noise

Amplifiers, smart antenna core chips and epitaxy/foundry services and has some 70 employees; sold to Financière Victoire SAS of France.

Philips Optical Storage Optical Media & Technology

Optical Media & Technology, part of Optical Storage, is engaged in the development and verification/certification of formats/standards in optical media and the development and marketing of test disks and has some 55 employees; sold to MoserBaer.

Table of Contents

Philips Optical Storage Automotive Playback Modules
Automotive Playback Modules develops and markets playback modules for the automotive industry and has some 1,600 employees; sold to LiteOn IT Corporation.

**Remaining activities**

As of the end of 2007, Corporate Investments consists of Assembléon and High-tech Plastics Optics.

Assembléon

Assembléon is a wholly owned subsidiary that develops, assembles, markets and distributes a diverse range of surface-mount technology placement equipment. Its customers use Assembléon machines to place surface-mount devices and other electronic components on printed circuit boards. Assembléon employs some 750 people, mainly in the Netherlands.

High-tech Plastics-Optics

High-tech Plastics Optics develops, manufactures and markets high-end plastics, opto- and opto-mechanical products. It employs some 360 people, almost all in China.

In 2008, Corporate Investments will be repositioned as the New Venture Integration Group, which will focus on the integration of newly acquired companies across all sectors.

**Philips Design**

Philips Design is one of the largest and longest-established design organizations of its kind in the world. It is headquartered in Eindhoven, the Netherlands, with branch studios in Europe, the USA and Asia Pacific.

Its creative force of some 550 professionals contains more than 30 different nationalities, embracing disciplines as diverse as psychology, cultural sociology, anthropology and trend research in addition to conventional design related skills.

Philips Design works according to a proprietary methodology known as High Design. High Design is completely human-focused and research-based, and always uses a deep understanding of people s needs as the starting point for the design process. It also provides the framework for translating these insights into imaginative yet feasible solutions. In this way Philips Design is an important driver in making the Philips brand promise of sense and simplicity tangible. Philips believes it is only by appreciating the values and motivations of end-users that it can create sustainable propositions that are simple to experience and enrich the quality of people s lives.

Philips Design offers a full range of design services to many different types of clients both within and outside the Philips organization. These include design management, corporate identity creation and innovation design, as well as design of products, communication materials, interfaces and solutions for internet and new media.

In 2007, Philips received an outstanding total of over 35 design awards. The Red Dot best of the best for designs considered pioneering in their field was awarded to the Philips Design Skin Probes, which also featured in TIME Magazine s list of best inventions 2007 . These far-future research initiatives track trends and developments that may ultimately evolve into mainstream issues with a significant impact on Philips business.

In 2007, Philips Design also received the first ever Design Management Europe award for its successful integration of design into business.

**Consumer Healthcare Solutions**

Philips Consumer Healthcare Solutions* provides products and services that improve the quality of life for at-risk seniors, people with chronic illnesses and their caregivers, by enabling independent living at home.

* *In 2007, Consumer Healthcare Solutions was reported in the sector Innovation & Emerging Businesses. As*

*of January 1, 2008, Consumer Healthcare Solutions renamed Home Healthcare Solutions has been incorporated in the new Philips Healthcare sector.*

22

**Table of Contents**

Given the unsustainable level of healthcare costs in many markets and the growing emphasis on both efficiency and patient comfort, we are witnessing a gradual shift towards diagnosing, treating and monitoring patients in their homes rather than in hospitals. Demand for home healthcare is also growing due to the increasing number of elderly people and the rising incidence of chronic diseases.

The business consists of Lifeline and Philips Remote Patient Management.

Lifeline is the North American market leader for medical alert services. Its 1,100 employees work closely with community hospitals, homecare agencies and referral networks to provide emergency medical alert services and social support to the at-risk elderly to enhance their independence and quality of life.

In 2007, Lifeline continued to realize double-digit organic growth of its subscriber base. With the purchase of Health Watch, Lifeline now monitors over 700,000 subscribers. The Senior Living division, which serves the independent and assisted living market, now services nearly 150,000 residents in senior living facilities.

In 2008, Lifeline will continue to develop its core business by leveraging healthcare channels in local communities, as well as investing in innovation to stimulate further market development and deploying new marketing tools, such as customer relationship management software for more touch points with potential subscribers. The consolidation of the Health Watch platform into Lifeline is well under way and will be completed in 2008.

In 2007, Philips Remote Patient Management with some 400 employees focused on building awareness within the home health industry of its comprehensive offering of telehealth products and services for post-hospital discharge monitoring of chronically ill patients.

This offering includes wireless home telemonitoring devices and web-based clinical review software, as well as a suite of services such as data review, program development and deployment support designed to help customers build or improve their telehealth programs.

In 2008, Philips Remote Patient Management will continue to focus on the home care market. By implementing initiatives designed to leverage Lifeline s relationships with home health agencies, and by developing strategic relationships with home care associations and technology partners, Philips expects patient enrollment to increase gradually and consistently throughout the year.

The recent acquisition of Raytel Cardiac Services, a provider of solutions for pacemaker, implanted defibrillator, holter, event and anticoagulation monitoring, complements Philips portfolio of home healthcare solutions. By adding home cardiac monitoring services and clinical call center competencies, the acquisition allows Philips to better serve the home healthcare market and exploit potential synergies with its cardiology competency. Over the next several years, Philips will leverage Raytel s clinical call center infrastructure, referral base and experience in out-of-hospital services to enhance its home healthcare business.

Our proposed acquisition of Respironics a leading USbased global provider of innovative respiratory and sleep therapy solutions for hospital and home use is part of Philips strategy to create a global leadership position in the fast-growing home healthcare market, where we can leverage our Philips brand and our understanding of people s needs. Building upon the prior 2007 acquisitions of Health Watch and Raytel Cardiac Services, the acquisition of Respironics will establish us as the market leader in home healthcare solutions.

With regard to sourcing, please refer also to the business description of Philips Supply Management under the heading Group Management & Services in this item 4.

With regard to regulatory requirements, please refer to regulatory requirement in the business description of Medical Systems.

With regard to strategy and 2008 objectives, please refer to the Philips Healthcare strategy and 2008 objectives in the business description.

The information on the financial performance of the sector Innovation & Emerging Businesses under the heading Operating and financial review and prospects in item 5 is incorporated herein by reference.

Table of Contents

## Group Management & Services

The sector Group Management & Services comprises the activities of the corporate center including Philips global brand management and sustainability programs, as well as country and regional overhead costs, and costs of pension and other postretirement benefit plans. Additionally, the Global Service Units such as Philips General Purchasing and Real Estate are reported in this sector.

The information on the financial performance of the sector Group Management & Services under the heading Operating and financial review and prospects in item 5 is incorporated herein by reference.

**Supply Management**

The Company s mission for supply management is to create value by leveraging the power of One Philips and transforming the transactional purchasing function into strategic supply management.

2007 marks the fourth year of a comprehensive change program. Supply Management plays a key role in value creation, and 74% of Philips spend is now centralized or center-led. From 2003 until 2007 the total number of active suppliers was reduced from more than 50,000 to less than 20,000. 80% of spend on Bill of Material (BOM) is now concentrated on 255 suppliers, and in Non-Product-Related (NPR) on 670 suppliers.

**Leveraging the power of One Philips**

Leveraging the company s spend and resources in key areas and negotiating as One Philips improves time-to-market, reduces total cost of ownership and increases quality. Strategic priorities are:

- NPR spend: Philips has centralized its NPR spend. In addition to enhancing negotiating power, this organization initiates cost-saving projects together with operational units and suppliers, in the areas of cost avoidance and efficiency enhancement. During 2007 the transactional shared service centers for NPR purchasing were outsourced, together with the Finance Shared Service activities, to Infosys.
- Cross-divisional BOM opportunities: ownership of some EUR 3 billion cross-divisional spend is concentrated centrally. Cross-divisional teams led by divisional Chief Purchasing Officers are active in ten commodity areas, including metals and electronic components. Centralized One Philips leveraging of this spend with fewer, more strategic suppliers has resulted in significant value creation.
- Outsourcing strategy and guidance: this initiative supports industrial strategy decision-making, addressing the shift in resources required to manage the change to an outsourcing relationship. The Company s total OEM/ODM outsourcing spend has almost doubled in the past three years to EUR 6.5 billion. To encourage development of more strategic relationships, the number of preferred EMS suppliers has been reduced from 61 in 2004 to 8 in 2007.

Supply Management set a target in 2005 to achieve two year cumulative savings of EUR 1 billion in the One Philips spend categories. This target was met in the 2006/2007 time frame and has helped to improve Philips competitiveness.

**Transforming toward strategic supply management**

Strategic suppliers

Philips can realize more value by working closely with a strong network of strategic suppliers. The Partners for Growth strategic supplier relationship management program brings Philips together with its top 30 suppliers to identify and exploit concrete business opportunities. Philips business with Partners for Growth suppliers has increased by 29% since 2004.

More than 50% of total product costs are defined in the early development stages. Therefore, early supplier/supply management involvement in the product creation process is essential in realizing quality plus time- and cost-saving initiatives. This priority has led to an increased involvement of supply management and strategic suppliers in the creation process, also via a wider application of tools like design-in workshops.

Supplier Performance Measurement

A Global Supplier Rating System (GSRS) is now operational in all businesses, resulting in a more professional and structural supplier performance measurement and subsequent improvement actions**.** In 2007 the rating system covered 84% of the total spend.

Supplier consolidation

Supplier concentration is a key element in reducing complexity in the supply chain. For example, Medical Systems sources sub-assembly units from a limited number of global suppliers. The drive towards supplier consolidation continues, with Medical Systems on target to procure 80% of its BOM from fewer than 100 preferred suppliers.

Sustainability

In support of the Company s strong commitment to sustainability, all suppliers with spend above EUR 100,000 in risk areas are audited, partially with the help of external, independent auditing firms. A rigorous program is in place to follow up any issues that may occur. As part of the Dow Jones Sustainability Index assessment, the rating for this practice went up from 81 to 92 in 2007.

Managing sourcing risk

To enhance risk management in the supply chain, Consumer Electronics has for many years implemented a dual-sourcing strategy to ensure competitive sourcing and continuity of supplies. It has done this through strategic partnerships, mainly in the areas of LCD panels and EMS. In 2007 the major challenge was to manage the tightening market in LCD panels. In another example of reducing sourcing risk, Lighting has established partnership agreements with those key suppliers on which it depends for the supply of critical lamp components.

Low-cost country sourcing

Low-cost country sourcing activities have continued to be a major source of value in supply management. For example, Lighting utilizes a global supply base to support its varied manufacturing operations. A dedicated China Sourcing Group is in place to source products for both local and export markets. While China is the main area of attention, other countries are also under review for further extension of the supply base presence. In 2007, 58% of BOM spend and 24% of NPR spend took place in low-cost countries.

E-contract management

E-contract management is being rolled out across the company. In 2007, EUR 2.6 billion (or 14%) in spend was managed via e-bidding events, compared to around EUR 387 million in 2005.

Market intelligence

In 2007 a central-led Supply Market Intelligence and Services group (SMIS) was created with presence in key supply markets (China, India, Korea, Japan and Taiwan). The SMIS teams work closely together with businesses to identify supply market opportunities.

## Organizational structure

The information concerning Philips significant subsidiaries in Exhibit 8 to this Annual Report on Form 20-F is incorporated herein by reference.

## Property, plant and equipment

Philips owns and leases manufacturing facilities, research facilities, warehouses and office facilities in numerous countries over the world.

Philips has approximately 100 production sites in 29 countries. Philips believes that its plants are well maintained and, in conjunction with its capital expenditures for new property, plant and equipment, are generally adequate to meet its needs for the foreseeable future. For the net book value of its property, plant and equipment and developments therein, reference is made to note 15 Property, plant and equipment on page 161 of the 2007 Annual Report incorporated herein by reference. The geographic allocation of assets employed as shown in the section entitled Information by sectors and main countries on pages 137 through 139 of the 2007 Annual Report and incorporated herein by reference, is generally indicative of the location of manufacturing facilities. The headquarters in Amsterdam are leased. The information as shown in note 26, entitled Contractual Obligations on page 173 of the 2007 Annual Report, partly related to the rental of buildings, is incorporated herein by reference.

For environmental issues affecting the Company s properties, reference is made to note 27 on pages 173 through 176 of the 2007 Annual Report incorporated herein by reference.

Capital expenditures in progress are generally expected to be financed through internally generated cash flows. For a description of the geographic spread of capital expenditures, reference is made to the section Information by sectors and main countries on pages 137 through 139 of the 2007 Annual Report incorporated herein by reference.

**Table of Contents**

For a description of the Company s principal acquisitions and divestitures, reference is made to note 2 on pages 147 through 152 of the 2007 Annual Report incorporated herein by reference.

## Item 4A. Unresolved Staff Comments

None.

26

# Item 5. Operating and financial review and prospects

## Operating results

### The year 2007

2007 was a successful year for Philips. We delivered on our growth target, realizing 5% comparable sales growth, and exceeded our profit target with adjusted income from operation (adjusted IFO) of 7.7%. Our strong innovation pipeline and balanced portfolio proved their robustness in a weakening economic environment.

In 2007 we accelerated the transformation of Philips into a market-focused, people-centric company capable of delivering sustained profits.

We invested a total of EUR 1.5 billion in acquiring high-growth, high-margin businesses to strengthen our leadership position in promising markets and to gain access to new markets.

At the end of the year, we announced the two largest acquisitions in recent company history, Genlyte and Respironics. The integration of these highly profitable companies is in line with our Vision 2010 strategy.

In 2007 we further reduced our shareholdings in LG.Philips LCD and TSMC to 19.9% and 5.0% respectively, generating cash inflows of EUR 5.4 billion and a gain of over EUR 3 billion.

We bought back shares for EUR 1.6 billion and returned EUR 0.6 billion cash to our shareholders via the annual dividend payment.

At the end of 2007 we announced a further EUR 5 billion share buy-back program, which we intend to largely complete by the end of 2008. In addition, we are proposing a dividend of EUR 0.70 per share in 2008, a 17% increase compared to 2007.

### Key data

| in millions of euros, except for the per common share data | | 2006 [1] | 2007 |
|---|---|---|---|
| Sales | | 26,682 | 26,793 |
| IFO | | 1,201 | 1,852 |
| as a % of sales | | 4.5 | 6.9 |
| Adjusted IFO | | 1,386 | 2,065 |
| as a % of sales | | 5.2 | 7.7 |
| Financial income and expenses | | 28 | 2,613 |
| Income tax expense | | (167) | (622) |
| Results equity-accounted investees | | (157) | 763 |
| Minority interests | | (4) | (5) |
| Income from continuing operations | | 901 | 4,601 |
| Income (loss) from discontinued operations | | 4,482 | (433) |
| Net income | | 5,383 | 4,168 |
| Per common share (in euro) | basic | 4.58 | 3.84 |
| Per common share (in euro) | diluted | 4.55 | 3.80 |
| Net operating capital (NOC) | | 8,518 | 10,586 |
| Cash flows before financing activities | | (2,472) | 5,449 |

| | | |
|---|---|---|
| Employees (FTE) | 121,732 | 123,801 |
| of which discontinued operations | 6,640 | 5,703 |

1) Restated to present the MedQuist business as a discontinued operation.

In 2007 the Philips Group achieved comparable sales growth of 5%. However, because of a 3% negative currency effect and the impact of acquisitions and divestments, nominal sales remained stable compared to 2006. Comparable sales growth was realized by all divisions, with DAP (15%) and Lighting (6%) delivering particularly strong growth. Comparable sales growth at CE was limited to 1% mainly due to market share losses in Connected Displays in the first half of 2007, especially in the US. At Medical Systems, comparable sales increased by 4%, despite a softening of the imaging market in the US, due in part to the impact of the Deficit Reduction Act, and in Japan.

Sales growth was particularly strong in emerging markets, which will continue to be increasingly important to Philips. Emerging markets, most notably China, Russia and India, contributed 60% to our comparable sales increase in value, while accounting for 30% of total revenues.

IFO amounted to EUR 1,852 million, compared to EUR 1,201 million in 2006.

The Group s adjusted IFO improved by EUR 679 million and amounted to EUR 2,065 million, or 7.7% of sales, the highest margin in recent years, up from 5.2% in 2006. The higher results were primarily driven by DAP and Lighting, which achieved adjusted IFO margins of 17.6% and 11.9% respectively. Additionally, the EUR 146 million cost reduction in the Group Management & Services sector contributed significantly to the earnings improvement. The increase in adjusted IFO was also attributable to a EUR 256 million product liability charge in 2006.

Income from continuing operations amounted to EUR 4,601 million, an increase of EUR 3,700 million compared to 2006. The improvement was driven by EUR 651 million higher operational earnings and EUR 2,585 million increased financial income, primarily due to the sale of shares in TSMC. Income tax charges were EUR 455 million higher, at an effective tax rate of 13.9% in 2007 compared to 13.6% in 2006. Results of equity-accounted investees improved by EUR 920 million, including a EUR 508 million non-taxable gain from the sale of shares of LG.Philips LCD and a EUR 456 million improvement in that company s operational results.

Income from discontinued operations showed a loss of EUR 433 million, mainly due to MedQuist-related impairment charges, taking into account cumulative foreign currency translation differences. In 2006, income from discontinued operations included a total gain of EUR 4,283 million from the sale of Philips majority stake in Semiconductors.

Net income for the Group resulted in a profit of EUR 4,168 million, or EUR 3.84 per share.

Cash flows before financing activities increased by EUR 7.9 billion, largely due to increased cash flows from operating activities, higher inflows from the sale of stakes in TSMC and LG.Philips LCD, and lower cash outflows for acquisitions.

## Performance of the Group

### Sales

In percentage terms, the composition of sales growth in 2007, compared to 2006, was as follows:

### Sales growth composition 2007 versus 2006[1)]

| in % | comparable growth | currency effects | consoli-dation changes | nominal growth |
|---|---|---|---|---|
| Medical Systems | 3.6 | (5.2) | 1.9 | 0.3 |
| DAP | 15.4 | (3.1) | 4.9 | 17.2 |
| Consumer Electronics | 1.0 | (2.2) | (0.8) | (2.0) |
| Lighting | 6.0 | (3.1) | 8.6 | 11.5 |
| Innovation and Emerging Business | 32.2 | (4.5) | (80.6) | (52.9) |
| Group Management & Services | 30.8 | (2.3) | (10.5) | 18.0 |
| Philips Group | 4.9 | (3.3) | (1.2) | 0.4 |

1) Restated to present the MedQuist business as a discontinued operation.

Group sales grew by 5% on a comparable basis to EUR 26,793 million in 2007. However, because of a 3% negative currency effect and a negative net impact of acquisitions and divestments, mainly due to the divestment of Optical

Storage and Mobile Phones, nominal sales remained stable year-over-year.
The comparable sales growth was driven by all market clusters and all product divisions, and was particularly strong at DAP (15.4%) and Lighting (6.0%).
The robust sales increase at DAP was driven by double-digit sales growth in all businesses, most notably Domestic Appliances, and was visible throughout all market clusters, with especially strong growth rates in emerging markets.
The increase in Lighting sales was mainly attributable to solid growth in energy-efficient lighting within the Lamps and Luminaires businesses.

**Table of Contents**

Medical Systems growth (3.6%) was led by Ultrasound & Monitoring and Customer Services. Overall sales growth was tempered by a decline at Imaging Systems, primarily due to a softening of the market in the US (including the effect of the Deficit Reduction Act) and Japan. At CE, the sales increase (1.0%) was driven by all businesses, except Connected Displays, which lost market share in the first half of 2007, and was faced with fierce competition and price pressure in the Flat TV segment, particularly in the US.

## Earnings

In 2007, Philips gross margin of EUR 9,169 million, or 34.2% of sales, represented an improvement of EUR 919 million compared to 2006 (EUR 8,250 million, or 30.9%). Adjusted for the product liability charge in 2006 (EUR 256 million), gross margin improved from 31.9% of sales to 34.2%. This improvement was primarily driven by higher gross margins at Medical Systems and Lighting.

Selling expenses increased from EUR 4,655 million in 2006 to EUR 4,980 million in 2007, largely due to higher expenditures at Lighting and DAP, both partly related to acquisitions and higher sales. As a percentage of sales, selling expenses increased from 17.4% in 2006 to 18.6% in 2007, mainly attributable to Lighting (mostly due to acquisitions) and Medical Systems.

Research and development costs (EUR 1,629 million, or 6.1% of sales) declined slightly compared to 2006 (EUR 1,659 million, or 6.2% of sales), as lower expenditures at CE, mainly related to the divestment of Mobile Phones, offset increased investments in Medical Systems, Lighting, DAP and Innovation & Emerging Businesses.

General and administrative expenses (EUR 854 million) declined by 12% compared to 2006 (EUR 969 million), largely as a result of lower pension costs and reduced overhead costs in corporate and regional organizations, following the simplification of the regional management structure. As a percentage of sales, G&A costs declined from 3.6% in 2006 to 3.2% in 2007.

The following overview shows sales, IFO and adjusted IFO according to the 2007 sector classification.

| in millions of euros | | | | | 2007 |
|---|---|---|---|---|---|
| | sales | IFO | as a % of sales | adjusted IFO | as a % of sales |
| Medical Systems | 6,470 | 743 | 11.5 | 875 | 13.5 |
| DAP | 2,968 | 510 | 17.2 | 523 | 17.6 |
| Consumer Electronics | 10,362 | 322 | 3.1 | 325 | 3.1 |
| Lighting | 6,093 | 675 | 11.1 | 722 | 11.9 |
| Innovation and Emerging Business | 703 | (101) | (14.4) | (83) | (11.8) |
| Group Management & Services | 197 | (297) | | (297) | |
| Philips Group | 26,793 | 1,852 | 6.9 | 2,065 | 7.7 |

| in millions of euros | | | | | 2006 [1)] |
|---|---|---|---|---|---|
| | sales | IFO | as a % of sales | adjusted IFO | as a % of sales |

| | | | | | |
|---|---|---|---|---|---|
| Medical Systems | 6,448 | 734 | 11.4 | 861 | 13.4 |
| DAP | 2,532 | 370 | 14.6 | 378 | 14.9 |
| Consumer Electronics | 10,576 | 313 | 3.0 | 314 | 3.0 |
| Lighting | 5,466 | 577 | 10.6 | 608 | 11.1 |
| Innovation and Emerging Business | 1,493 | (94) | (6.3) | (76) | (5.1) |
| Group Management & Services | 167 | (699) | | (699) | |
| Philips Group | 26,682 | 1,201 | 4.5 | 1,386 | 5.2 |

1) Restated to present the MedQuist business as a discontinued operation.

In 2007, IFO increased by EUR 651 million compared to 2006, to EUR 1,852 million or 6.9% of sales. Excluding the EUR 256 million product liability charge which was recognized in 2006, IFO profitability improved by 1.4% in relation to sales, driven by the improved performance of DAP, Lighting and Group Management & Services.

Total adjusted IFO for the Group increased from EUR 1,386 million, or 5.2% of sales, in 2006 to EUR 2,065 million, or 7.7% of sales, in 2007, exceeding the Group s profitability target of 7.5%.

The main drivers of the year-on-year adjusted IFO improvement were the strong, mainly sales-driven performance at DAP (EUR 145 million) and higher earnings at Lighting (EUR 114 million), as a result of higher sales across almost all businesses and a lower loss in the fluorescent-based LCD Backlighting business. Excluding the EUR 256 million negative impact of product liability charges in 2006, Group Management & Services result improved by EUR 146 million due to reduced corporate and regional costs as well as lower pension and brand campaign costs.

Medical Systems adjusted IFO of EUR 875 million represented a slight increase compared to 2006, both in absolute value and as a percentage of sales (13.5%).

Higher earnings at Customer Services, Ultrasound & Monitoring and Healthcare Informatics were partly offset by lower earning at Imaging Systems, largely as a consequence of lower sales. However, the division fell short of its 2007 target of 14-15% adjusted IFO profitability, almost entirely due to the challenging nature of the imaging market in 2007, especially in the US, which was affected by the Deficit Reduction Act. The 2007 adjusted IFO included EUR 8 million acquisition-related charges for Intermagnetics, whereas EUR 78 million post-merger integration costs and purchase-accounting charges related to the acquisitions of Witt Biomedical and Intermagnetics were included in 2006.

Exceeding the targeted 15% adjusted IFO profitability, DAP s adjusted IFO increase of EUR 145 million compared to 2006 was primarily driven by strong sales growth, supported by the full-year contribution of Avent, and rapid expansion in emerging markets with stable margins. In addition, effective cost management supported the adjusted IFO profitability increase of 2.7% of sales compared to 2006. All DAP businesses supported the overall year-on-year improvement, both in nominal terms and as a percentage of sales.

CE s adjusted IFO reached EUR 325 million, or 3.1% of sales, compared to 3.0% in 2006, in line with the target set for the division. A sales decline and high margin pressure at Connected Displays, particularly in North America, were more than offset by higher adjusted IFO in the other businesses, most notably Peripherals & Accessories and Entertainment Solutions.

Lighting s adjusted IFO improved to EUR 722 million, or 11.9% of sales, mainly due to higher earnings in Lamps, Lumileds, Luminaires and additional adjusted IFO from the acquisition of Partners in Lighting International (PLI). The exit from the loss-making fluorescent lamp-based LCD backlighting business at the beginning of 2007 also added to the adjusted IFO improvement.

The adjusted IFO loss at Innovation & Emerging Businesses amounted to EUR 83 million, compared to a loss of EUR 76 million in 2006. Adjusted IFO in 2006 included an aggregated gain of EUR 76 million on the divestment of several businesses within Corporate Investments and Corporate Technologies. In 2007, adjusted IFO improved due to EUR 44 million higher license income.

Adjusted IFO at Group Management & Services improved by EUR 402 million compared to 2006, when the EUR 256 million product liability charge was recognized. The improvement in adjusted IFO was also driven by a EUR 146 million reduction in Corporate, Country & Regional overheads, lower pension costs and reduced investments in the brand campaign.

## Pensions

In 2007, net periodic pension costs of defined-benefit pension plans amounted to EUR 27 million, compared to EUR 75 million in 2006, mainly due to an increase in plan assets in 2006. The payments to defined-contribution pension plans amounted to EUR 84 million, EUR 4 million higher than in 2006, largely due to acquisitions.

### Total pension costs

| in millions of euros | 2006 | 2007 |
|---|---|---|
| Total pension costs | (155) | (111) |
| of which operating divisions | (93) | (99) |
| of which Group Management & Services | (62) | (12) |

**Table of Contents**

The accounting rule for pensions and other postretirement benefits (SFAS No. 158) requires Philips to recognize the funded status of pensions and other postretirement benefit plans on the balance sheet. As a consequence, new actuarial gains and losses and unrecognized prior service cost resulting from plan amendments will directly affect stockholders equity through changes in other comprehensive income. The amortization of such costs is removed from equity in the period that they are included in the net periodic pension costs. The effect of SFAS 158 on stockholders equity resulted in an increase in other comprehensive income of EUR 218 million in 2007, compared to a net reduction of equity of EUR 477 million in 2006.

## Restructuring charges

In 2007, IFO included a net charge of EUR 37 million for restructuring.

### Restructuring charges by sector

| in millions of euros | 2006 [1)] | 2007 |
|---|---|---|
| Medical Systems | 14 | 1 |
| DAP | 13 | 1 |
| Consumer Electronics | 12 | 7 |
| Lighting | 48 | 28 |
| Innovation & Emerging Business | | 1 |
| Group Management & Services | | 4 |
| Reduction of excess provisions | (5) | (5) |
| | 82 | 37 |

1) Restated to present the MedQuist business as a discontinued operation.

The most significant new restructuring projects in 2007 were related to Lighting and consisted mainly of the exit from the fluorescent lamp-based LCD backlighting business and several projects in the Lamps business.

The Company s remaining restructuring in 2007 covered a number of smaller projects.

The most significant restructuring projects in 2006 were Medical Systems transfer of the production of SPECT cameras from Milpitas to Cleveland, the restructuring of the Klagenfurt site (Austria), and a reduction of the fixed cost base and the creation of a more diverse and flexible supply base in DAP. Other projects included the reallocation of parts of the Lighting activities in Weert (Netherlands) to low-cost areas, the relocation in Mexico of all Juarez Lighting-plant activities to the Monterrey plant, and Lighting s relocation of the standard Lead in Wire business from Deurne (Netherlands) to Poland.

## Financial income and expenses

Financial income and expenses consist of:

| in millions of euros | 2006 [1)] | 2007 |
|---|---|---|
| Interest expenses (net) | (189) | (43) |
| Sales of securities | | 2,549 |
| Other | 217 | 107 |

| | |
|---|---|
| 28 | 2,613 |

1) Restated to present the MedQuist business as a discontinued operation.

The net interest expense in 2007 was EUR 146 million lower than in 2006, mainly as a result of the higher average cash position of the Group and higher average interest rates applied to those deposits. Additionally, interest expense decreased mainly as a result of a reduction in average debt during 2007 compared to 2006.

31

Income (loss) from the sale of securities consists of:

| in millions of euros | 2006 | 2007 |
|---|---|---|
| Income (loss) from the sale of securities: | | |
| Gain on sale TSMC shares | | 2,528 |
| Loss on sale of JDS Uniphase | | (10) |
| Gain on sale of Nuance | | 31 |
| | | 2,549 |

In 2007, a total gain of EUR 2,549 million was recognized on the sale of shares in TSMC, Nuance and JDS Uniphase, whereas during 2006 there were no sales of securities.

Other financial income of EUR 107 million in 2007 included a cash dividend of EUR 128 million from TSMC and a EUR 12 million gain related to the revaluation of the convertible bond received from TPV Technology. This was partly offset by a EUR 36 million impairment of JDS Uniphase prior to the sale.

In 2006, other financial income of EUR 217 million included a cash dividend of EUR 223 million from TSMC, a gain of EUR 97 million upon the designation of the TSMC stock dividend as trading securities, and a gain of EUR 29 million as a result of an increase in the fair value of these trading securities.

This was partly offset by losses of EUR 77 million resulting from an impairment of the available-for-sale holding in TPO Display and of EUR 61 million due to a decline in the fair value of the share option within a convertible bond received from TPV Technology.

## Income taxes

Income taxes amounted to EUR 622 million, compared to EUR 167 million in 2006. The tax burden in 2007 corresponded to an effective tax rate of 13.9% on pre-tax income, compared to 13.6% in 2006.

The effective tax rate in 2007 was affected by tax-exempt items such as the non-taxable gain on the sale of shares in TSMC. Non-taxable items in 2006 were the TSMC dividend, as well as the gains and losses resulting from changes in the fair value of TSMC stock and the TPV convertible bond. Income taxes in 2006 were also positively affected by a reduction in the Dutch corporate tax rate and gains resulting from final agreements on prior-year taxes in various jurisdictions.

For 2008, the effective tax rate excluding non-taxable items is expected to be around 30%, broadly in line with 2007.

The information in note 6, pages 155 through 157 of the 2007 Annual Report is incorporated herein by reference.

## Results of equity-accounted investees

The results relating to equity-accounted investees increased by EUR 920 million compared to 2006 and resulted in income of EUR 763 million in 2007, a breakdown of which is given in the table below.

| in millions of euros | 2006 [1)] | 2007 |
|---|---|---|
| Company s participation in income (loss) | (180) | 271 |
| Results on sales of shares | 79 | 514 |
| Gains arising from dilution effects | 14 | |
| Investment impairment and guarantee charges | (70) | (22) |
| | (157) | 763 |

1) Restated to present the

MedQuist business as a discontinued operation.

The Company s participation in the net income of equity-accounted investees increased from a loss of EUR 180 million in 2006 to a profit of EUR 271 million in 2007, mainly due to higher earnings at LG.Philips LCD. Philips share in LG.Philips LCD s operational result in 2007 improved by EUR 456 million compared to 2006, resulting in a profit of EUR 260 million, compared to a loss of EUR 196 million in 2006.

Earnings from the sale of shares mainly consisted of the EUR 508 million non-taxable gain on the sale of a 13% stake in LG.Philips LCD, reducing Philips shareholding from 32.9% to 19.9%. In 2006, a EUR 76 million non-taxable gain was recognized on the sale of the remaining 8.4 million shares of common stock in FEI, which reduced Philips shareholding from 24.8% to zero.

In 2006, gains and losses arising from dilution effects were mainly due to a EUR 14 million dilution gain recorded for TPV.

In 2006, investment impairment and guarantee charges primarily related to a EUR 61 million loss which was recognized as a result of agreements made with LG.Philips Displays for voluntary payments (social contributions and environmental clean-up), mainly in France, Germany, the Netherlands and the UK.

## Minority interest

The share of minority interests in the income of Group companies reduced income by EUR 5 million, compared to EUR 4 million in 2006.

## Discontinued operations

In this Annual Report, Philips reports the results of Mobile Display Systems, Semiconductors and MedQuist separately as discontinued operations. Consequently, the related results, including transaction gains and losses, are shown separately in the financial statements under discontinued operations.

The loss from discontinued operations of EUR 433 million in 2007 was primarily attributable to a EUR 360 million impairment charge for MedQuist, taking into account EUR 325 million cumulative foreign currency translation differences, which had previously been accumulated under equity since the date of the acquisition in 2000. In addition, a EUR 43 million loss related to the 2006 sale of a majority stake in the Semiconductors division was recognized, mainly due to pension settlements.

In 2006, the Company sold a majority stake in its Semiconductors division to a private equity consortium. The transaction consisted of the sale of the division for a total consideration of EUR 7,913 million and the simultaneous acquisition of a minority interest in the recapitalized organization at a cost of EUR 854 million. A net gain of EUR 4,283 million was recorded on the sale.

The 2006 results of discontinued operations also included a EUR 29 million gain on the sale of Mobile Display Systems to TPO.

## Net income

In 2007, income from continuing operations amounted to EUR 4,601 million, an increase of EUR 3,700 million compared with 2006. The improvement was driven by EUR 651 million higher IFO and a EUR 2,585 million increase in financial income, primarily due to the sale of shares in TSMC. The EUR 455 million higher income tax charges were more than offset by a EUR 920 million increase in results relating to equity-accounted investees, which included a EUR 508 million gain on the sale of shares of LG.Philips LCD as well as a EUR 456 million increase in that company s operational results.

The loss from discontinued operations amounted to EUR 433 million, mainly due to the aforementioned MedQuist related losses, whereas 2006 included a total gain of EUR 4,283 million from the sale of a majority stake in the Semiconductors division.

Net income for the Group showed a profit of EUR 4,168 million, or EUR 3.84 per common share, compared to EUR 5,383 million, or EUR 4.58 per common share, in 2006.

**Table of Contents**

## Performance by sector
## Medical Systems
### Key data

| in millions of euros, except for FTE data | 2006 [1)] | 2007 |
|---|---|---|
| Sales | 6,448 | 6,470 |
| Sales growth | | |
| % increase, nominal | 7 | |
| % increase, comparable | 8 | 4 |
| Adjusted IFO | 861 | 875 |
| as a % of sales | 13.4 | 13.5 |
| IFO | 734 | 743 |
| as a % of sales | 11.4 | 11.5 |
| Net operating capital (NOC) | 4,125 | 4,104 |
| Cash flows before financing activities | (427) | 420 |
| Employees (FTEs) | 26,203 | 27,441 |

1) Restated to present the MedQuist business as a discontinued operation.

Sales in 2007 totaled EUR 6,470 million, a stable nominal performance compared to 2006. Excluding the 2% positive impact of portfolio changes and the 5% unfavorable currency effect, comparable sales growth was 4%. Particularly strong growth in Ultrasound & Monitoring and Customer Services was partly offset by the decline in Imaging Systems which was negatively affected by the continued softening of the imaging market in the US, in part a result of the impact of the Deficit Reduction Act, and in Japan.

### Sales per market cluster

| in millions of euros | 2006 [1)] | 2007 |
|---|---|---|
| Western Europe | 1,704 | 1,767 |
| North America | 3,053 | 3,047 |
| Other mature markets | 642 | 559 |
| Total mature markets | 5,399 | 5,373 |
| Key emerging markets | 624 | 653 |
| Other emerging markets | 425 | 444 |

| | | |
|---|---|---|
| | 6,448 | 6,470 |

1) Restated to present the MedQuist business as a discontinued operation.

From a regional perspective, single-digit comparable sales growth was achieved in the mature markets, including North America, which generated double-digit growth in all businesses except Imaging Systems. The key emerging markets experienced 10% comparable growth, with particularly strong performance in India (17%) and solid growth of 9% each in China and Latin America.

Adjusted IFO amounted to EUR 875 million or 13.5% of sales in 2007, compared to EUR 861 million or 13.4% in 2006. Earnings fell short of the divisional target of 14-15%, as higher earnings at Ultrasound & Monitoring, Customer Services and Healthcare Informatics were largely offset by lower sales-driven earnings at Imaging Systems, partly due to the impact of the Deficit Reduction Act.

IFO improved from EUR 734 million in 2006 to EUR 743 million in 2007.

34

Cash flows before financing activities included net payments totaling EUR 70 million for the acquisitions of Emergin, VMI and XIMIS in 2007, while 2006 included acquisition-related cash outflows of EUR 1,103 million, for Intermagnetics and Witt Biomedical. Excluding these acquisition-related disbursements, cash flows before financing activities were EUR 186 million below 2006, mainly due to higher working capital requirements and increased capital expenditures.

For 2008, strong sales growth is anticipated in Patient Monitoring, Cardiac Care, Home Healthcare Solutions and Customer Services, tempered by limited growth in Imaging Systems.

## Domestic Appliances and Personal Care

### Key data

| in millions of euros, except for FTE data | 2006 | 2007 |
|---|---|---|
| Sales | 2,532 | 2,968 |
| Sales growth | | |
| % increase, nominal | 15 | 17 |
| % increase, comparable | 11 | 15 |
| Adjusted IFO | 378 | 523 |
| as a % of sales | 14.9 | 17.6 |
| IFO | 370 | 510 |
| as a % of sales | 14.6 | 17.2 |
| Net operating capital (NOC) | 1,138 | 1,136 |
| Cash flows before financing activities | (287) | 415 |
| Employees (FTEs) | 9,933 | 9,881 |

2007 was a very successful year for DAP. Full-year sales increased by EUR 436 million, or 17% on a nominal basis. Adjusted for the 5% positive effect from the integration of Avent (acquired in September 2006) and adverse currency developments (3%), comparable sales grew by 15%, significantly ahead of the 7% growth target set at the beginning of the year.

### Sales per market cluster

| in millions of euros | 2006 | 2007 |
|---|---|---|
| Western Europe | 1,107 | 1,256 |
| North America | 523 | 564 |
| Other mature markets | 111 | 128 |
| Total mature markets | 1,741 | 1,948 |
| Key emerging markets | 367 | 479 |
| Other emerging markets | 424 | 541 |
| | 2,532 | 2,968 |

Double-digit comparable sales growth was achieved by all businesses and market clusters. From a business perspective, growth was led by excellent performance at Domestic Appliances, mainly driven by the Kitchen Appliances business, benefiting from our investments in innovation and the brand. Shaving & Beauty benefited from the successful introduction of two new shavers (Arcitec and the Moisturizing Shaving System) and the continued acceptance and further roll-out of Bodygroom products. At Health & Wellness, sales increased largely as a result of the good market acceptance of Oral Healthcare products, supported by the launch of the new FlexCare toothbrush and the successful market introduction of the Wake-up Light.

From a geographical perspective, comparable sales growth was evident in all countries, with double-digit increases in all market clusters. Emerging markets including China, India, Brazil and Russia representing about one third of DAP s sales contributed 28% comparable sales growth in 2007.

35

**Table of Contents**

Compared to 2006, adjusted IFO increased by EUR 145 million to EUR 523 million, corresponding to a profitability improvement of 2.7% of sales, reaching 17.6% of sales in 2007, well above the targeted 15%. The year-on-year earnings rise was largely driven by higher sales and tight cost management. Adjusted IFO improvements were visible both in absolute amounts and relative to sales in all businesses.

IFO increased by EUR 140 million to EUR 510 million in 2007, compared to EUR 370 million in 2006.

DAP generated EUR 415 million cash flows before financing activities, broadly in line with last year, excluding the EUR 689 million net cash payment for the acquisition of Avent. Higher earnings were largely offset by increased working capital needs.

## Consumer Electronics

### Key data

| in millions of euros, except for FTE data | 2006 | 2007 |
|---|---|---|
| Sales | 10,576 | 10,362 |
| Sales growth | | |
| % increase, (decrease) nominal | 1 | (2) |
| % increase, comparable | 5 | 1 |
| Adjusted IFO | 314 | 325 |
| as a % of sales | 3.0 | 3.1 |
| IFO | 313 | 322 |
| as a % of sales | 3.0 | 3.1 |
| Net operating capital (NOC) | (228) | (246) |
| Cash flows before financing activities | 248 | 357 |
| Employees (FTEs) | 14,486 | 13,516 |

Sales totaled EUR 10,362 million in 2007, reflecting a nominal decline of 2% compared to 2006. Adjusted for 1% portfolio changes (mainly the sale of Mobile Phones in March 2007 and the acquisition of DLO in May 2007) and 2% negative currency effects, comparable sales increased by 1%. Year-on-year sales growth was delivered by all businesses except Connected Displays, which suffered from challenging market conditions and a loss of market share in the first half of the year. The sales decline at Connected Displays was due to the positive effect, in 2006, of soccer s World Cup, as well as increased competition and price pressure in Flat TV, the latter particularly in the US. However, in the second half of the year Connected Displays showed 10% comparable growth.

### Sales per market cluster

| in millions of euros | 2006 | 2007 |
|---|---|---|
| Western Europe | 4,275 | 4,483 |
| North America | 2,496 | 2,153 |
| Other mature markets | 191 | 223 |
| Total mature markets | 6,962 | 6,859 |

| | | |
|---|---|---|
| Key emerging markets | 2,215 | 1,962 |
| Other emerging markets | 1,399 | 1,541 |
| | 10,576 | 10,362 |

From a geographical perspective, sales growth was strong in Europe and the emerging markets in Asia Pacific, driven by increases in all businesses. Sales declined in North America and Latin America, primarily due to Connected Displays.

CE s focus on margin management resulted in an adjusted IFO of EUR 325 million, or 3.1% of sales, compared to 3.0% in 2006, in line with the target set for the division.

**Table of Contents**

Significant margin pressure at Connected Displays, particularly in the US, was more than offset by higher adjusted IFO in the other businesses.
IFO reached EUR 322 million (3.1% of sales), compared to EUR 313 million (3.0% of sales) in 2006.
Net operating capital at the end of 2007 amounted to negative EUR 246 million (2006: negative EUR 228 million), reflecting the continued success of the division s asset-light strategy.
Cash flows before financing activities improved from EUR 248 million in 2006 to EUR 357 million in 2007, primarily driven by tight working capital management at Connected Displays.
In December 2007, Philips agreed to sell its Set-Top Boxes and Connectivity Solutions activities to UK-based technology provider Pace Micro Technology. Closure of the deal is expected in Q1 2008.

## Lighting

### Key data

| in millions of euros, except for FTE data | 2006 | 2007 |
|---|---|---|
| Sales | 5,466 | 6,093 |
| Sales growth | | |
| % increase , nominal | 14 | 11 |
| % increase, comparable | 8 | 6 |
| Adjusted IFO | 608 | 722 |
| as a % of sales | 11.1 | 11.9 |
| IFO | 577 | 675 |
| as a % of sales | 10.6 | 11.1 |
| Net operating capital (NOC) | 2,527 | 3,886 |
| Cash flows before financing activities | 451 | (648) |
| Employees (FTEs) | 47,739 | 54,323 |

Lighting sales in 2007 grew 11% in nominal terms, supported by the contribution of the acquired companies PLI and Color Kinetics. Excluding these acquisitions and the negative currency impact of 3%, comparable growth reached 6%, led by robust growth of energy-efficient lighting, primarily within Lamps and Luminaires. Sales of Solid-State Lighting applications grew 281% year-on-year, reaching EUR 160 million, helped by the acquisition of Color Kinetics. Automotive Lighting and Lighting Electronics also achieved further comparable growth. However, the remaining businesses showed comparable declines, mainly due to the contracting rear-projection TV market (Special Lighting Applications).

### Sales per market cluster

| in millions of euros | 2006 | 2007 |
|---|---|---|
| Western Europe | 2,022 | 2,436 |
| North America | 1,194 | 1,125 |
| Other mature markets | 343 | 304 |

| | | |
|---|---|---|
| Total mature markets | 3,559 | 3,865 |
| Key emerging markets | 1,072 | 1,216 |
| Other emerging markets | 835 | 1,012 |
| | 5,466 | 6,093 |

Geographically, the division showed strong growth in all markets clusters except North America. Emerging markets delivered particularly strong growth of 17% in currency-comparable terms, attributable to solid growth across all businesses except for Special Lighting Applications in Asia, related to the rapid contraction of the rear-projection TV market. Sales growth was notably strong in China (18%) and India (16%).

Adjusted IFO in 2007 amounted to EUR 722 million, growing by EUR 114 million year-on-year to reach 11.9% of sales, compared to EUR 608 million or 11.1% in 2006. This improvement was driven by solid earnings growth at Lamps and Luminaires, additional adjusted IFO following the successful integration of PLI, and lower losses related to the fluorescent-based backlighting solutions business which we exited in Q1 2007.

IFO improved by EUR 98 million to reach EUR 675 million, or 11.1% of sales. Restructuring charges, purchase-accounting- related charges and other net incidental items totaled EUR 55 million, compared to EUR 48 million in 2006.

Cash flows before financing included acquisition-related investments totaling EUR 1,162 million in 2007, most notably the net payments of EUR 561 million for Partners in Lighting International and of EUR 515 million for Color Kinetics. Net capital expenditures declined by EUR 88 million compared to 2006, mainly due to higher investments in Lumileds in 2006.

Net inventories increased to 15.4% of sales, compared to 13.5% in 2006, primarily due to higher inventory levels within PLI (due to rapid order fulfillment requirements and above-average lead times from PLI-owned factories in China) and at Lamps (due to increased lead times resulting from the transfer of the production of energy-efficient lamps to Asia).

## Innovation & Emerging Businesses

### Key data

| in millions of euros, except for FTE data | 2006 | 2007 |
|---|---|---|
| Sales | 1,493 | 703 |
| Sales growth | | |
| % increase, nominal | (22) | (53) |
| % increase (decrease), comparable | (9) | 32 |
| IFO | (94) | (101) |
| as a % of sales | (6.3) | (14.4) |
| Adjusted IFO Corporate Technologies | (91) | (76) |
| Adjusted IFO Corporate Investments / Other | 17 | (5) |
| Adjusted IFO CHS | (2) | (2) |
| Adjusted IFO | (76) | (83) |
| as a % of sales | (5.1) | (11.8) |
| Net operating capital (NOC) | 748 | 1,001 |
| Cash flows before financing activities | (625) | (348) |
| Employees (FTEs) | 9,852 | 7,638 |

**Corporate Technologies**

Corporate Technologies adjusted IFO improved to a loss of EUR 76 million, compared to a loss of EUR 91 million in 2006, which included a EUR 31 million gain on the sale of CryptoTec. The improvement in adjusted IFO was largely attributable to an increase in income from intellectual property and cost efficiencies at Research, partly offset by increased investment in the Healthcare and Lifestyle Incubators and in research activities in emerging markets. In 2007, Corporate Technologies recognized a gain on the sale of TASS (EUR 6 million), which was divested in the first quarter.

### Corporate Investments

As a result of the portfolio clean-up within Corporate Investments, sales declined by EUR 930 million, or 78%, in 2007. Adjusted for portfolio changes (81%) and unfavorable currency movements (4%), comparable sales increased by 21%, which was almost entirely attributable to Assembléon.

Adjusted IFO in 2007 amounted to a loss of EUR 4 million. This included a total loss of EUR 4 million on the divestment of the remaining businesses within Philips Optical Storage (Automotive Playback Module), Philips Business Communication in China and Ommic, whereas 2006 included gains on divestments totaling EUR 44 million.

### Consumer Healthcare Solutions

Consumer Healthcare Solutions sales grew by 47% on a nominal basis, reaching EUR 168 million in 2007, partly due to the acquisition of Health Watch in the second quarter and Raytel Cardiac in the fourth. On a comparable basis, sales growth of 10% was largely driven by Lifeline.

Adjusted IFO was in line with 2006, at a loss of EUR 2 million. The improved performance at Lifeline was offset by post-merger integration costs of EUR 6 million, mainly related to Health Watch.

IFO showed a loss of EUR 19 million, in line with the 2006 loss of EUR 18 million.

The positive cash flow generated by operating activities was more than offset by cash outflows for the acquisitions of Health Watch and Raytel Cardiac. In 2006, the acquisition of Lifeline Systems resulted in a cash outflow of EUR 583 million.

## Group Management & Services

### Key data

| in millions of euros, except for FTE data | 2006 | 2007 |
|---|---|---|
| Sales | 167 | 197 |
| Sales growth | | |
| % increase, nominal | 23 | 18 |
| % increase, comparable | 14 | 31 |
| IFO | (699) | (297) |
| Adjusted IFO Corporate and regional costs | (226) | (156) |
| Adjusted IFO Brand campaign | (126) | (111) |
| Adjusted IFO Service Units, Pensions, Other | (347) | (30) |
| Adjusted IFO | (699) | (297) |
| Net operating c | | |